

# Al Ezz Rolling Mills 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 Rolling Mills 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 Rolling Mills Co S.A.E as at 31 December 2018.

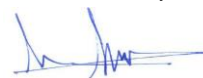
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Yours faithfully



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

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## 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 Rolling Mills Co S.A.E 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 Rolling Mills Co S.A.E.

The valuation was prepared using the following principles:

We have determined the fair value of the Al Ezz Rolling Mills Co S.A.E 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 Rolling Mills Co S.A.E 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 Rolling Mills Co S.A.E as at 31 December 2018 amounted to EGP 2,074,367,971 (Two billion and seventy four million, three hundred and sixty seven thousand and nine hundred and seventy-one Egyptian Pounds distributed over 89,899 thousand shares. This indicates a share price of EGP 23.07 (twenty three Egyptian pounds and seven piasters)

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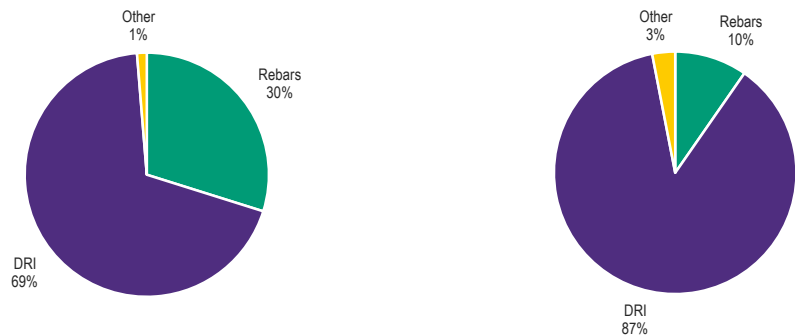
# Section 1: Introduction and scope

01. Introduction and scope

02. Executive summary

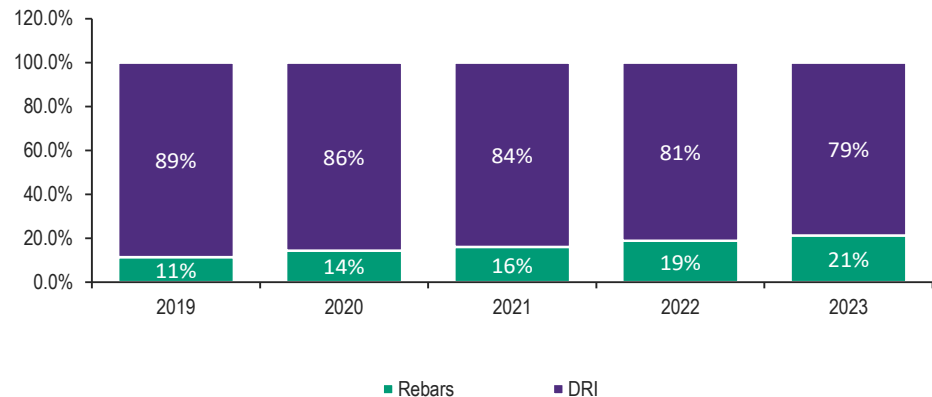
# Al Ezz Rolling Mills Co S.A.E (ERM) manufactures Rebars and produces direct reduced iron (DRI) as well as other steel products

Products revenue contribution to total revenue for 2017 and 2018



Sources: 1. Grant Thornton analysis 2. Management information

Forecast Production lines Revenue as a percentage of total Revenue



Sources: 1. Grant Thornton analysis 2. Management information

Business Overview

- Al Ezz Rolling Mills Co (ERM) was established on 10 March 1986, the Company is a subsidiary of Al Ezz Steel (Parent) owning 99% interest in the Company
- ERM is specialized in the production of Rebars, coils, billets. As of September 2009 a new production line of direct reduced iron (DRI) has been assembled.
- The factory’s capacity is 500 thousand tons of steel annually in the 10th of Ramadan City plant and a production capacity of 1.9 million tons of steel in Ein Al Sokhna plant.
- Revenue from the production of DRI increased from 69% in 2017 to 87% in 2018 as a percentage of total revenue due to the increase in DRI production from 800 thousand tons in 2017 to 1.2 million tons in 2018.
- The percentage of Rebar from total production decreased from 30% in 2017 to 10% in 2018 due to the decrease in production quantities from 230 thousand tons in 2017 to 80 thousand tons in 2018 due to liquidity problems within the company which impacted production.
- DRI revenue is expected to decrease from 89% in 2019 to 79% in 2023 as a percentage of total revenue.
- Rebars revenue is expected to increase from 11% in 2019 to 21% in 2023 as a percentage of total revenue.

ERM has experienced revenue growth of 75.5% (CAGR) from 2015 to 2018 increasing EBITDA margins from 3.7% in 2015 to 8.6% in 2018

### ERM – historical P&L

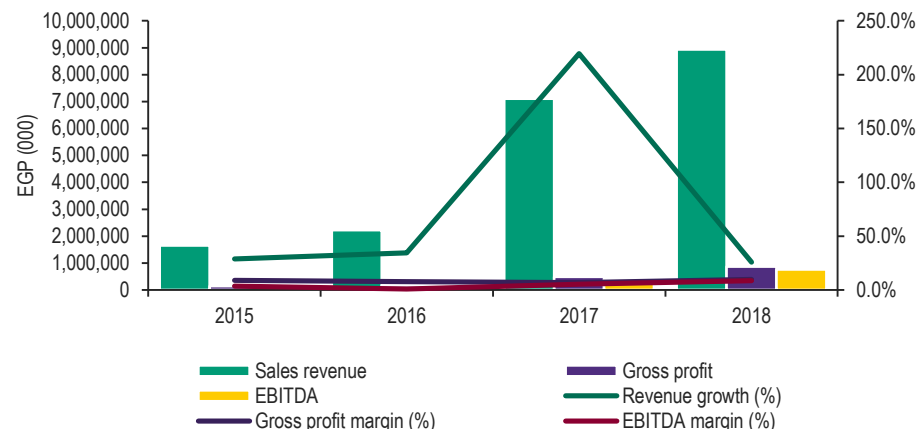
EGP (000)	2015	2016	2017	2018
Sales revenue	1,653,916	2,222,580	7,102,932	8,934,251
Cost of sales	(1,506,259)	(2,051,640)	(6,613,351)	(8,066,047)
<b>Gross profit</b>	<b>147,656</b>	<b>170,940</b>	<b>489,581</b>	<b>868,204</b>
General and administrative expenses	(94,207)	(122,777)	(113,738)	(184,776)
Other operating expenses	7,345	(23,991)	17,377	83,020
<b>EBITDA</b>	<b>60,794</b>	<b>24,172</b>	<b>393,220</b>	<b>766,448</b>
Depreciation and amortization	(4,760)	(59,535)	(247,089)	(242,491)
<b>EBIT</b>	<b>56,034</b>	<b>(35,362)</b>	<b>146,130</b>	<b>523,957</b>
Revenue growth (%)	29.0%	34.4%	219.6%	25.8%
Gross profit margin (%)	8.9%	7.7%	6.9%	9.7%
EBITDA margin (%)	3.7%	1.1%	5.5%	8.6%
EBIT margin (%)	3.4%	-1.6%	2.1%	5.9%

Sources: 1. Management information

### Overview

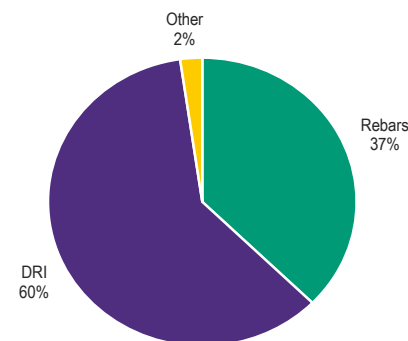
- ERM has experienced revenue growth of 75.5% (CAGR) from 2015 to 2018. The remarkable growth in 2017 revenue is due to the central bank's decision to float the Egyptian pound by the end of 2016, prompting companies to increase steel prices.
- DRI revenue accounted for the largest percentage of total revenue by c.60%, followed by Rebars with c.37% while other revenue represented c.2% of total Revenue.
- Gross profit margin increased from 8.9% in 2015 to 9.7% in 2018 due to lower production costs (cost of sales) to stabilize at an average of 92% of total revenue over the historical period.
- EBITDA margin decreased in 2016 to -1.6% due to the overall increase in expenses, however EBITDA margins increased in 2017 and 2018 as production and operations relatively stabilize

### ERM – historical results (2015 to 2018)



Sources: 1. Management information

### Average product contribution of revenue over the historical period



Sources: 1. Management information

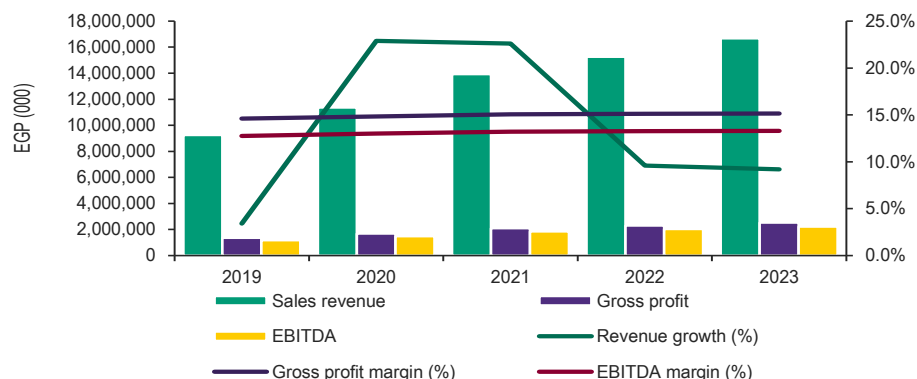
Revenue is expected to increase by 15.9% (CAGR) over the forecast period driven by the increase in utilization and selling prices

### ERM - forecast P&L

EGP (000)	2019	2020	2021	2022	2023
Sales revenue	9,240,000	11,355,750	13,924,313	15,259,933	16,663,158
Cost of sales	(7,890,547)	(9,669,985)	(11,826,948)	(12,954,814)	(14,139,218)
<b>Gross profit</b>	<b>1,349,453</b>	<b>1,685,765</b>	<b>2,097,364</b>	<b>2,305,119</b>	<b>2,523,940</b>
General and marketing expenses	(169,875)	(208,772)	(255,995)	(280,550)	(306,348)
<b>EBITDA</b>	<b>1,179,578</b>	<b>1,476,993</b>	<b>1,841,370</b>	<b>2,024,569</b>	<b>2,217,593</b>
Depreciation and ammortization	(252,336)	(257,084)	(262,090)	(267,394)	(273,038)
<b>EBIT</b>	<b>927,242</b>	<b>1,219,909</b>	<b>1,579,279</b>	<b>1,757,175</b>	<b>1,944,554</b>
Revenue growth (%)	3.4%	22.9%	22.6%	9.6%	9.2%
Gross profit margin (%)	14.6%	14.8%	15.1%	15.1%	15.1%
EBITDA margin (%)	12.8%	13.0%	13.2%	13.3%	13.3%
EBIT margin (%)	10.0%	10.7%	11.3%	11.5%	11.7%

Sources: Management Information

### ERM – forecast results (2019 to 2023)



Sources: Management Information

### Overview

- Revenue is expected to increase by 15.9% (CAGR) over the forecast period driven by the increase in utilization and quantities sold as well as the growth in selling prices at a fixed rate of 3% during the period from 2019 to 2023.
- It is expected that the production of Rebars will increase from 100 thousand tons in 2019 to 300 thousand tons at the end of 2023 by an increase of 200%.
- Production of DRI is expected to increase from 1.3 million tons in 2019 to 1.85 million tons in 2023 with an increase of 42%.
- The company is expected to achieve an average profit margin of 15% during the forecast period
- EBITDA is expected to gradually increase from 12.8% in 2019 to 13.3% in 2023.

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## Section 2: Executive Summary

01. Introduction and Scope

02. Executive summary



# The value of 100% of ERM's equity share capital is EGP 2,074 million based on the income approach as at 31 December 2018

## Valuation summary

EGP million	
Sum of present values	2,615
Present value of terminal value	5,157
<b>Enterprise value</b>	<b>7,773</b>
add: cash and cash equivalents	9
add: assets available for sale	282
less: debt	(5,990)
<b>Equity value</b>	<b>2,074</b>
No. of outstanding shares	89,899
<b>Share price (EGP)</b>	<b>23.07</b>

Sources: 1. Grant Thornton analysis

## Valuation Summary

- We have used Discounted Cash Flow (DCF) analysis to derive the value of 100% of ERM. Our analysis is based on Management's most recent forecasts from 2019 to 2023
- Using Management's forecasts, we have applied a discount rate of 17.8% and a terminal growth rate of c.4% in our DCF analysis deriving an enterprise value of EGP 7,773 million
- It is worth mentioning that when calculating the weighted average cost of capital (WACC), a rate of 3.0% was assumed as a company specific premium 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 EGP 2,074 million indicating a share price of EGP 23.07 as presented in the table opposite
- 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 ERM 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 ERM's 2019 and 2020 figures would not reflect the true fair value of the company at the valuation date

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# Appendices

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

# A. Discounted Cash Flow

Assumptions							
Weighted average cost of capital (WACC)	(1)	17.79%					
Target Company Tax Rate	(2)	22.5%					
Terminal growth rate	(3)	4.0%					
EGP (million)		2019	2020	2021	2022	2023	Terminal Value
Net Revenue		9,240	11,356	13,924	15,260	16,663	17,330
Annual Growth (%)		3.4%	22.9%	22.6%	9.6%	9.2%	4.0%
Cost of Sales		(7,891)	(9,670)	(11,827)	(12,955)	(14,139)	(14,705)
Gross Profit		1,349	1,686	2,097	2,305	2,524	2,625
Operating expenses		(170)	(209)	(256)	(281)	(306)	(319)
EBITDA		1,180	1,477	1,841	2,025	2,218	2,306
Depreciation		(252)	(257)	(262)	(267)	(273)	(260)
EBIT		927	1,220	1,579	1,757	1,945	2,046
Estimated Income Taxes	(2)	(209)	(274)	(355)	(395)	(438)	(460)
Profit After Tax		719	945	1,224	1,362	1,507	1,586
Plus: Depreciation		252	257	262	267	273	260
Working Capital movement	(5)	(609)	(446)	(507)	(290)	(461)	(100)
Capital Expenditure	(4)	(97)	(99)	(102)	(105)	(109)	(260)
Cash Flow to the Enterprise		265	657	876	1,234	1,211	1,486
Discount Periods (Mid-Period)		0.50	1.50	2.50	3.50	4.50	4.50
Present Value Factor		0.921	0.782	0.664	0.564	0.479	0.479
Present Value of Cash Flow		244	514	582	696	579	5,157
Sum of Present Values		2,615		34%			
Plus: Present Value of Terminal Value		5,157		66%			
Enterprise Value (1)		7,773					
Add: cash and cash equivalents		9					
Add: Investments available for sale		282					
Less: debt		(5,990)					
Equity value of ERM		2,074					

Sources: 1. Grant Thornton analysis

## Notes to the discounted cash flow

1. Based on WACC of 17.79%
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

<b>Cost of capital</b>		
Rsk free rate	(1)	12.9%
Equity risk premium	(2)	6.0%
Beta	(3)	1.07
Industry adjusted premium		6.4%
Company specific risk	(4)	3.0%
<b>Cost of equity</b>		<b>22.4%</b>
Pre tax cost of debt	(5)	17.8%
Tax rate	(6)	22.5%
<b>After tax cost of debt</b>		<b>13.8%</b>
<b>Capital structure</b>		
Equity weight	(7)	46.8%
Debt weight		53.2%
<b>Weighted average cost of capital</b>		<b>17.8%</b>

Sources: 1. Grant Thornton analysis

We have assessed a weighted average cost of capital for Al Ezz Rolling Mill 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 Egyptian government treasury bills)
- 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) 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
- 5) Cost of debt based on cost of debt in Egypt as of the valuation date
- 6) Based on statutory tax rates in Egypt
- 7) 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 17.8%

# 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
			<b>Median</b>	113.8%	53.2%		0.57
<b>Re-levering of Beta:</b>							
Selected asset beta	0.57						
Debt to equity market value	113.8%						
Estimated income tax rate	22.5%						
<b>RELEVERED BETA</b>	<b>1.07</b>						

Sources: S&P Capital IQ



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