SHUAA

Thursday, 30 May 2019 / 1:00 pm CLT
Egypt / Industrials / Results Commentary

Elsewedy Electric (SWDY)

Overweight / Moderate Risk

12-Month Price Target: **EGP19.80** (+40%)
(Set on 30 May 2019)

Turnkey Projects Stage a Comeback; Operational Results in Line

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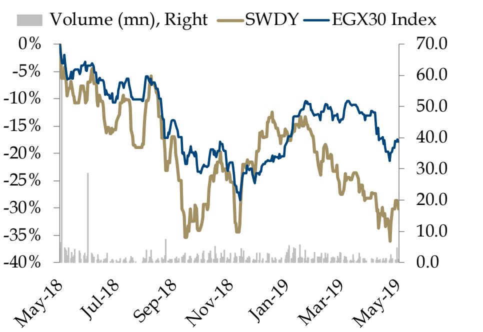
The solid return of Elsewedy Electric's (SWDY) turnkey projects segment after a period of normalization stimulated revenue growth in Q1 2019. However, the increase in administrative expenses, provisions, and income tax, coupled with lower investment income and a swing to FX losses on a stronger EGP, marred the 12% y/y increase in revenues and 5% y/y increase in gross profit, leaving SWDY with lower net earnings of EGP957mn in Q1 2019 vs. EGP1.40bn in Q1 2018. A phase of cost optimization and a wider geographic footprint is next. Save for non-operational items, results are broadly in line with our operational estimates for 2019. Thus, we maintain our Overweight / Moderate Risk with 12M PT of EGP19.80/share (adjusted for the recent EGP0.80/share cash dividend).

Stock chart & data



Last Price (EGP)		14.19
52 Week Range (EGP)		12.81 - 22.289
6M-ADVT (EGPmn)		28.24
Market Cap (EGPmn)		30,994
No. of Shares O/S (mn) / Free float	2,184.2	/ 32.3%

Note: Last price is as of 29 May 2019.
Source: Bloomberg.

- **Turnkey projects drove y/y revenue growth:** Revenues grew 12% y/y from EGP9.98bn in Q1 2018 to EGP11.22bn in Q1 2019 (c.24% of our 2019e), drawing largely on turnkey projects whose revenues climbed 33% y/y (29% of total revenues) and on the wires and cables segment whose revenues rose 7% y/y (58% of total revenues) on the increase in aluminum cables sales in the local market. Trunkey projects went through a phase of normalization during 2018, after Egypt was nearly done with its high-margin power generation projects. However, with its track record and ability to expand in other markets, SWDY managed to revert to those high-margin power generation projects, only in other regions: Africa and the GCC, now making 45% and 21%, respectively, of its EGP64bn backlog. SWDY's management said that widening its geographic footprint will be a priority for the remainder of the year. Meanwhile, revenues fell 8% q/q on 31% lower turnkey project revenues from EGP4.63bn in Q4 2018 to EGP3.20bn in Q1 2019. Nonetheless, revenue growth from wires and cables (+7% q/q) partially offset the fall in turnkey projects revenues. Despite its good performance in general, the wires and cables segment has not been performing well in Saudi Arabia in the past three years with issues in receivables collection. However, SWDY is keen to maintain its operations despite breaking even or making marginal profits in order to capture any potential opportunities as they arise, especially after SWDY had changed its management in Saudi Arabia and opened new channels for distribution. Overall, SWDY is seeking new markets for its wires and cables segment to compensate for the currently troubled ones.

Financial summary

EGPmn	2016a	2017a	2018a	2019e	2020e	2021e
Revenue	24,645	42,911	42,491	47,495	52,264	55,918
EBITDA	4,205	7,802	6,060	6,164	6,882	7,350
Net Income	3,853	6,368	4,993	4,986	5,234	5,596
Revenues Growth (%)	20%	74%	-1%	16%	10%	7%
EBITDA Growth (%)	117%	62%	-22%	13%	12%	7%
Net Income Growth (%)	332%	65%	-22%	12%	5%	7%
EBITDA Margin (%)	17.1%	15.9%	14.3%	13.0%	13.2%	13.2%
Net Margin (%)	15.6%	14.8%	11.7%	10.5%	10.0%	10.0%
EPS (EGP)	1.76	2.92	2.29	2.28	2.40	2.56
BVPS (EGP)	5.30	6.48	7.39	8.47	9.43	10.47
DPS (EGP)	0.41	1.60	0.80	1.48	1.56	1.67
PER (x)	4.2x	5.1x	7.2x	6.2x	5.9x	5.5x
Dividend Yield (%)	5.5%	10.9%	4.9%	10.4%	11.0%	11.8%

Source: Company reports, SHUAA Securities Egypt.

- **Higher backlog ensures sustainability of turnkey projects:** SWDY managed to grow its backlog by as much as 76% y/y from EGP36.4bn in Q1 2018 to EGP64bn in Q1 2019 (covering SWDY for three years) with an even better composition. Of the Q1 2019 backlog, both civil & networks (C&N) and transmission & distribution (T&D) amounted to 18% each, while the relatively high-margin power generation captured 64%. This revenue mix is a product of SWDY's strategic alternation of its markets. Egypt now makes up only 34% of SWDY's backlog in Q1 2019 vs. 56% in Q1 2018. Higher backlog in Africa was due to the new Tanzanian dam project awarded in Q4 2018.
- **Projects margins to normalize:** Despite the fact that SWDY managed to grow its backlog, especially in the power generation sector, those projects' margins would not be as high as they were when the majority of these turnkey projects were in Egypt. This is due to the competitive nature of these projects in the GCC and the fact that Africa's high-margin markets take longer to penetrate due to the lengthy process of project financing there. On another note, revenues from the Tanzanian dam project will be recognized starting 2020, after the ongoing mobilization period ends.
- **Q1 2019 new awards dominated by Egypt:** In Q1 2019, SWDY has been awarded three projects which amounted to EGP8bn. Two of the three projects are in Egypt (Benban-Naga Hamady's two overhead transmission lines and East Port Said Industrial District Substation). The other one is in the UAE (*Layyah Project*). So far, Egypt is the main contributor to SWDY's Q1 awards.
- **Profitability temporarily dented but a phase of cost optimization is underway:** Gross profit (net of depreciation) increased by a modest 5% y/y from EGP1.88bn in Q1 2018 to EGP1.98bn in Q1 2019. Meanwhile, EBITDA margin fell from 14.1% in Q1 2018 to 11.5% in Q1 2019 as …

    - administrative expenses increased by 28% y/y to EGP421mn,
    - provisions skyrocketed by 430% y/y to EGP55mn, and
    - impairment of receivables shot up 193% y/y to EGP68mn on temporary pressures and delayed collection in the local market which is expected to be resolved in Q2 2019).

  We note that net profit after minority fell from EGP1.40bn (NPM of 14.1%) in Q1 2018 to EGP957mn (NPM of 8.5%) in Q1 2019, driven by …

    - a 21% y/y increase in income tax to EGP319mn as the tax exemption of four of SWDY's factories came to an end by the end of 2018,
    - a drop in investment income from EGP153mn in Q1 2018 to EGP92mn in Q1 2019 (-40% y/y) on lower revenues from SWDY's subsidiary in Qatar despite capturing a 70% market share on market slowdown in a phase of normalization, and
    - turning from FX gains of EGP61mn in Q1 2018 to FX losses of EGP15mn, driven by a stronger EGP.

  That said, SWDY's management highlighted that they will prioritize cost optimization for the rest of the year.

- **New credit facilities secured:** SWDY's BoD has approved some new credit facilities to finance its projects. The company secured:
  - an EUR42mn loan from **National Bank of Greece (NBG)** to finance three renewable energy projects SWDY is close to securing in Greece.
  - a term sheet for a USD350mn facility with the **Afreximbank** as part of SWDY's USD500mn agreement signed in 2018. USD150mn was already used for Uganda's project, while the remaining USD350mn was lined up for further expansion in Africa. The loan amounts used will be announced on a project-by-project basis.
  - a credit facility from **Banque Misr** of USD100mn for the letters of guarantee for the Tanzanian dam project.

  Meanwhile, SWDY's BoD approved either establishing or acquiring a free-zone company in the **UAE** to act as headquarters for SWDY's subsidiaries outside Egypt.

- **Overweight / Moderate Risk maintained:** With results coming broadly in line with our operational estimates for the full year of 2019, we maintain our Overweight / Moderate Risk rating, albeit with a slightly lower 12M PT of EGP19.80/share (adjusted for the recent EGP0.80/share cash dividend), implying a 40% upside. We note that we had added SWDY to our EGX Model Portfolio on 15 April 2019 after the 19% pull-back in its price.

Results summary

EGPmn	Q1 2019	Q1 2018	y/y	Q4 2018	q/q
Revenues	11,224	9,982	12%	12,175	-8%
COGS	9,247	8,106	14%	9,990	-7%
Gross profit (net of depreciation)	**1,977**	**1,876**	**5%**	**2,185**	**-10%**
Gross Profit Margin	17.6%	18.8%	-118 bps	17.9%	-34 bps
EBITDA	**1,290**	**1,409**	**-8%**	**1,566**	**-18%**
EBITDA Margin	11.5%	14.1%	-262 bps	12.9%	-137 bps
Net income (after minority)	**957**	**1,402**	**-32%**	**1,489**	**-36%**
Net Margin	8.5%	14.1%	-552 bps	12.2%	-370 bps

Source: Company reports, SHUAA Securities Egypt.

Disclosure Appendix

METHODOLOGY: When setting an investment and risk ratings, we utilize all publicly-available sources to build an understanding of the issuer's business model and hence its intrinsic value based on one or more valuation methods. To reach a valuation, we assess factors that we deem relevant, including—but not limited to—macro, sector, and company-specific aspects.

INVESTMENT RATING: Depending on each issuer's business model, we may use (1) an income approach, (2) a markets-based approach, (3) an asset-based approach, and/or (4) sum-of-the-parts approach. In certain cases where we do not have our own financial and valuation models, we may present the consensus rating/view. For all securities actively covered, we assign one of three investment ratings (Overweight, Neutral, or Underweight) depending on the security's expected total return (price + yield) over a 12-month investment horizon as compared to the security's Required Rate of Return (RRR) as calculated using the Capital Asset Pricing Model (CAPM) and adjusted for the Risk Rating we assign to the security. Please read below for more details about our Risk Rating. Our assigned fair values are subjective and are estimates of the analysts where the security(ies) covered will trade within the next 12 months. The assigned investment rating/fair value is only valid for a maximum of three months from the date it was set.

RISK RATING: Based on the overall risk profile of each issuer/security covered, we assign one of three risk ratings (High, Moderate, or Low). The risk rating is a function of a weighted assessment of the issuer's (1) sector, (2) corporate profile, and (3) security and related volatility. The assigned risk rating is only valid for a maximum of three months from the date it was set.

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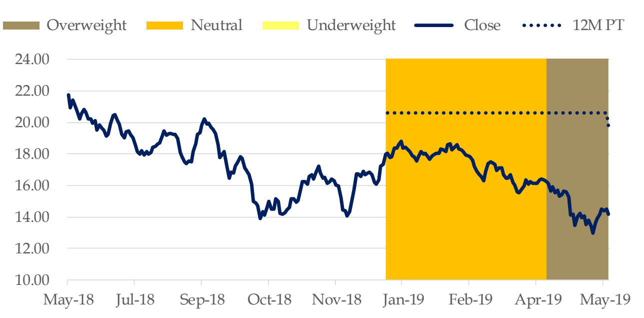
Return / Risk Profile

	If Total Return is ...	Investment Rating		
		Overweight	Neutral	Underweight
Risk Rating	Low	Higher than RRR	Between RRR and 20% of RRR	Lower than 20% of RRR
	Moderate	Higher than RRR	Between RRR and 40% of RRR	Lower than 40% of RRR
	High	Higher than RRR	Between RRR and 60% of RRR	Lower than 60% of RRR
	Not Rated (NR)	We have decided not to publish a rating on the stock due to certain circumstances related to the company (i.e. special situations).		
	Not Covered (NC)	We do not currently cover this stock or we are restricted from coverage for regulatory reasons.		

Investment Rating & Price Target History



Rating history

From	To	Date	Analyst
NC	Neutral / Moderate Risk	1-Jan-19	Lobna Khaled
Neutral / Moderate Risk	Neutral / Moderate Risk	28-Feb-19	Ahmed Abdelnaby
Neutral / Moderate Risk	Overweight / Moderate Risk	15-Apr-19	Mai Abdelaziz

12-month price target history

From	To	Date	Analyst
None	20.60	1-Jan-19	Lobna Khaled
20.60	20.60	28-Feb-19	Ahmed Abdelnaby
20.60	20.60	15-Apr-19	Mai Abdelaziz
20.60	19.80	30-May-19	Mai Abdelaziz

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