

Al Ezz Flat Steel Co. S.A.E

Valuation executive summary

June 2019

Our reference: AF/AH

Four Seasons Nile Plaza (Corporate Building)
1089 Cornich El-Nil, Garden City
Cairo, Egypt

27 June 2019

Dear Sirs

Al Ezz Flat Steel Co S.A.E – company valuation

In accordance with your instructions, we have pleasure in enclosing a copy of our executive summary prepared in connection with the valuation Al Ezz Flat Steel Co S.A.E as at 31 December 2018.

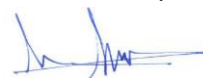
Specialist Advisory Services

Grant Thornton Financial
Consulting for Marketable
Securities (SAE)
87 Ramsis Street
Cairo
Egypt

T +202 2574 4810
F +202 2576 0915
www.gtegypt.org

This report is confidential and has been prepared exclusively for Al Ezz Flat Steel Co S.A.E. It should not be used, reproduced or circulated for any other purpose, in whole or in part, without our prior written consent, other than in accordance with the terms of the Letter of engagement. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than Al Ezz Flat Steel Co S.A.E for our work, our report and other communications, or for any opinions we have formed. We do not accept any responsibility for any loss or damages arising out of the use of the report by the addressee(s) for any purpose other than in connection with Al Ezz Flat Steel Co S.A.E

Yours faithfully



Grant Thornton Egypt

If you have any questions in respect of this report or its contents, please contact:

Amr Fathalla

Partner

T +2 0122 218 2726

E amr.fathalla@eg.gt.com

Ahmed Hilal

Director

T +2 0122 733 0606

E ahmed.hilal@eg.gt.com



Grant Thornton

An instinct for growth™

Private and Confidential

In accordance with your instructions and terms of the Letter of engagement, for the purpose of a share swap among shareholders of Al Ezz Flat Steel Co. and Al Ezz Dekheila Steel Company - Alexandria S.A.E, the fair value of the company was estimated on the basis of the assumptions, data and information provided by Management of Al-Ezz flat steel Co.

The valuation was prepared using the following principles:

We have determined the fair value of the Al Ezz Flat Steel Co using the income approach, Discounted Cash Flow (DCF) analysis.

We have taken into account the financial valuation standards issued by the Board of Directors of the Financial Regulatory Authority No. 1 For the year 2017.

Information submitted to us by Management are under the responsibility of the Company, we do not accept responsibility for such information which remains the responsibility of Management. We have satisfied ourselves, so far as possible, that the information presented in our report is consistent with other information which was made available to us in the course of our work in accordance with the terms of the Letter of engagement, however we take into account any amendments that we considered necessary to formulate our valuation opinion

The income approach used in the valuation of Al-Ezz flat steel Co. represents the most widely used method to determine the fair value of the shares. It is based on measuring the true performance of the company through its projected cash flows (not just profitability) as well as assessing the underlying business to continue as a going concern

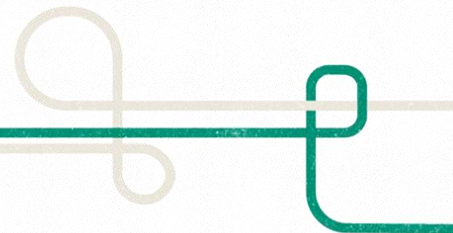
Income approach method is based on the following steps:

- The estimation of free cash flows over the forecast period assessing the economic benefit stream of the asset or business interest under analysis, usually based on historical or forecasted cash flow often a derivative of profits
- Estimating the terminal value following the forecast period
- These cash flows is then discounted to present value with an appropriate risk-adjusted discount rate capturing the debt to capital ratio as well as the nature of the business, industry risk and risk free rate
- Determining the fair value of the equity after deducting debt (if any) and the addition of the cash and cash equivalents. The total present value of future cash flows over the discrete forecast period plus the terminal value indicates the equity value and therefore the price per share.
- In light of the above, the fair value of Al Ezz Flat steel Co. as at 31 December 2018 amounted to \$756,420,786 (seven hundred and fifty-six million four hundred and twenty thousand and seven hundred and eighty-six dollars) distributed over 75,000 shares. This indicates a share price of \$10.09 (ten dollars and nine cents)

Section 1: Introduction and scope

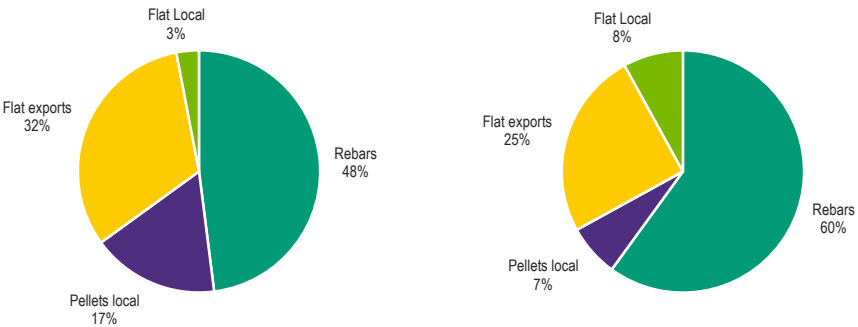
01. Introduction and scope

02. Executive summary



Al Ezz Flat Steel Co. (EFS) total production capacity is 2.2 million tons, 1.2 million tons of Rebars and 1.0 million tons of flat steel

Production lines revenue as a percentage of total revenue for 2017 and 2018

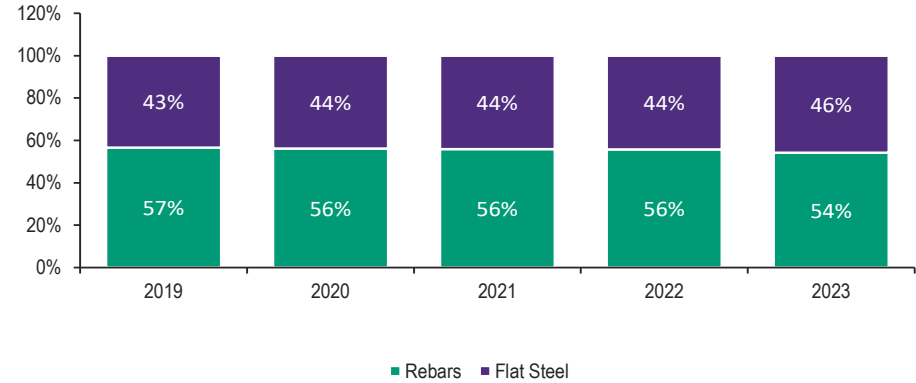


Sources: 1. Grant Thornton analysis 2. Management information

Business Overview

- Al Ezz Flat Steel Co. produces flat cut steel, rolled steel coils and strips that is treated by acid and other products
- The company operates in manufacturing, trade and distribution of all types of Rebars and related contracting works and services
- EFS’s plant commenced initial operations in July 2004. In 2011 and 2012 the Billets and Rebars plants commenced operations following the expert’s certificate issuance amid finalization of tests to start production.
- EFS total production capacity is 2.2 million tons, 1.2 million tons of Rebars and 1.0 million tons of flat steel
- Al Ezz Dekheila Steel Company - Alexandria S.A.E. owns 44% of EFS. Also, Ezz Steel Company (Parent) owns directly and indirectly c.71.1% of EFS

Forecast Production lines revenue as a percentage of total revenue



Sources: 1. Grant Thornton analysis 2. Management information

EFS experienced revenue growth of c.54.7% (CAGR) from 2015 to 2018, however loss making at the EBITDA level

EFS – historical P&L

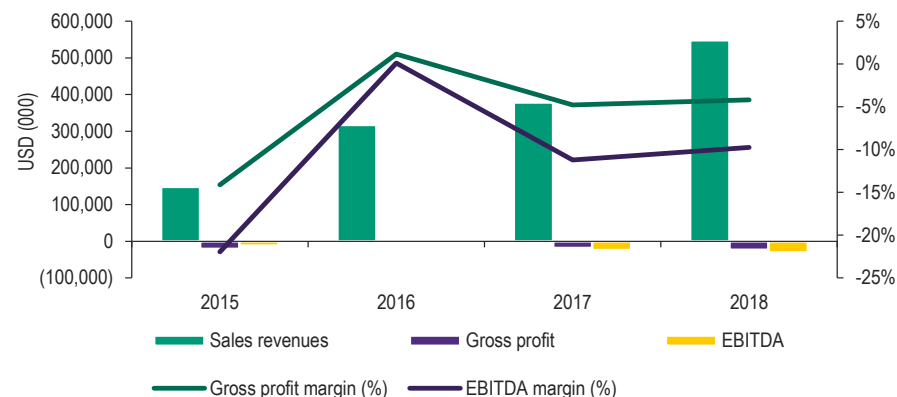
USD (000)	2015	2016	2017	2018
Sales revenues	148,005	317,084	378,133	548,186
Cost of sales	(168,907)	(313,419)	(396,244)	(571,143)
Gross profit	(20,902)	3,665	(18,112)	(22,957)
General and administrative expenses	(5,040)	(4,593)	(3,142)	(4,874)
Selling and marketing expenses	(867)	(2,408)	(2,963)	(2,703)
Other operating expenses	15,240	(28)	(17)	(20)
EBITDA	(11,569)	(3,365)	(24,233)	(30,554)
Depreciation and Amortization	(29,816)	(29,740)	(29,796)	(29,905)
EBIT	(41,385)	(33,105)	(54,030)	(60,459)
Revenue growth (%)	(46)%	114%	19%	45%
Gross profit margin (%)	(14)%	1%	(5)%	(4)%
EBITDA margin (%)	(8)%	(1)%	(6)%	(6)%
EBIT margin (%)	(28)%	(10)%	(14)%	(11)%

Sources: 1. Management information

Overview

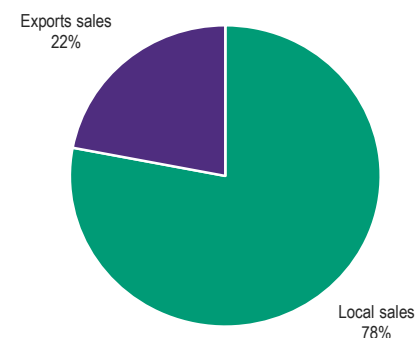
- EFS experienced revenue growth of c.54.7% (CAGR) from 2015 to 2018.
- Revenue grew by 45% in 2018 due to the following reasons:
 - The increase in production utilization of Rebars and flat steel by 20% and 6%, respectively.
 - The increase in Rebars and flat steel prices by 3%
- Average local and export sales over the historical period accounted for 78% and 22% respectively
- The gross profit margin increased from (14%) in 2015 to 1% in 2016 and then dropped again into negative c.4% in 2017 and 2018.
- Average EBITDA margins have been negative over the historical period driven by low utilization of the plant due to the lack of financing

EFS – historical results (2015 to 2018)



Sources: 1. Management information

Exports sales vs local sales



Sources: 1. Management information

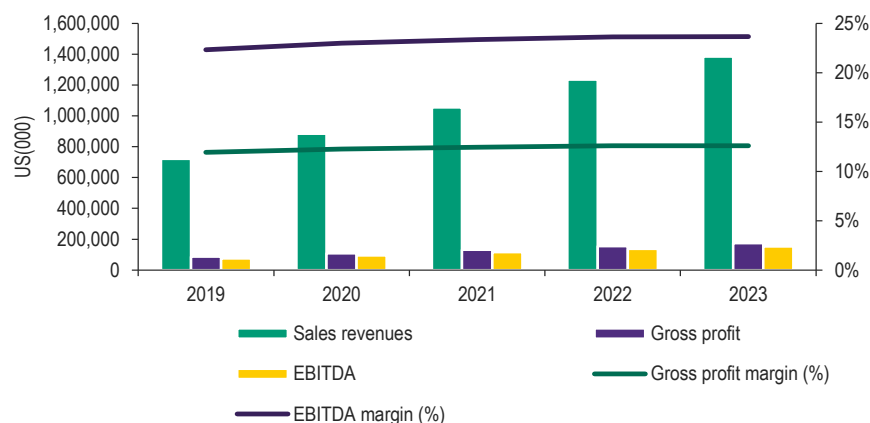
Revenue is expected to grow by 17.7% (CAGR) over the forecast period driven by price and volume growth

EFS – forecast P&L

USD (000)	2019	2020	2021	2022	2023
Sales revenues	720,515	882,922	1,054,425	1,235,424	1,384,624
Cost of sales	(634,580)	(774,705)	(923,212)	(1,079,973)	(1,210,362)
Gross profit	85,935	108,217	131,213	155,451	174,262
General and administrative expenses	(6,406)	(7,850)	(9,375)	(10,984)	(12,311)
Selling and marketing expenses	(4,599)	(5,636)	(6,731)	(7,886)	(8,838)
Other operating expenses	(21)	(22)	(23)	(25)	(26)
EBITDA	74,908	94,709	115,084	136,557	153,087
Depreciation and Amortization	(33,085)	(33,272)	(33,471)	(33,683)	(33,908)
EBIT	41,824	61,437	81,613	102,874	119,179
Revenue growth (%)	31.4%	22.5%	19.4%	17.2%	12.1%
Gross profit margin (%)	11.9%	12.3%	12.4%	12.6%	12.6%
EBITDA margin (%)	10.4%	10.7%	10.9%	11.1%	11.1%
EBIT margin (%)	5.8%	7.0%	7.7%	8.3%	8.6%

Sources: Management Information

EFS – forecast results (2019 to 2023)



Sources: Management Information

Overview

- The production of Rebars is expected to increase from 580,000 tons in 2018 to 1.1 million tons in 2023. The production of flat steel is expected to increase from 330,000 tons in 2018 to 900,000 tons in 2023
- Based on Management's assumptions, the sale price of Rebars and flat steel is expected to increase by 3% annually from 2019 to 2023.
- As a result, revenue is expected to grow by 17.7% (CAGR) over the forecast period.
- Gross profit margins are expected to increase to 12% in 2019 then rise slightly to 12.6% in 2023.
- The company is expected to achieve an EBITDA margin of c.10% in 2019 and then rise slightly to about 11% in 2021 and expected to maintain that level to 2023

Section 2: Executive Summary

01. Introduction and Scope

02. Executive summary

The value of 100% of EFS's equity share capital is \$756.4 million which is equivalent to \$10.09 per share based on the income approach

Valuation summary

USD (000)	
Sum of present values	368,039
plus: present value of terminal value	669,810
Enterprise value	1,037,849
add: cash and cash equivalents	8,964
less: debt	(290,392)
Equity value	756,421
No. of outstanding shares	75,000
share price \$	10.09

Sources: 1. Grant Thornton analysis

Valuation Summary

- We have used the Discounted Cash Flow (DCF) analysis to derive the value of 100% of EFS. Our analysis is based on Management's most recent forecasts from 2019 to 2023
- Management has prepared forecasts from 2019 to 2023, which show an increase in revenue by 17.7% (CAGR) during the period. We note, the company's revenue growth was 54.7% (CAGR) from 2015 to 2018.
- Management expects gross profit margins to reach 12.6% in 2023, which is expected to improve EBITDA margins to reach 11.1% in 2023
- Changes in working capital and cash flows from investing activities are projected based on data provided to us by Management.
- Using Management's forecasts, we have applied a discount rate of 12.61% and a terminal growth rate of c.4% in our DCF analysis deriving an enterprise value of \$1,037.8 million
- It is worth mentioning that when calculating the weighted average cost of capital (WACC), a company specific premium of 4.0% was assumed as to cover sector risks and the risks associated with the company's ambitious projections
- After deducting the Company's current net debt as at 31 December 2018, we derive an equity value of \$756.4 million which is equivalent to \$10.09 per share based on the income approach
- A weight of 100% was allocated to the income approach as the company was loss making in previous years, however with the beginning of 2019, Management expects performance to gradually improve as well as in the coming years. Based on the above, we have excluded the market approach in the valuation of EFS as it depends largely on a stable level of profitability, which is not expected to occur over the next two years so using forecast multiples and apply it to EFS's 2019 and 2020 figures would not reflect the true fair value of the company at the valuation date

Appendices

- | | |
|----|--|
| A. | Discounted Cash Flow (DCF) analysis |
| B. | Discount rate |
| C. | Guideline Public Companies – beta analysis |

A. Discounted Cash Flow

Assumptions						
Discount rate	(1)	12.61%				
Tax rate	(2)	22.5%				
Terminal growth rate	(3)	4.0%				
USD(000)	2019	2020	2021	2022	2023	Terminal value
Sales Revenue	720,515	882,922	1,054,425	1,235,424	1,384,624	1,440,009
Annual growth (%)	31.4%	22.5%	19.4%	17.2%	12.1%	4.0%
Cost of sales	(634,580)	(774,705)	(923,212)	(1,079,973)	(1,210,362)	(1,258,776)
Gross profit	85,935	108,217	131,213	155,451	174,262	181,233
Operating expenses	(11,027)	(13,508)	(16,129)	(18,895)	(21,175)	(22,022)
EBITDA	74,908	94,709	115,084	136,557	153,087	159,211
Depreciation and Amortization	(33,085)	(33,272)	(33,471)	(33,683)	(33,908)	(21,600)
EBIT	41,824	61,437	81,613	102,874	119,179	137,611
Estimated income taxes	(2)	-	-	-	(26,815)	(30,962)
profit after tax	41,824	61,437	81,613	102,874	92,364	106,648
plus: Depreciation and Amortization	33,085	33,272	33,471	33,683	33,908	21,600
Working capital movements	(5)	(936)	(6,708)	(6,009)	(7,171)	(5,333)
Capital Expenditures	(4)	(3,088)	(3,289)	(3,401)	(3,523)	(3,659)
Cashflow to the enterprise	70,884	84,712	105,675	125,862	117,281	98,341
Discount periods (midpoints)	0.50	1.50	2.50	3.50	4.50	4.50
Present value factor	0.942	0.837	0.743	0.660	0.586	0.586
Present value of Cash Flow	66,799	70,893	78,537	83,069	68,740	669,810
Sum of present values	368,039					
plus: present value of terminal value	669,810					
Enterprise value	1,037,849					
Add: cash and cash equivalents	8,964					
Less: Debt	(290,392)					
Equity Value	756,421					

Sources: 1. Grant Thornton analysis

Notes to the discounted cash flow

1. Based on WACC of 12.61%
2. Based on the statutory tax rates in Egypt
3. Terminal growth rate based on expected long term level of Egypt's inflation
4. Capex is forecast based information provided by Management
5. Working is forecast based information provided by Management

B. Discount rate

Weighted Average Cost of Capital

Cost of Capital		
Risk free rate	(1)	2.4%
Equity risk premium	(2)	6.0%
Beta	(3)	1.07
Industry adjusted premium		6.4%
Country Risk Premium	(4)	7.5%
Company specific risk	(5)	4.0%
Cost of equity		20.3%
pre-tax cost of debt	(6)	7.5%
tax rate	(7)	22.5%
After tax cost of debt		5.8%
Capital structure		
Equity weight	(8)	46.8%
Debt weight		53.2%
Weighted average cost of capital		12.61%

Sources: 1. Grant Thornton analysis

We have assessed a weighted average cost of capital for Al Ezz Flat Steel Co. based on the capital asset pricing model (CAPM), where:

$$Re = Rf + b(Rm - Rf) + SP$$

- 1) Rf = Risk-free rate of return (based on the nominal return on ten year US government bond rates) - CapIQ
- 2) $(Rm - Rf)$ = The estimated Market Risk Premium (MRP) of 6.0%, which equals $Rm - Rf$, incorporates perspective provided by recent long-term market return studies (Damodaran)
- 3) b = Beta, a measure of the relationship between industry risk and aggregate market risk, derived from the comparable company analysis set out in Appendix C
- 4) CRP = based on country risk premiums published by Damodaran
- 5) Company specific premium = Additional risk premium reflects the perceived uncertainties associated with the operating forecast for the subject company and the speculative nature of the returns associated therein
- 6) Based on company's cost of debt (USD debt)
- 7) Based on statutory tax rates in Egypt
- 8) Debt-to-total capital ratio based on market participant optimal capital structure per the GPCs. Refer Appendix C

We assess that an appropriate discount rate based on the Company's WACC is 12.61%

C. Guideline public companies – beta analysis

Beta analysis

(USD)							
SELECTED PUBLIC	MONTHLY		MARKET	MARKET	MARKET	EFFECTIVE	
GUIDELINE COMPANIES	EQUITY	TOTAL	VALUE OF	VALUE OF	VALUE OF	INCOME	MONTHLY
	BETA	DEBT	COMMON	DEBT TO	TOTAL	TAX	ASSET
			EQUITY	EQUITY	CAPITAL	RATE	BETA
Al Ezz Dekheila Steel Company - Alexandria S.A.E.	1.26	843,417	742,201	113.6%	53.2%	23.0%	0.67
Ezz Steel Company	1.47	1,515,050	542,795	279.1%	73.6%	23.0%	0.47
Lingyuan Iron & Steel Co., Ltd.	0.89	392,848	1,075,784	36.5%	26.7%	29.6%	0.71
Xinxing Ductile Iron Pipes Co., Ltd.	0.80	2,292,377	2,500,981	91.7%	47.8%	27.5%	0.48
Usinas Siderúrgicas de Minas Gerais S.A.	3.01	1,598,096	2,929,923	54.5%	35.3%	12.9%	2.04
Dongkuk Steel Mill Company Limited	1.65	2,612,138	618,714	422.2%	80.8%	21.0%	0.38
Welspun Corp Limited	0.79	183,831	529,771	34.7%	25.8%	35.0%	0.65
Tung Ho Steel Enterprise Corporation	0.82	555,105	623,251	89.1%	47.1%	20.7%	0.48
Nippon Steel Corporation	1.21	20,538,304	15,216,624	135.0%	57.4%	16.7%	0.57
Tata Steel Limited	0.87	15,851,000	8,593,273	184.5%	64.8%	19.2%	0.35
JFE Holdings, Inc.	1.59	11,987,106	9,217,774	130.0%	56.5%	26.6%	0.81
POSCO	1.02	19,945,242	17,495,928	114.0%	53.3%	30.3%	0.57
			Median	113.8%	53.2%		0.57
Re-levering of Beta:							
Selected asset beta	0.57						
Debt to equity market value	113.8%						
Estimated income tax rate	22.5%						
RELEVERED BETA	1.07						

Sources: S&P Capital IQ



© 2019 Grant Thornton Egypt. All rights reserved.

'Grant Thornton' refers to the brand under which the Grant Thornton member firms provide assurance, tax and advisory services to their clients and/or refers to one or more member firms, as the context requires.

Grant Thornton Egypt is a member firm of Grant Thornton International Ltd (GTIL). GTIL and the member firms are not a worldwide partnership. GTIL and each member firm is a separate legal entity. Services are delivered by the member firms. GTIL does not provide services to clients. GTIL and its member firms are not agents of, and do not obligate, one another and are not liable for one another's acts or omissions.

gtegypt.org