

Q2/H1 2012 Update

Sector: Electric Equipment
Country: Egypt
Date: September 10, 2012

Share Price (EGP): 25.25
Target Price (EGP): 28.20
Upside: 11.68%
Recommendation: ACCUMULATE
Risk: Medium (Market)

Upgrading to an ACCUMULATE rating with a Fair Value of EGP 28.2 after breaking previous target price of EGP 24 in April

Revenues resume growth, though forex losses slash net income 70%

Revenue growth has ended its 9 month downward trend registering 6% growth in Q2. This contributed to an increase in operating income by 17% to EGP 251 million. All major El Sewedy divisions have achieved growth this quarter led mostly by cables and electrical products. Wires and Cables registered 4.4% growth while electrical products experienced 23% growth mostly driven by the success of their meters business. However, finance costs have doubled q-o-q due to a EGP 93 million foreign exchange loss on the Sudanese pound. Net income, while down 70% q-o-q, has remained positive this quarter at EGP 42 million.

Growth to shift from GCC to Iraq, Egypt and Sub-Saharan Africa

With increased demand for infrastructure, housing and power generation comes increased demand for cables and turnkey products. The infrastructure boom experienced over the past decade in the GCC has contributed significantly to El Sewedy's expansion. However, given the strong local competition and low market share, we expect El Sewedy to shift its focus to geographies that provide opportunity for market share growth. Iraq, Egypt and the African continent are seen as the main target for El Sewedy's expansion as electricity supply shortfalls and need for renewed infrastructure will be tackled over the medium term. El Sewedy's recent success in gaining large scale contracts in Iraq and Niger signal their ability to profit from this pursuit.

El Sewedy undervalued, but Syria and Sudan pose downside risks

We estimate the fair value of El Sewedy Electric at EGP 28.20 representing an upside potential of 11.68% over the recent closing price. Our terminal year assumption is at 3% perpetual growth, which is the long run average growth estimate for the Egyptian economy. Along with upside potential, we perceive significant risks mainly from Sudanese and Syrian operations. Sudan, along with Ethiopia, is seen as a gateway to the sub-Saharan cables market contributing 12,000 tons of capacity. With Sudanese operations hit by currency devaluation, a turn-around is needed to avoid stagnant cables growth in Africa. Additionally, the Syrian conflict has resulted in 70% of idle capacity in the Syrian plant, most of which is exported to neighboring countries. However, potential gains still outweigh the risks at hand leading us to upgrade el Sewedy to an ACCUMULATE rating.

Share Data

Bloomberg Symbol	SWDY.EY
Reuters Symbol	SWDY.CA
Market Cap (EGP)	5,641,304,500
Number of Shares	223,418,000
Free Float	33.75%
Price-to-Earnings 11	11.07
Price-to-Book 11	1.01

Share Performance



1 Month Return	12%
3 Month Return	16%
6 Month Return	-2%
12 Month Return	13%
52 Week Range	18.10 to 27.60

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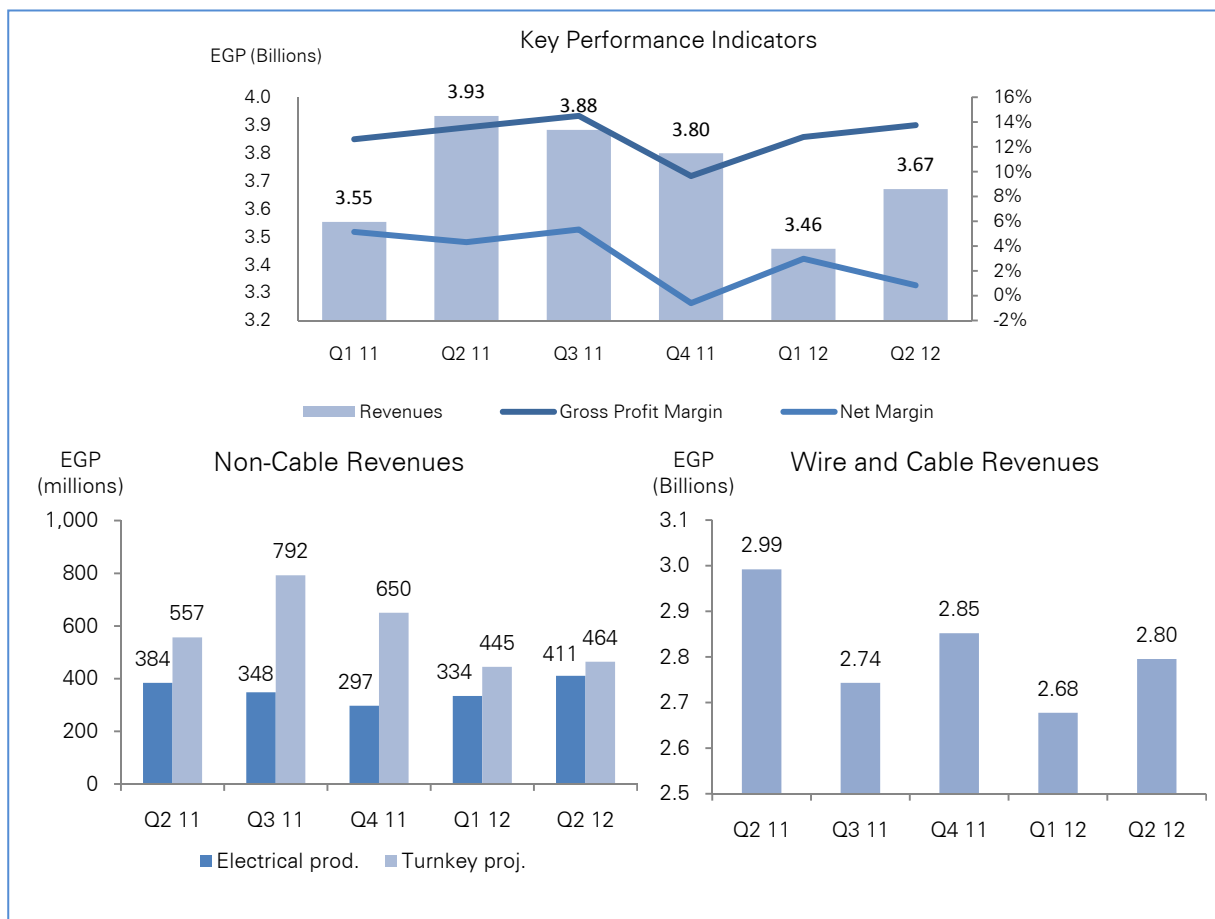
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Performance and Forecasts

In EGP millions	Q2 12	Q1 12	Q-o-Q	Q2 11	Y-o-Y
Revenues	3,671	3,457	6%	3,933	-7%
Net Income	31	103	-70%	170	-82%
Wire and Cables revenue	2,795	2,678	4%	2,992	-7%
Turnkey Projects revenue	464	445	4%	557	-17%
Electrical Products revenue	411	334	23%	384	7%

Revenue growth resumes after 9 month decline, though forex losses dampen net income

Revenue for the second quarter registered EGP 3,671 million representing the first positive growth rate in three consecutive quarters. However, this was coupled with a EGP 92 million foreign exchange loss due to the devaluation of the Sudanese Pound announced in mid-June. This drove a 70% decline in net profits. Wire and Cable revenues grew 4.4% q-o-q to EGP 2,795 million. Turnkey projects grew 4.3% q-o-q to EGP 464 million while revenues from electrical products surged 23% to EGP 411 million in Q2 12. While all three divisions showed positive growth on a quarterly basis, comparing first half results to the same period last year, Cables and Turnkey project revenues are down 4% and 16% respectively. Only Electrical products showed growth of 7.5% due to ongoing success in El Sewedy's meters business.



Source: El Sewedy Electric

Iraq, Egypt and sub-Saharan Africa to be focal points for El Sewedy's growth strategy

El Sewedy recently signed a contract with the Iraqi government for USD 56 million to supply medium voltage cables to increase electricity distribution. This is the first Iraqi government contract El Sewedy signed in 10 years marking a significant step to build their business in the growing economy. In 2011, the Iraqi government announced plans to spend USD 27 billion between 2012 and 2017 to rehabilitate war torn electricity grids and expand generation. This is expected to bring potentially lucrative turnkey and contracting revenue to complement El Sewedy's growth strategy in the country.

In Egypt, current power production capacity stands at 23,500 MW but suffers from a 3000 MW shortfall. Due to high energy demand over the summer, Egypt has suffered blackouts which took a hit on the stock exchange and the overall economy. With the government believed to take action on the matter in the short term, we expect El Sewedy to focus on the Egyptian cables business where it has considerable market share.

Sub-Saharan Africa has proven to be an emerging market where El Sewedy provided fiber optic and copper cables as well as turnkey products. El Sewedy's USD 26 million contract with Niger's SONITEL along with statements from management signal that the company will profit from a focus on Africa. Turnkey products are likely to be a high growth segment in Africa as power generation is in high demand in a growing economy.

Concerning Libya, the transitional government has made it a priority to rebuild its war-torn infrastructure awarding a USD 1 billion contract to a consortium of companies, including El Sewedy Electric. The contract was to install new gridlines that were damaged from last year's conflict, however, the company breakdown of the contract was not disclosed and so it is not clear how much El Sewedy earned from this deal. If successfully completed, this could bring in further business in other regions.

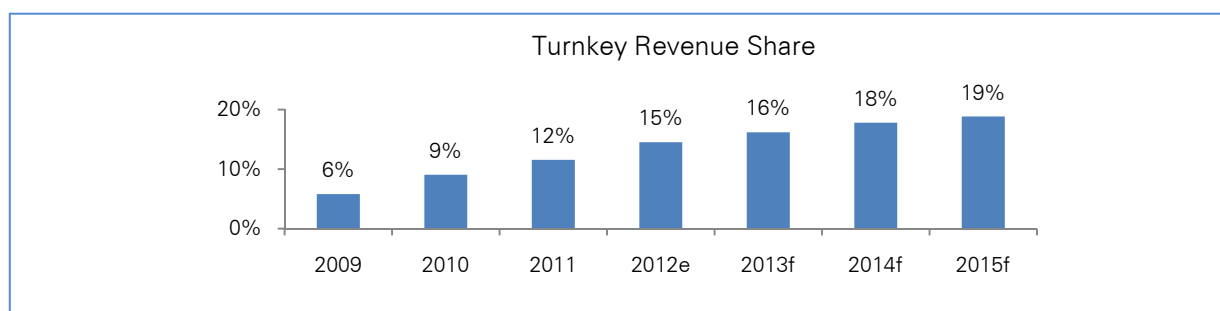
Sudanese and Syrian operations pose significant risks to El Sewedy

In mid-June, Sudanese officials announced the devaluation of the Sudanese pound (SDG) from 2.7 SDG/USD to 4.4 SDG/USD in order to narrow the gap between the official exchange rate and the black market rate. With contracts of the Sudanese subsidiary denominated in SDG, a loss of EGP 92 million was incurred. In response, the company decided to discontinue sales in the local currency leading both volumes and margins to fall dramatically. Unless El Sewedy plans a turnaround in their Sudanese operations, the company's ambitions in Africa may be thwarted as Sudan contributes 31% of cables capacity in Africa outside Egypt.

As a result of the ongoing crisis in Syria, El Sewedy is operating its 24,000 ton cables plant at a utilization of 30%, most of which is exported to neighboring countries. However, we expect a resumption to 85% utilization after the conflict draws to a close. Syrian operations represent around 8% of total cables capacity, indicating El Sewedy's potential contribution to Syria's recovery in the 2 to 5 year term.

Source of Turnkey growth to shift from GCC to Iraq and sub-Saharan Africa

In 2010, El Sewedy experienced a Y-o-Y growth in turnkey revenue of 97%, mainly due to the Saudi government's multibillion dollar plan to boost power generation. The following year showed a further 49% growth in turnkey revenues as El Sewedy supplied more power generators and related services. This trend is expected to continue however, with Africa, Egypt and Iraq being the focal points for this growth. In the medium term, we expect the turnkey business to represent a greater share of El Sewedy's total revenues



Source: El Sewedy Electric, BlomInvest estimates

Upside potential stemming from Egypt, Africa and Iraq; however political risk looms

We value El Sewedy Electric at EGP 28.20 per share using a discounted cash flow analysis with a discount rate of 16.5%. This presents an upside potential of 11.68% over the recent closing price. Our forecast extends over a 5 year time horizon with a terminal growth rate of 3%. The main driver of growth for El Sewedy will likely stem from the turnkey and cables divisions in Iraq, Egypt and Africa as demand for electricity outstrips supply. The sharp devaluation of the Sudanese pound will likely affect profitability of the cables unit in the medium term, as new contracts begin to be drafted. El Sewedy currently possesses 12,000 tons of cables capacity in Sudan with utilization expected to be affected this year. With that said, we still upgrade El Sewedy to an ACCUMULATE rating with a MEDIUM risk outlook as the potential gains from stock appreciation outweigh the risks associated with it.

Quarterly Income Statement

(in EGP million)	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12
Revenues	3,553	3,933	3,883	3,799	3,457	3,671
%change Q-o-Q		11%	-1%	-2%	-9%	6%
Cost of Revenues	(3,105)	(3,399)	(3,320)	(3,433)	(3,015)	(3,166)
Gross Profit	448	534	563	366	442	505
Gross Profit Margin	12.6%	13.5%	14.4%	9.6%	21%	14%
Selling & distribution expenses	(76)	(89)	(78)	(102)	(80)	(109)
Admin. Expenses	(131)	(136)	(130)	(159)	(151)	(106)
Other OPEX	(15)	(20)	4	(20)	(21)	(34)
Other operating income	25	26	17	26	23	(5)
Operating income	251	316	377	111	213	251
Operating Margin	7.0%	8.0%	9.7%	2.9%	6%	7%
Finance Income	24	4	10	23	27	3
Finance costs	(62)	(118)	(157)	(145)	(103)	(211)
Net profit before tax	213	202	230	(11)	137	42
Income tax	(31)	(32)	(22)	(12)	(35)	(12)
Net profit after tax	183	170	207	(23)	103	31
%change		-7%	22%	-111%		-70%
Net Margin	5.2%	4.3%	5.3%	-0.6%	3%	0.8%
Attributable to:						
Equity holders of parent	171	161	196	(19)	98	32
Minority interest	11	9	11	(4)	4	(1)
EPS	1.00	0.72	0.88	(0.32)	0.44	0.14

Source: El Sewedy Electric



Balance Sheet

(in EGP million)	2009	2010	2011	Q2 2012
Assets				
Long term assets				
Fixed assets	2,670	3,544	3,480	3,346
Projects under construction	1,059	270	256	209
Investments AFS	17	14.3	15	15
Investments in associates	336	10.3	13	12
Paid on account of investments	20	1.2		
Debit balances	474	197	203	139
Non-tangible assets	28	208	227	239
Deferred tax assets	22	32	37	35
Total LT assets	4,626	4,277	4,231	3,995
Current assets				
Inventories	2,779	3,700	3,554	3,706
Trade, notes & other receivables	2,656	4,115	4,391	4,375
Due from affiliates	276	283	156	146
Investment fund/ T Bills / CDs	311	569	401	258
Cash & cash equivalents	715	1,000	1,242	982
Total current assets	6,737	9,667	9,744	9,467
Total assets	11,363	13,944	13,975	13,462
Current liabilities				
Banks facilities & overdrafts	2,996	4,164	4,061	3,647
ST loans and installments of LTD	629	601	922	840
CDs payable to banks			175	212
Trade, notes & other payables	1,760	2,316	1,930	2,209
Due to affiliates	55	156	240	155
Provisions	95	72	49	47
Dividends Payable				223
Total current liabilities	5,534	7,310	7,377	7,333
Long term liabilities				
Loans	989	1,073	825	681
Deferred tax liabilities	62	109	120	124
Other liabilities	194	111	78	74
Total long term liabilities	1,245	1,293	1,023	878
Total liabilities	6,779	8,603	8,401	8,212
Shareholders' equity				
Issued and paid capital	1,322	1,719	2,234	2,234
Own stock	(1.8)	(1.7)	(1)	(1)
Legal reserve	16.9	84.0	122	135
Increase in net assets of the acquired subsidiaries over the consideration paid for the investment	579	579	579	579
Retained earnings	1,709	1,810	1,798	2,004
Net profit for the period	634	795.5	509	130
Forex from foreign entities translation	(47)	(59)	(80)	(222)
Total shareholders' equity	4,212	4,927	5,161	4,859
Minority interests	372	414	414	392
Total Equity	4,584	5,341	5,574	5,251
Total Liabilities and Equity	11,363	13,944	13,975	13,462

Source: El Sewedy Electric



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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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