



Alert on 2011 Earnings

Sector: Basic Materials & Industrial Products

Country: Egypt

Date: April 24, 2012

Share Price (EGP): 7.32

Fair Value (EGP): 8.60

Upside: 17.5%

Recommendation: Accumulate

Risk: High

Resilient local demand continues to shield operations at Ezz Steel

Despite the unstable economic environment in Egypt and the controversy surrounding the acquisition of the DRI steel licenses, Ezz Steel reported a 12% y-o-y increase in net sales to EGP 18.6 billion for 2011, close to our estimates. This was supported by higher steel prices for both long and flat products during the period but also by strong long product sales volumes which grew by 7% y-o-y to 3.62 million tons, reflecting a persistent strong domestic demand. Net sales from long products stood at EGP 13.8 billion, 20% higher than 2010 levels. On the other hand, the sales volume of flat steel dropped by 21% y-o-y to 1 million tons due to a feeble global market. Flat steel production also stopped at the EFS facility during 2011, due to the installation of a new mill for the production of long steel.

Net income pressured by income taxes

During 2011, Ezz was able to improve operating efficiency as gross margin slightly edged up to 12% from 11.6% the year before, sending the gross profit up by 15% y-o-y to EGP 2.2 billion. The operating profit followed suit, rising by 17% y-o-y to EGP 1.8 billion and its margin was 40 bps higher than its 2010 level, at 9.7%. However, net income dropped by 20% y-o-y to EGP 202 million, in line with our expectations, and the net margin dropped to 1.1%, down from 1.5% in 2010. Net income was pressured by income tax charges which include a one-off adjustment to deferred tax liability, more than doubled during the year. The corporate tax rate increase from 20% to 25% during the year was one contributor to the jump in income tax expense, but the biggest hit came from a penalty of EGP 219 million imposed on the company for unsettled taxes on the profits of flat steel sales at EZDK from 2000 till 2004. The company agreed to pay EGP 50 million in September and October 2011 and the balance through monthly installments over two years.

Upgrading to Accumulate on strong operational performance

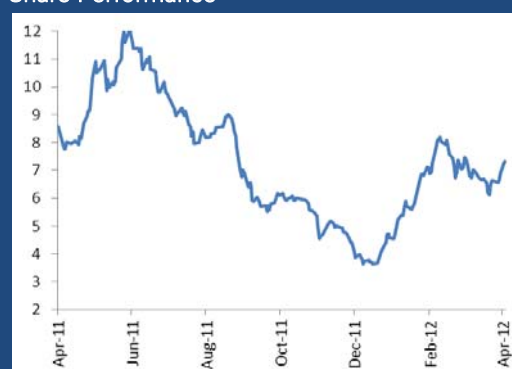
We increased our target price to EGP 8.60 from EGP 6.50 previously, after revising our 2012 revenue forecast upward with an 11% y-o-y increase, while maintaining our discount rate at 24%. Ezz Steel has proven resilient during the year to both macroeconomic and legal uncertainties. Operations at Ezz resisted the public unease concerning the acquisition of EZDK and the two DRI licenses. The court ruling against fraudulent companies linked to the ousted Mubarak regime imposed fines on those companies equal to the difference between the market value of their acquired assets net of the actual purchase price, reflecting the government's efforts to protect investors' interests and restore confidence in the market.

We issue an ACCUMULATE recommendation on Ezz's equity, on the back of sustained strong operations while highlighting the high-risk nature of the stock. The upside potential to the price remains highly sensitive to the short term political developments.

Share Data

Bloomberg Symbol	ESRS EY
Reuters Symbol	ESRS.CA
Market Cap (EGP)	3,976,699,998
Number of Shares	543,265,027
Free Float	35%
Price to 2011 Earnings	19.69
Price to 2011 Book Value	0.63

Share Performance



Source: Reuters

1 Month Return	-7.06%
3 Month Return	47.31%
6 Month Return	18.45%
12 Month Return	-14.69%
52 Week Range (EGP)	3.64 – 12.08

Source: Reuters

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Performance and Forecasts

In EGP millions	2010	2011	2012e	2013f	2014f	2015f
Revenues (EGP M)	16,621	18,611	20,739	22,544	24,507	25,790
Net Income (EGP M)	251	202	356	364	398	434
EPS (EGP)	0.46	0.37	0.66	0.67	0.73	0.80
BVPS (EGP)	11.36	11.68	11.88	12.79	11.24	10.50
ROA	1.4%	1.0%	1.8%	1.7%	1.8%	1.9%
ROE	3.9%	3.1%	5.3%	5.2%	5.8%	6.9%

Source: Ezz Steel, Blominvest

PROJECTED INCOME STATEMENT

<i>In EGP million</i>	2010	2011	2012e	2013f	2014f	2015f
Net sales	16,621	18,611	20,739	22,544	24,507	25,790
Cost of goods sold	(14,698)	(16,404)	(18,250)	(19,884)	(21,566)	(22,643)
Gross Profit	1,923	2,207	2,489	2,660	2,941	3,146
Selling & marketing expenses	(154)	(113)	(166)	(180)	(196)	(206)
General & admin. Expenses	(235)	(297)	(290)	(271)	(294)	(335)
Impairment loss on assets	(2)	(17)	-	-	-	-
Provisions	(95)	(82)	(132)	(132)	(132)	(132)
Total expenses	(486)	(509)	(588)	(583)	(622)	(674)
Finance expenses	(754)	(764)	(855)	(976)	(1,090)	(1,154)
Interest income	67	64	97	87	83	100
Other income	22	30	-	-	-	-
Total other expenses	(665)	(670)	(758)	(890)	(1,006)	(1,054)
Net profit before tax & non-controlling interest	772	1,028	1,143	1,188	1,312	1,419
Income tax expense	(171)	(359)	(286)	(297)	(328)	(355)
Deferred tax expense	(37)	(133)	(100)	(100)	(100)	(100)
Net profit before minority interests	564	536	757	791	884	964
Minority interest	(313)	(334)	(401)	(427)	(486)	(530)
Net profit after minority interests	251	202	356	364	398	434

Source: Ezz Steel, Blominvest

PROJECTED BALANCE SHEET

<i>In EGP million</i>	2010	2011	2012e	2013f	2014f	2015f
Non-current Assets						
Property, plant & equipment	9,567	9,937	10,092	10,497	10,848	10,214
Projects under construction	3,319	3,558	4,021	4,714	4,243	4,031
Goodwill	315	315	315	315	315	315
Other non-current assets	244	280	110	110	110	110
Total non-current assets	13,445	14,090	14,538	15,637	15,517	14,670
Current Assets						
Inventories	3,734	3,628	3,111	3,382	3,799	4,126
Trade & notes receivable	185	122	270	338	319	335
Debtors & other debit balances	586	628	664	676	735	774
Advances to suppliers	48	135	207	248	245	258
Investments in treasury bills	57	63	380	380	380	380
Cash & cash equivalents	1,415	1,171	1,244	1,353	1,470	2,321
Total current assets	6,026	5,747	5,876	6,377	6,948	8,194
Total Assets	19,470	19,837	20,414	22,014	22,464	22,864
Non-current Liabilities						
Loans	4,466	3,937	3,650	3,977	4,313	4,529
Other non-current liabilities	205	238	262	288	317	348
Bonds loan	651	433	213	-	-	-
Deferred tax liabilities	658	791	870	957	1,053	1,158
Total Non - current liabilities	5,980	5,399	4,995	5,222	5,683	6,035
Current Liabilities						
Banks credit accts & Overdrafts	1,136	999	1,278	1,392	1,510	1,585
ST Loans & Borrowings	3,292	3,577	3,833	4,374	4,852	5,208
Bonds loan	220	220	220	220	220	220
Trade & notes payable	1,145	1,364	1,460	1,591	1,725	1,811
Advances from customers	410	236	415	451	490	516
Creditors & other credit balances	677	1,177	1,186	1,292	1,402	1,472
Provisions	123	204	150	100	50	-
Total Current Liabilities	7,003	7,777	8,541	9,420	10,249	10,812
Total Liabilities	12,983	13,176	13,536	14,642	15,932	16,847
Shareholders' Equity	6,487	6,661	6,877	7,372	6,532	6,017
Total Liabilities & Shareholders' Equity	19,470	19,837	20,414	22,014	22,464	22,864

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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