



Alert on Q1 2013 Earnings

Sector: Basic Materials & Industrial Products

Country: Egypt

Date: September 23, 2013

Share Price (EGP): 11.38

Target Price (EGP): 12.07

Upside: 6.1%

Recommendation: HOLD

Risk: High

Raising our target price on Ezz to EGP 12.07 from EGP 10.27 previously after it was reached in July

Growth in long steel sales boosts Ezz's top-line

Ezz Steel recorded a 7.4% y-o-y rise in revenues to EGP 5.6 billion during the first quarter of 2013, mainly due to higher average selling prices and a 7.5% y-o-y increase in long product sales to 1 million tons. This has offset the 1.9% drop in flat steel sales to 267 thousand tons following weaker global demand, which incited Ezz to suspend flat steel production at its EFS facility and focus on long products. Long steel prices rose by 2.5% in the local market, while flat steel export prices increased 3%. We expect 2013 revenues to grow 5.7% to EGP 20.9 billion, supported by a strong local demand and attractive local pricing.

Sharp surge in earnings buoyed by robust local demand and lower costs

Gross profit rose to EGP 760 million during Q1 2013 from EGP 475 million a year earlier, due to higher sales and a decline in production costs which accounted for 86.4% of revenues compared to 90.9% of revenues in Q1 2012. As a result, net income witnessed a remarkable jump to EGP 202 million from EGP 18 million in Q1 2012 as revenues grew faster than expenses and borrowing costs, further supported by a EGP 130 million in foreign exchange gains. We expect Ezz Steel's bottom-line to grow at a CAGR of 30.9% between 2013 and 2016 with an estimated net income of EGP 250 million for 2013.

Ezz raises EGP 550 million top-up loan to complete DRI project

Total debt decreased by 2.8% y-o-y to reach EGP 9,794 million in Q1 2013, sending the total debt-to-equity ratio to 143%, down from 160% a year earlier, on lower overdrafts and short-term borrowings. However, long-term loans increased following an EGP 550 million top-up syndicated loan facilities signed in 2013 with a group of local banks. These funds will be used to complete the construction of the Direct Reduced Iron project at Sokhna-Suez, which is expected to commence production by the end of 2014. The factory will increase Ezz's profitability by replacing scrap iron in the manufacturing process with DRI.

The cloud of political uncertainty continues to hover over Egyptian equities

We revise our target price on Ezz Steel up to EGP 12.07 per share from EGP 10.27 per share previously, using a WACC of 20% after accounting for the additional specific risk associated with the lawsuits filed against the ex-chairman, Ahmed Ezz, and the ability of the company to hold on to its largest and most profitable subsidiary, EZDK. We maintain our HOLD rating, anticipating a continuous pressure on Ezz's share price amid greater levels of political and economic uncertainties. Moreover, we believe that the depreciation of the EGP and the steep drop of the Central Bank Foreign Reserves will keep on weighing negatively over Egyptian equities.

Share Data

Bloomberg Symbol	ESRS EY
Reuters Symbol	ESRS.CA
Market Cap (EGP)	6,182,356,007
Number of Shares	543,265,027
Free Float	35%
Price-to-Earnings 2013e	24.73
Price-to-Book 2013e	0.87

Share Performance



Source: Reuters

1 Month Return	-0.70%
3 Month Return	47.41%
6 Month Return	22.63%
12 Month Return	-6.72%
52 Week Range	7.72 - 12.59

Source: Reuters

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Performance and Forecasts

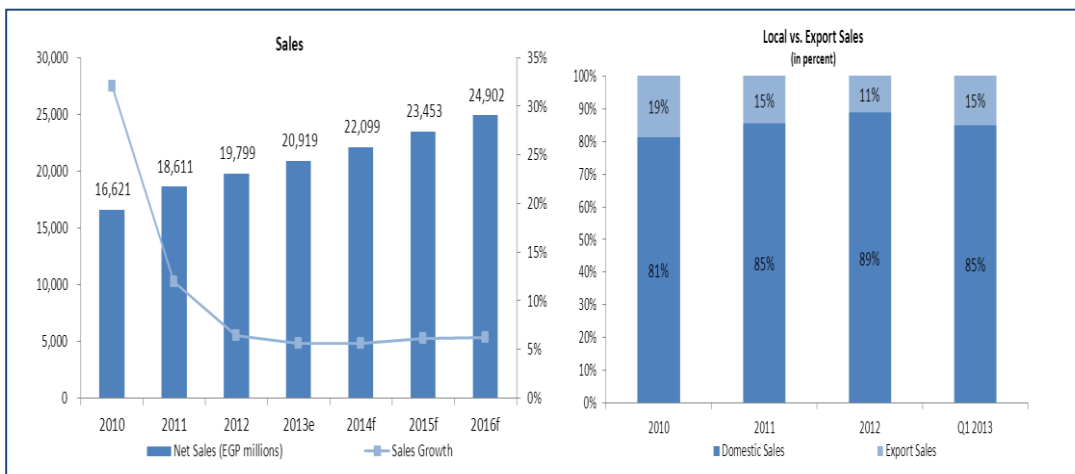
In EGP millions	2011	2012	2013e	2014f	2015f
Revenues	18,611	19,799	20,919	22,099	23,453
Gross Profit	2,207	1,690	2,301	2,541	2,814
Gross Profit Margin %	11.9%	8.5%	11.0%	11.5%	12.0%
Net Income	202	8	250	317	444
Profit Margin %	1.1%	0.0%	1.2%	1.4%	1.9%

Source: Ezz Steel, Blominvest

INCOME STATEMENT HIGHLIGHTS

Ezz Steel's top-line rises on resilient local demand

In spite of the unstable economic and political environment in Egypt, Ezz Steel reported a 7.4% y-o-y increase in revenues during the first quarter of 2013 to reach EGP 5.6 billion, supported by stronger long product sales and higher average selling prices. Sales from long steel used in construction constituted EGP 4.4 billion or 79% of revenues in Q1 2013, while the rest was attributed to flat steel that is used in manufacturing. Long steel sales, which almost fully serve the local market, rose by 7.5% y-o-y to 1 million tons, reflecting a persistent strong domestic demand. These largely offset the 1.9% drop in flat steel sales to 267 thousand tons following the suspension of flat steel production at EFS facility in 2012 and the switch to long products due to weak international demand and more attractive local pricing. In addition, long steel prices edged up by 2.5% y-o-y in the local market during Q1 2013, while flat steel export prices rose 3%, further backing the increase in the company's top line.

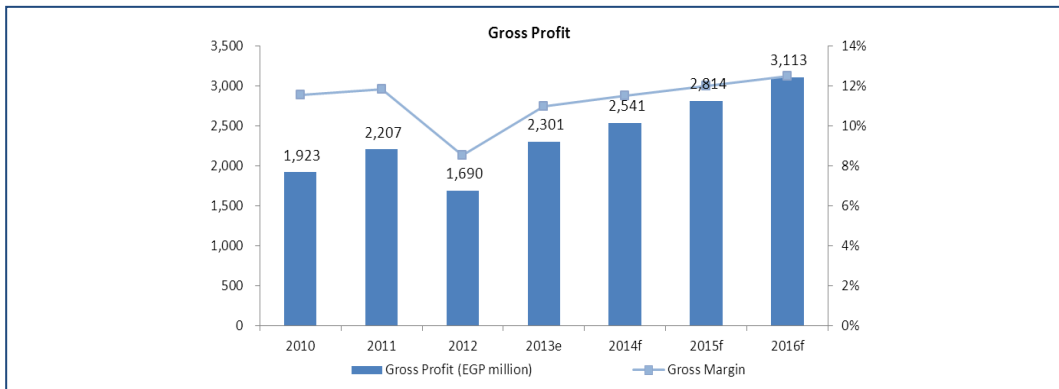


Source: Ezz Steel, Blominvest

Going forward, despite the political instability and the uprisings that have stalled most construction activity in Egypt's major cities during the past years, we expect sales at Ezz Steel to grow at a CAGR of 6% between 2013 and 2016, with an estimated 2013 revenue growth of 5.7% to reach EGP 20.9 billion, supported by an increase in local demand and local steel prices.

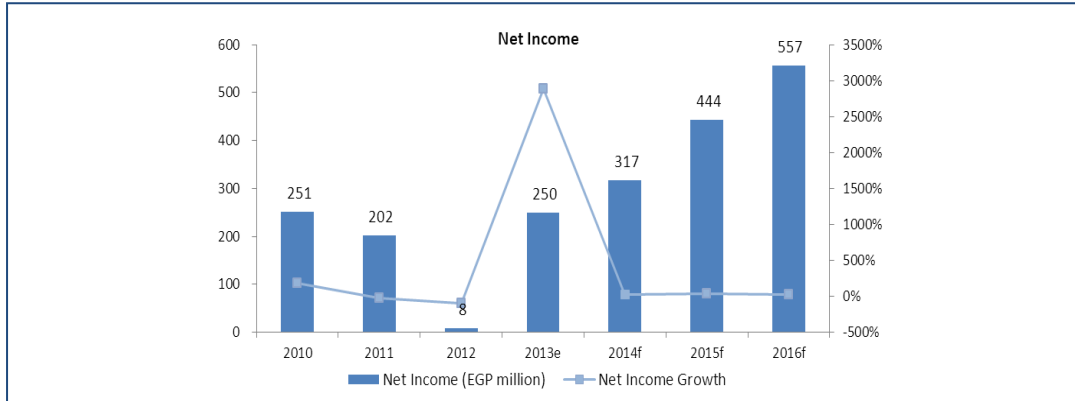
Earnings' improvement expected to continue through 2013

The performance of Ezz Steel improved during Q1 2013 as the gross profit edged up to EGP 760 million from EGP 475 million a year earlier, sending the gross margin up to 13.6% from 9.1%. This is mainly due to higher sales and lower production costs which dropped to 86.4% of revenues from 90.9% of revenues in Q1 2012.



Source: Ezz Steel, Blominvest

Earnings before taxes and minority interest followed suit, reaching EGP 499 million compared to EGP 185 million registered a year earlier, supported by EGP 130 million in foreign exchange gains. Similarly, net income witnessed a remarkable jump to EGP 202 million from EGP 18 million in Q1 2012 as revenues grew faster than expenses and borrowing costs. The majority of earnings at Ezz were generated through its largest and most profitable subsidiary Ezz El Dekhila (EZDK), which reported an EBITDA of EGP 719 million compared to EGP 70 million for ESR/ERM and EGP -16 million for EFS.



Source: Ezz Steel, Blominvest

During 2013, we anticipate a rise in Ezz Steel's gross margin to 11% from 8.5% in 2012. Moreover, the company's bottom line is expected to grow at a CAGR of 30.9% between 2013 and 2016 with an estimated net income of EGP 250 million for 2013.

BALANCE SHEET HIGHLIGHTS

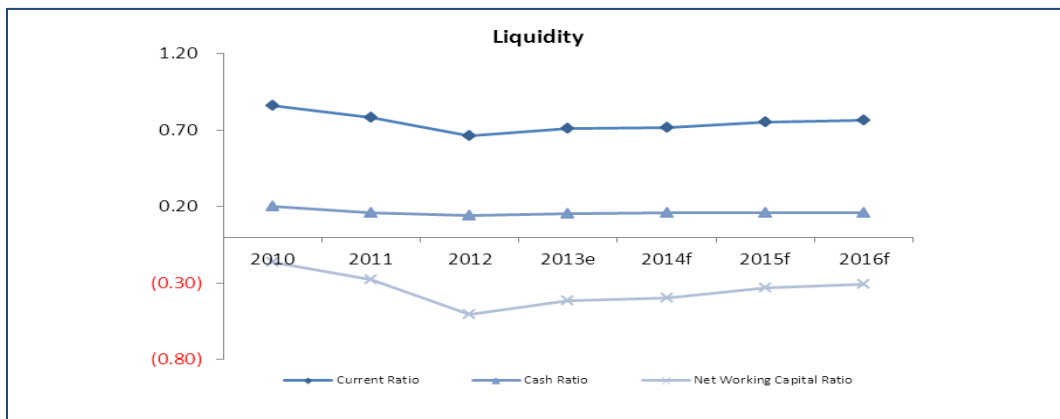
Liquidity

Ezz Steel witnessed an increase in liquidity during the first quarter of 2013, supported by a 2.8% y-o-y rise in current assets and a 3.4% drop in current liabilities. The current, quick and cash ratios increased to 0.71, 0.33 and 0.19 respectively, up from 0.66, 0.26 and 0.14 during the previous financial reporting period. As for the net working capital ratio, it reached minus 0.42 as opposed to minus 0.51 a year earlier. We anticipate a continuous improvement in liquidity during 2013.

Current Ratio = Current Assets / Current Liabilities

Cash Ratio = Cash / Current Liabilities

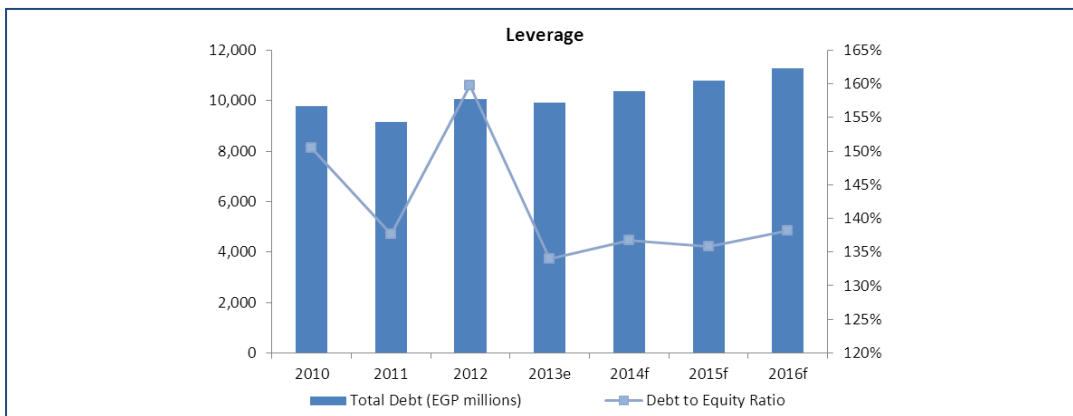
Net Working Capital Ratio = (Current Assets – Current Liabilities) / Current Assets



Source: Ezz Steel, Blominvest

Financial Leverage

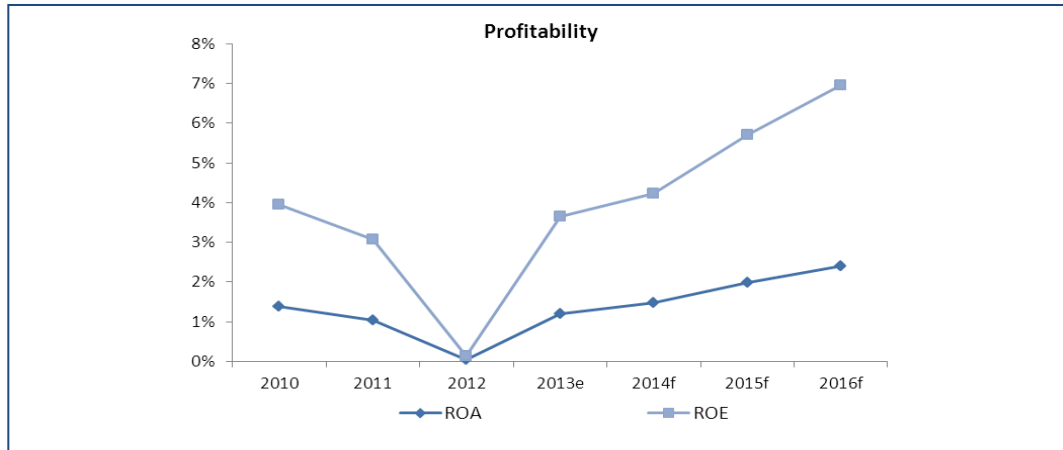
The total debt of the steel maker including bank overdrafts and bond loans decreased by 2.8% y-o-y to reach EGP 9,794 million in Q1 2013, sending the total debt-to-equity ratio to 143%, down from 160% a year earlier, on lower overdrafts and short-term borrowings. Ezz Steel signed an EGP 550 million top-up syndicated loan facility with a group of local banks. These funds will be used to complete the construction of the Direct Reduced Iron (DRI) project at Sokhna-Suez, which is expected to commence production by the end of 2014. The total cost of the investment is estimated at EGP 3.7 billion, of which EGP 2.8 billion will be financed through debt and the remaining amount through internal cash flows. The loan will be repaid quarterly over six years starting 2015. The DRI will improve Ezz's profitability over the long term with cheaper production costs compared to the traditional fully integrated steel plants.



Source: Ezz Steel, Blominvest

Profitability

As for profitability indicators, the cement producer's Return on Assets (ROA) increased to 0.96% in Q1 2013 as opposed to 0.09% in Q1 2012. As well, Return on Equity (ROE) rose from 0.29% to 2.96%. These ratios indicate how efficiently the company is managing its assets and capital to generate earnings. Going forward, we expect these indicators to perform better starting 2013. We estimate the company's ROA ratio to reach 1.2% in 2013 and the ROE to increase to 3.6%, on higher earnings caused by better sales and pricing.



Source: Ezz Steel, Blominvest

VALUATION

Issuing a HOLD rating on sustained macroeconomic and firm-specific risks

Following Ezz Steel's strong performance despite the macroeconomic and legal uncertainties, we maintain a HOLD recommendation, revising our target price up to EGP 12.07 from EGP 10.27 previously after it was reached in July. This represents a 6.1% premium over the current stock price of EGP 11.38. We kept the discount rate at 20% with a terminal growth rate of 3% after taking into consideration the outlook of the company in addition to the local and regional economic and political conditions.

Additionally, when comparing Ezz Steel to its peers, the company appears to be undervalued with a P/E of 24.73 compared to 30.1 for its peers. We attribute this discount to the additional specific risk associated with the company's ability to hold on to its largest and most profitable subsidiary, EZDK. We believe that although the political impasse and the lawsuits filed against the ex-chairman, Ahmed Ezz, will continue their pressure on investors' confidence over the short-to-medium term, the strong domestic demand will ensure better financial results during 2013. However, the depreciation of the EGP and the steep drop of the Central Bank Foreign Reserves are expected to keep on weighing negatively over the Egyptian equities' performance.

Sensitivity Analysis

Discount Rate	Terminal Growth	Fair Value/Share	Premium
19%	2%	12.39	8.88%
19%	3%	12.81	12.57%
19%	4%	13.29	16.75%
20%	2%	11.71	2.91%
20%	3%	12.07	6.07%
20%	4%	12.48	9.64%
21%	2%	11.10	-2.44%
21%	3%	11.42	0.31%
21%	4%	11.76	3.37%

PROJECTED INCOME STATEMENT

<i>In EGP million</i>	2010	2011	2012	2013e	2014f	2015f	2016f
Net sales	16,621	18,611	19,799	20,919	22,099	23,453	24,902
Cost of goods sold	(14,698)	(16,404)	(18,109)	(18,618)	(19,557)	(20,639)	(21,789)
Gross Profit	1,923	2,207	1,690	2,301	2,541	2,814	3,113
Selling & marketing Exp.	(154)	(113)	(102)	(126)	(133)	(164)	(174)
General & Admin. Expenses	(235)	(297)	(373)	(356)	(331)	(328)	(349)
Impairment Loss on Assets	(2)	(17)	(4)	-	-	-	-
Provisions	(95)	(81)	(2)	(2)	-	-	-
Total expenses	(486)	(509)	(480)	(483)	(464)	(493)	(523)
Finance expenses	(754)	(764)	(880)	(941)	(985)	(1,027)	(1,071)
Interest income	67	64	42	50	54	55	59
Other income	22	30	148	40	45	42	50
Total other expenses	(665)	(670)	(690)	(852)	(887)	(930)	(962)
Net profit before tax & non-controlling interest	772	1,028	520	967	1,190	1,392	1,628
Income tax expense	(171)	(359)	(275)	(242)	(298)	(348)	(407)
Deferred tax expense	(37)	(133)	5	(100)	(100)	(100)	(100)
Net profit before minority interests	564	536	250	625	793	944	1,121
Minority interest	(313)	(334)	(242)	(375)	(476)	(500)	(560)
Net profit after minority interests	251	202	8	250	317	444	560

Source: Ezz Steel, Blominvest

PROJECTED BALANCE SHEET

<i>In EGP million</i>	2010	2011	2012	2013e	2014f	2015f	2016f
Non-current Assets							
Property, plant & equipment	9,567	9,937	11,127	11,503	11,731	11,790	11,849
Projects under construction	3,319	3,558	2,755	2,879	3,008	3,144	3,285
Goodwill	315	315	315	315	315	315	315
Other non-current assets	244	281	304	290	268	276	254
Total non-current assets	13,445	14,090	14,500	14,987	15,323	15,524	15,703
Current Assets							
Inventories	3,734	3,629	3,620	3,765	3,978	4,456	4,731
Trade & notes receivable	185	122	52	84	88	117	125
Debtors & other debit balances	586	628	924	941	994	1,055	1,121
Advances to suppliers	48	135	59	84	88	117	125
Investments in treasury bills	57	63	47	55	50	55	65
Cash & cash equivalents	1,415	1,171	1,290	1,360	1,481	1,524	1,619
Total current assets	6,025	5,747	5,991	6,289	6,680	7,325	7,785
Total Assets	19,470	19,837	20,492	21,276	22,002	22,850	23,487
Non-current Liabilities							
Loans	4,466	3,937	3,377	3,351	3,520	3,715	3,922
Other non-current liabilities	205	667	779	701	645	590	546
Bonds loan	651	433	216	194	179	168	159
Deferred tax liabilities	658	790	789	710	653	594	547
Total Non - current liabilities	5,980	5,828	5,161	4,957	4,997	5,068	5,175
Current Liabilities							
Banks credit accts & Overdrafts	1,136	1,003	2,061	2,048	2,151	2,167	2,179
ST Loans & Borrowings	3,292	3,573	4,203	4,096	4,303	4,540	4,794
Bonds loan	220	220	220	220	220	220	220
Trade & notes payable	1,145	1,364	1,413	1,396	1,467	1,548	1,525
Advances from customers	410	236	287	314	331	352	374
Creditors & other credit balances	677	389	359	372	391	413	436
Income Tax	-	359	275	242	298	348	407
Provisions	123	204	205	200	180	160	140
Total Current Liabilities	7,003	7,349	9,023	8,888	9,341	9,748	10,074
Total Liabilities	12,983	13,177	14,184	13,845	14,338	14,816	15,249
Shareholders' Equity	6,487	6,661	6,307	7,431	7,664	8,034	8,239
Total Liabilities & Equity	19,470	19,837	20,492	21,276	22,002	22,850	23,487

Source: Ezz Steel, Blominvest

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Equity Rating Key

Recommendations are based on the upside (downside) between our 12-month Fair Value estimate and the current Market Price.

Buy: Fair Value higher than Market Price by at least 20%

Accumulate: Fair Value higher than Market Price by 10% to 20%

Hold: Fair Value ranges between -5% to +10% in relation to Market Price

Reduce: Fair Value lower than Market Price by 5% to 15%

Sell: Fair Value lower than Market Price by at least 15%

Risks are based on share price volatility along with qualitative factors such as the nature of the business, the country risk and sensitivity to a single event, single product or single buyer. We've arranged the risk factor into 5 trenches:

- High Risk
- Medium-to-High Risk
- Medium Risk (similar to Market Risk)
- Medium-to-Low Risk
- Low Risk

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