MERIS
Middle East Rating & Investors Service

Cairo, June 22nd, 2009

Press Release: Ezz Steel Rebars Company S.A.E. (ESR)

MERIS (Middle East Rating & Investors Service) Maintained the National Scale Rating (NSR) of a "BBB-" for the Entity Rating and the Instrument Rating of Ezz Steel Rebars Company second bond issue. The rating outlook is "Stable" for both the entity and the instrument.

MERIS (Middle East Rating & Investors Service) reviewed the senior unsecured debt NSR of Ezz Steel Rebars (ESR); the rating was maintained at "**BBB-**" for the entity and the second bond issue. The rating outlook is "**stable**" for both the entity and the instrument.

A "**BBB**" rating denotes that the issuer or issue represents an **Average Creditworthines**s relative to other domestic issuers. The (+/-) signs denote relative status within each rating category.

ESR on a consolidated basis is considered the largest steel manufacturer in Egypt and the region producing around 5.3mn tons of different types of steel (i.e. Rebars and flat Steel) and leading the local market capturing around 65% market share over the last three years. The company is majority owned (65.28%) through direct and indirect stake by Ezz Industries Group which is wholly owned by Eng. Ahmed Ezz, while the remaining shares are traded in Cairo & Alex Stock Exchange and London Stock Exchange. ESR in its present form owns a controlling stake in three operating subsidiaries, namely: "Al Ezz Dekheila Steel Company (EZDK)" owing 53.24%, "EZZ Flat Steel (EFS)" retaining 75% and "Ezz Rolling Mill (ERM)" with 90.7% stake. It is worth mentioning the EZDK is considered the key engine for the ESR cash generating ability through dividend distribution. This is mainly in light of the fact that EZDK maintains relatively a strong profitability margin, attributed to its being the sole firm in Egypt applying the integrated mini-mill technique, thus enjoys relatively strong operating margins, and subsequently strong margins.

Despite the slowdown in the global steel industry, the Egyptian market has remained resilient, backed by the increase in demand in the individual homebuilding which was driven mainly by the decrease in steel prices and the stimulating programs which the Egyptian government is promoting. Therefore, ESR management is pursuing a strategy to strengthen its leading position in the domestic steel market – especially rebars. At the same time to maintain its presence in the regional/international markets once the conditions recovered.

With regard to the expansion strategy, management has reviewed the timetable for executing its initial strategy to take into account the changes in the global fundamentals. The revised version will include establishing two new DRI facilities – through ERM and EFS – to start immediately by the DRI facility in ERM and to be followed by the second one in EFS, which will be used internally to secure the group's raw material needs. Moreover, management is undertaking initiatives to upgrade technology applied in EFS facility – 1.2mn tons per annum – to tolerate the existing melt shop to produce flat as well as rebars products, which will give the group an edge to be flexible to capture the increase in demand in the local rebars market, and at the same time maintain its presence in the flat market when needed. In general, the company will continue to evaluate possible regional cross-border investments with high-growth potential where it will have a competitive edge; which was planned to be accomplished through venturing into the Algerian market to capture on the shortage of supply. Initially, the investment scheme proposed to start investment immediately and to be accomplished by 2011; however, due to the global financial turmoil and difficulties management faced in Algeria, management reviewed the initial plan. With regard to the Algeria facility, the time frame is not clear yet. In terms of investment needs, these will be sourced through a mix of internal and external resources. **MERIS** continues to view the expansion initiatives as solid steps to reinforce the group's overall performance. Nonetheless, we are rather concerned about the company's cash generating ability in the short term; especially in light of the relative weak financial fundamentals of ERM and EFS and in case of any fluctuations/shortage in dividends received from EZDK.

In a recent action, ESR announced the stand alone full year results ended 2008, which reported revenue and net income figures at EGP 5.8bn and 1.46bn, showing a growth of 53% and 52% respectively. Nonetheless, the operating profit margins were affected substantially, to bottom down at 1% compared to 8% in 3Q08. The driver for this drop was the increase in COGS to revenue ratio to 98% compared to an average of 92%, attributed mainly to the lag between the raw materials cost and the finished goods selling prices. In other words, management decided to drive the high cost inventory out of the system entirely in financial year 2008 which hit the stand alone performance significantly. Nonetheless, net income margins have been maintained at a relatively better position (25% in FY08, compared to 28% in 3Q08), thanks to dividends received from subsidiaries.

The company's leverage position measured by gross debt to EBITDA and gross debt to equity dropped slightly to stand at 5.7x and 25% in 3Q08 compared to 4.6x and 21% in FY07, which was driven mainly by the increase in short term debts (mainly credit facilities and overdrafts). On the net position front, figures improved significantly reflecting the huge upturn in cash balances, thanks to the increase in the paid in capital by EGP 1.8bn which was accomplished during 2008.

ESR, on a stand alone basis, tapped the Egyptian capital market for the second time by a senior unsecured bond, equivalent to EGP 1.1bn in April 2008. The issued seven-year bond rank parri passu with any bank debts and/or new bond issuance. The issue is non-convertible and callable starting the beginning of the third year, with a coupon rate 11.5% annually, to be paid semi-annually. The proceeds of the instrument used to replace all the outstanding long-term bank debts and part of the short-term debts

In addition to the key rating factors which **MERIS** took it into consideration in the initial entity/bond credit rating report and the press release published in April 30th, 2008; **MERIS** also assumed the fundamentals factors supporting the rating review, which are: 1) Leading position in the local market, in addition to presence in regional/international markets through export activities; 2) Solid reputation, associated with a well known brand; 3) An owner with a visionary approach supported by high caliber management team with good experience in the industry; 4) Current corporate structure enhancing the group's business profile and intensifying synergies; 5) Despite the delay in the designed expansion plan; yet it is believed that once accomplished, will reflect positively on the group's overall performance in the medium to long term horizon. At the same time, the rating takes into consideration the main challenges which face the company, including: 1) ESR on a stand-alone basis has reached almost full utilization capacity; however, the expansion plan at the group level will ease this challenge to a certain extent; 2) The company's financial performance on a stand-alone basis depends to a very high extent on dividends received from subsidiaries, leaving the company's financial position vulnerable to any unpredicted events; coupled by the pessimism which the financial crisis shed on the global macro-economic environment; consequently might affect the local steel industry; 3) Highly vulnerable to the volatility of the international and domestic dynamics, which might adversely affect the overall mode of performance; 4) The track record for the first bond issuance was not up to standard; 5) Strong individual control, which might negatively affect corporate governance fundamentals; 6) High exposure to foreign exchange risk.