

Destination: Egypt

Optimism in the Cradle of Civilization

April 2020

CAIRO – In the weeks before the global pandemic took hold, Western tourists were crowding into and around the sites that mark this cradle of human civilization – the great pyramids, the Sphinx and the ancient city of Memphis. Tour guides gushed with optimism over

Research Report by
Chris Herrera



Modernity amid antiquity

the upcoming opening of the Grand Egyptian Museum, and there was an air of relative calm and security in a country that is home to Africa's second largest economy and to the largest population (more than 100 million) in the Arab world.

Located astride the Mediterranean Sea and Suez Canal, where Africa meets Asia and where ancient trade routes overlap modern shipping lanes, Egypt's position brings strategic relevance and economic opportunities in a globalizing region.

Today, under authoritarian leader Abdel Fattah el-Sisi, Egypt has taken steps to restore order from the chaos experienced under his predecessor, Mohamed Morsi. In the six years he has held office, el-Sisi has administered doses of economic discipline and fiscal austerity to get the Egyptian economy functioning properly. A necessary condition to successful reform was to address the overvaluation of the country's managed

currency. In November 2016 the currency was devalued by 48% to meet IMF-imposed conditions to secure a \$12 billion loan.

This has led to a dramatic reduction in inflation from over 30% in 2017 to 5.3% today. Interest rates have also been reduced from a high of 18.75% in 2017 to 9.25% today. Since the beginning of 2019, Egypt's central bank reduced rates by 7.5% as inflation in the economy declined. As of February 2020, the inflation rate was at an annualized rate of 5.3%, below the lower end of the 6-12% target range set by the Central Bank of Egypt.

In addition to improvements in inflation, interest rates and other macroeconomic indicators, Egypt possesses a strong demographic undercurrent by nature of its relatively young population. As a result of these factors, the operating environment for Egyptian companies has shown marked improvement and significant potential for growth. Of course, this outlook is all held in check by the coronavirus outbreak and is dependent on the ability of Egypt's economy and the global economy to recover in the eventual wake of the pandemic.

In our research on the ground in Egypt, we focused on three industries – banking, consumer products (food) and healthcare. We believe these industries stand to benefit from Egypt's improving conditions and strong demographics.

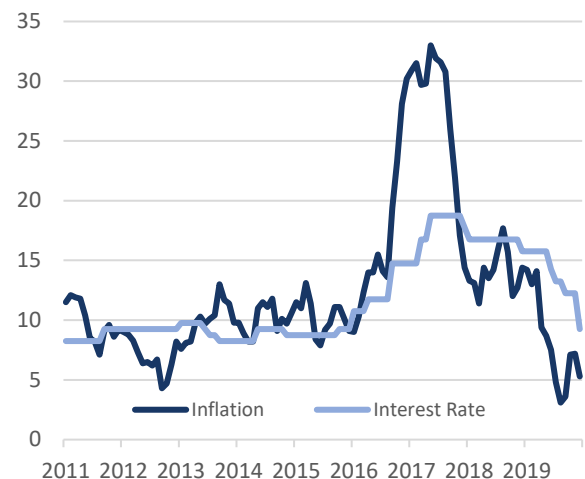
Banking

Egypt's banks have potential to grow organically. They command relatively low penetration rates, have not been aggressive in lending and are somewhat overcapitalized, with current quoted capitalization ratios of most institutions above 20%.

Much of the dearth of lending activity can be traced to the nation's strict economic regimen and the dampened consumer and business sentiment that it has sustained. The nation's lower interest rates and reduced inflationary pressures have triggered optimism for economic expansion and Egypt's central bank has begun implementing policies to subsidize retail mortgages and provide growth capex to small and medium sized companies.

Egypt: Improving Trends and Solid Underlying Fundamentals

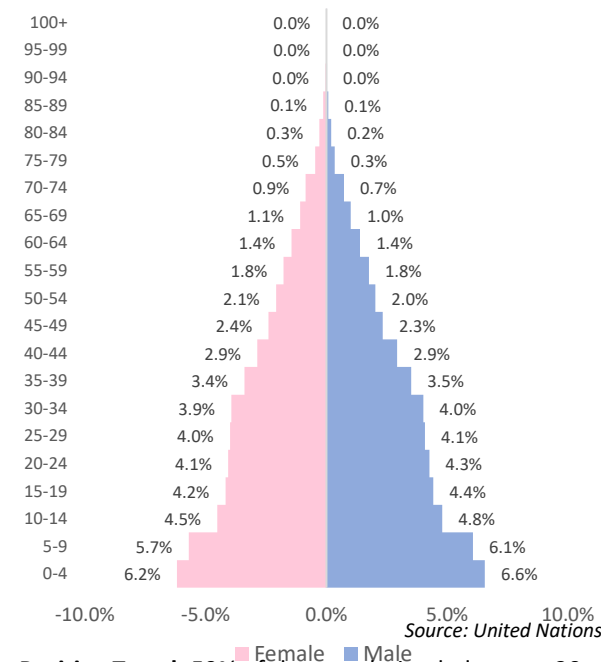
Inflation and interest rates



Source: Bloomberg

Improvement: Interest rates have declined from 18.75% in 2017 to 9.25% today. Inflation has fallen to 5.3%.

Demographics



Source: United Nations

Positive Trend: 59% of the population below age 30.

The companies we spoke to in Cairo and elsewhere in the region expressed expectations for an acceleration of corporate capex and retail-driven loan growth over the next few years.

At Commercial International Bank of Egypt (CIB) CEO Hussein Abaza believed a new capex cycle was starting and would be led by lending to multi-national corporations. This is an important development as most multi-national corporations have not invested in capex for 10 years and their local subsidiaries are operating at high levels of capacity utilization.

Additionally, the banking sector has potential for growth in the areas of microfinance and consumer lending. Several of the companies we met see an opportunity to serve small business enterprises and entrepreneurs with microfinance loans and to address the financial needs of the emerging middle class with consumer finance. In an economy where approximately 70% of the population holds 25% of the purchasing power, the potential market for consumer and small business credit products is significant and in both areas the growth, margins and returns on capital are higher than the banking sector average.



Strategic location

Consumer

We were also met with optimism by companies in Egypt’s milk, juice, yogurt, cheese, and snack segments of the consumer products sector. These companies were burdened by the devaluation of the Egyptian currency and by the forced austerity that took spending power away from their core customers – ordinary Egyptians. Now they stand to benefit from improving economics, solid youth-oriented demographics and high birth rate as well as by a recovery in overall consumer demand. Based on company disclosure, the Egyptian snack market has grown over 20% since 2015.



Expanding consumer choices

We met with managements from Juhayna Food Industries, Arabian Food Industries (Domty), and Edita Food Industries. The companies are expecting sales volumes to grow over the next few years, a turnaround from the stagnant environment of 2019. These companies have invested in new production capacity over the last few years in anticipation of a resumption in consumption growth.

With the creation of a Moroccan joint venture in 2017, snack food supplier Edita is pursuing growth outside Egypt. This regional producer of HoHos, Twinkies, and Tiger Tail also serves as exclusive distributor in the region for select brands of imported olive oils and pasta.

Over the last few years, there has been innovation in the snack food industry with the introduction of packaged sandwiches and changes in product sizes. Domty led the market with the introduction of a snack sandwich, priced at EGP 4 (~USD 0.25). This product sold very well as it filled a gap in the market for a satisfying, savory snack. Edita has recently entered the market with a similar product called the Molto Sandwich.

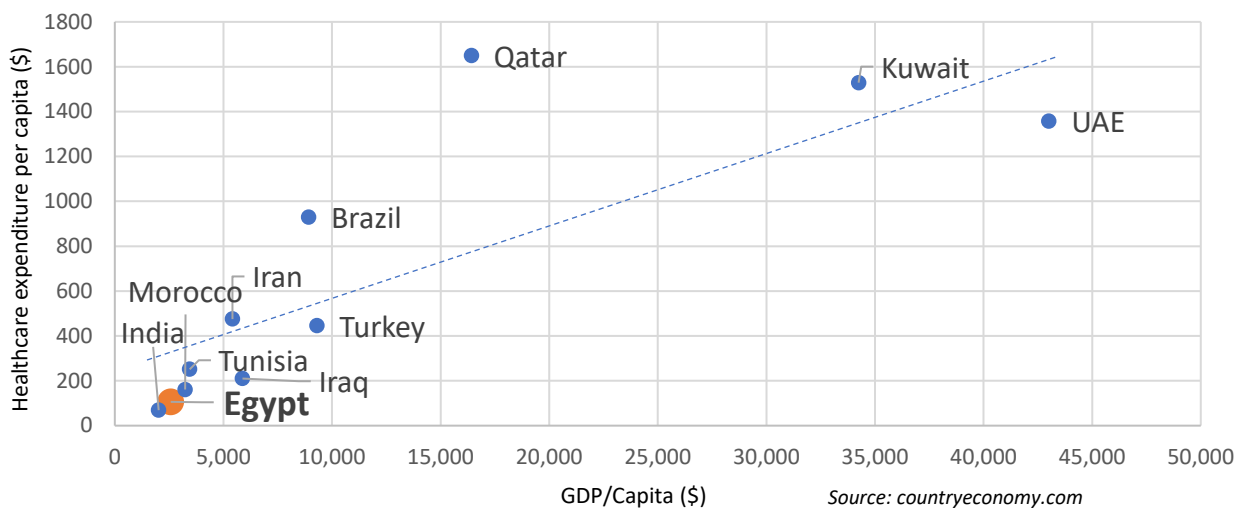
For Juhayna, the long-term growth potential of the milk industry shows signs of improvement with greater consumer acceptance and demand for packaged milk products. Currently, some 50% of the milk market is for loose product, with packaged milk providing the balance. As the economy and real wage growth improves, the companies expect packaged milk to take more share. This should improve profitability as packaged milk offers higher gross margins.

Healthcare

A key initiative of the el-Sisi administration is improvement in the Egyptian healthcare system. We met with managements from Ibn Sina Pharmaceutical, a drug distributor, and Cleopatra Healthcare, an owner of hospitals and clinics throughout the country. Both companies confirmed the positive long-term structural drivers of the healthcare industry.

The country's healthcare spending, at \$106 per capita annually and 8% of total household expenditure, trails that of most of its peers. But with a rapidly growing population and an expanding middle class, healthcare awareness and spending in Egypt is increasing. As a result, Egypt's healthcare industry is the fastest growing of any country in the region with total industry sales exhibiting a CAGR of 19% between 2013 and 2018. Implementation of the new national health insurance system, known as the Universal Healthcare Act, started in 2019. It seeks to make healthcare more accessible for Egyptians and to better manage costs for patients. Plans are for the system to transition into place over six phases, becoming fully operational in 2032. Yet to be determined is the role, if any, of private insurers. Currently AXA and Allianz have a presence in the Egyptian market for managed care. Private care providers in diagnostics, medical equipment, pharmaceuticals and supplies will likely benefit from the delivery of a higher level of care and more service offerings to Egyptian consumers.

Health care spending in Egypt is among the lowest in its peer group



Conclusion

We were encouraged by our trip to Egypt and made optimistic for the country's consumers and entrepreneurs. In the era of the new coronavirus, we are less sanguine but still hopeful. Most of what makes Egypt attractive as a developing economy remains intact and will have opportunity to flourish when the world returns to a state approaching what we have long recognized as normal.

Over more than four millennia, the pyramids at Giza have born witness to a great many threats to civilization. Ultimately, they have withstood all, as has humankind.



FGP Portfolio Manager Chris Herrera
at the Giza Necropolis

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