"*The expectations of life depend upon diligence; the mechanic that would perfect his work must first sharpen his tools.*" - **Confucius**

When we launched the Ajeej strategy in 2007, we began writing our investor letters around the metaphor of a marathon, primarily because of how our investment approach was long term in nature. Less than a year later the financial crisis hit, and the metaphor was extended to a marathon runner hitting the proverbial "wall"; and later again, as capital returned to EM, bifurcating the MENA markets with little heed to fundamentals, the up and down nature of our journey gave way to the allusion of hilly terrain. Finally, with the advent of the so called Arab Spring, the metaphor petered out, and was replaced by an array of different themes; however, none of which have had the staying power of the marathon.

Interestingly, we made our final reference to the marathon in our 2010 annual letter (issued January 2011), in which we highlighted that we had been making a sincere effort to tone our fast twitch muscles, along with our slow twitch muscles, in order to better navigate the markets' volatilities. This letter was sent out on the 18th of January 2011, the same day that the infamous "Day[s] of Rage" began igniting across the region's capitals; after which, ironically, it was our slow twitch steadfastness that ultimately differentiated our 2011 returns, and laid the groundwork for the next five years of outperformance.

The next few years were ideal for the Ajeej strategy, boasting fewer beta rallies and a strong reversion to fundamentals with a reform oriented backdrop, mainly in Saudi Arabia. Although we didn't include the marathon in our letter, we internally referred to this period as our second wind, having conquered the "wall".

Fast forward to 2020, and with the marathon in mind, we remind ourselves that a real marathon often ends up feeling a lot longer than expected, even for the experienced runners among us; and with that in mind, we recalibrate our metaphor's milestones once again. From 2007 up through 2010 was the start of our marathon, which was frantic with an initial sprint, followed immediately by a stumble and fall. The pile-up that felled capital markets participants was unfortunately significant, from which, some were forced to retire, while others were able to lick their wounds and get back up, albeit slowly and carefully. The years of 2011 to 2016 represented us finally getting into our stride and running either with or ahead of the lead pack…then we hit the "wall". In today's parlance, 2017 and 2018 were our "wall" years, as they proved challenging for likeminded investors, as fundamentals played second fiddle to effectively every other market driver imaginable. With that said, the overused and rarely accurate adage of "what doesn't kill you, only makes you stronger", in this particular case, has been apt. While we were not running this phase of the race as well as we could have been, as there were clear missteps, it was the genesis of our philosophy of defining the path to intrinsic value vs. intrinsic value, and where the former describes and calculates a firm's ability to over and under achieve potential, while the latter quantifies the potential. Defining paths to intrinsic value continue to be a going concern with an understanding that they are rarely ever linear.

Although not back up to full pace, 2019 represented us breaking out from behind our marathon's wall, finding our footing primarily on the silty banks of the Nile, and slowly starting to pick-up pace again. Last year was the first leg of our new second wind. While this leg came with its challenges during the year, we feel the ability of the portfolio to earn out is clearer, with an understanding that a political and EM veneer may serve to either expedite or supress potential. These factors are not in our control; however, we view the upside of the portfolio very positively despite them.

Thankfully, our 2019 momentum has persisted, supplementing the conviction in our strategy and current portfolio (which is itself the highest it's been in over 5 years), as the start of 2020 has come with its own unique set of challenges. However, we will delve into those in our next letter, after they've played out a little more. For now, we want to take the opportunity to give a little colour as to where we see our 2020 journey taking us.

First, we start with the Egyptian section of the race. We have repeatedly said that the region's most populated country plays host to one of the greatest potential investment opportunity earn outs of any market in the world today. We still believe that vehemently. However, realisation of the market's potential has fallen victim to the dynamics of global investor flows and depressed local risk appetite in the latter half of 2019. Few would disagree that the macro picture is strong; after all, tourist numbers are back up to historical highs, FDIs are at record levels, inflation is down to nearly 7% (this is very impressive for Egypt, where inflation – in a good year – historically has fallen between 8% and 12%), domestic energy production is going through a renaissance, the currency has appreciated 25% since its devaluation at the end of 2016 and the list goes on. The last point, namely devaluation, has been a double edged sword (again we've mentioned this before, but it is worth repeating). The USD:EGP rate moving from 5.5 to 20 via step function resulted in the culling of Egypt's EM benchmark representation. This has been further exacerbated by China's ballooning presence in the EM index, along with the delisting of several blue-chip names; all of which are largely post '08 developments. So it stands to reason, that the intersection of sound fundamentals with sustained capital market headwinds, has presented us with an Egyptian investable universe which offers P/E multiples in the high single digits coupled with 5 year earnings CAGRs in the 20% to 30% range on average. Generally though, the Egyptian earn out has been more nuanced than originally expected as the fundamental primers to attract capital, upon cementing its macro primers with the IMF, leave us on a tight rope balancing between monetary easing and foreign reserve management. The imperative of the demand function of sticky flows was predicated on an improved and cohesive directive to encourage and promote business through lower rates to catalyse a capex cycle across multiple industries. In spite of this, our exposure continues to be high as we believe that despite a well cemented path to cultivate growth, the growth (vis-à-vis the potential) will be supportive of the underlying value in the market.

Historically, Saudi Arabia has been the most attractive market for the AMF, and usually has boasted half or more of the fund's exposure since its inception, making our 2019 underweight all the more significant. While we currently view our under allocation to the market as temporary, it is clear that valuations continue to be over-stretched, which is due to effectively the inverse of the dynamics playing out in Egypt; namely that the "flow trade", due to the MSCI inclusion and Aramco IPO, have propped the market, while fundamentally the economy continues to be strained by painful reform. Notably, the interplay of both the Saudi firm and household reaching a new equilibrium has taken its toll on the private sector and led to malaise in the broader economy. With chronic over capacity leading to little plough back of capital into the economy, a pervasive negative mind-set by both firm and household has taken effect. However, during the latter half of 2019, we witnessed a positive shift in household attitudes, with the liberalisation of social trends and the lifting of the proverbial veil on a more inclusive and egalitarian social structure. With that being said, while the uplift in household morale has been successful, manifesting in an increased share of leisure domestically, it has done little to change the firm behaviour in the short term. The only real growth sector in Saudi Arabia has been in the entertainment industry, which at this juncture, is largely being led by the public sector. Although this makes sense at this stage, given the front ended loss leadership approach in pursuit of a social tipping point, it is imperative to pass the baton to the private sector as the country moves forward. For years we have been commenting on the untapped potential of religious tourism, where capturing a share-of-wallet of point-to-point religious pilgrims was never given any priority. However, the decisive, and often bold, directives of the current leadership have expedited the industry's reformation by providing a solid framework by which to capture religious tourism extensions and broader tourism. It will take a while to be able to fully ensure all nationalities have "full access" with a standard tourist visa; however, the means of executing broader visas on demand for 49 nationalities was exemplary. On the flipside, while the financial position of companies are likely at their lows and primed to improve, it is unclear whether potential future growth will cascade to the various industries in the short term. It is, however, quite clear that frameworks and regulations have improved across many industries, and while the capacity for broad-based growth is vague, it is important that most negative trends are behind us. Notably, we are starting to see defensive industries, like healthcare and education, manifest strong foundations; and these will be important sectors in which we will likely be reallocating to in the coming period as we see the fruits of the strategy ripen.

The UAE market is perhaps the most valuable today and the most expensive tomorrow. The nature of the distressed valuations reflect the true fragility of the economy at large. Unfortunately, three factors have added to this fragility of the market over the past 3 years. Firstly, the UAE historically benefitted largely from over regulation in developed markets serving as an oasis to many industries. However, in the last 18 months this point of differentiation has diminished as regulation and enforcement have become global. Therefore, the flow of liquidity and impetus to create white collar job formation has declined dramatically. Secondly the Qatari boycott and misconception of ring-fencing across the GCC has affected the branding of Dubai and the broader UAE as the Switzerland of the Middle East. Thirdly the thesis of a white collar hub for regional HQs has not played out well do to anaemic growth in the surrounding economies given the non-competitive cost structures for organizations to maintain such a base in broader soft markets. While the expo 2020 is positive in terms of brand awareness, the broader concern for many is to see what happens afterward. However, history has shown us that when it comes to the leadership and vision, major changes will take place over this period to once again spur the growth trajectory of this economy. Whilst we have become accustomed to deeper boom and bust cycles given the transient resident base, it is imperative that they address this issue and capture brain drain from the region to once again become a leading hub. It is easy to be sceptical of the UAE during soft cycles, however when we look at urban development holistically it is truly unparalleled amongst its peers. It is our hope we see bold initiatives to support the excess capacity of many sectors. We have a large exposure to the UAE, however this is not weighted to the Achilles' heel of the economy. Our banking exposure is predicated on asset quality where we believe the valuations more than compensate for the risk factors for our specific exposures. As for our exposure albeit small in real estate, the deep value is factoring a very negative scenario which we do not subscribe to.

We aspire to improve our returns significantly and feel the deep value of the portfolio will harvest over 2020 and 2021. Our frameworks associated with improving our ability to better capture the path to intrinsic value is a perpetual process , where we view the utilisation of our improved ESG framework as an important pillar amongst others. It may seem ironic given our exposure to NMC, however we address this point later along with articulating our ESG strategy in more detail.

NMC

As investors in NMC since 2012, the wild ride the stock experienced in 2019 (and certainly into the opening months of 2020) was dualistically Greek and tragic, both in the sense that it was a Greek tragedy, and in the sense that the accusations levelled by Muddy Waters, our own modern day Diogenes, were 'all Greek to us' because so many of them seemed nonsensical. Notably, while we have been intimate with the company since 2012, we have not, for better or worse, been invested through all the cycles. Our knowledge of the fundamentals and the company give us a comfort on the health care operations and the fundamental value drivers. However, we are now faced with a debate of whether horse or a jockey is more important in the underlying success. In short, the behaviour of the shareholders and top executive management, driven largely by ego and fuelled by the success of the company between 2015-2018, emboldened them to shift their attention to outright hazardous investing and structuring while using the stock as currency. Unfortunately, this manifested in the belief that the Midas touch was infinite. How very sad that they did not take lessons from this particular Greek tragedy! While the malfeasance per se is largely left to personal shareholders' decisions and to those of (to our understanding) a few figures of senior management, the imbalance created pressure on the stock and derailed credibility of founders' judgement and shed doubt on any previous foundational success on NMC asset. Needless to say, we believe the underlying healthcare asset is attractive and our current focus and vigour is drawn to the potential of the horse itself and being able to realise its potential in the future, but the horse is increasingly hobbled by apparent off balance sheet liabilities generated without board knowledge and by frightening hints that cash within NMC was used to benefit related party entities.

We are confident that NMC is an excellent healthcare operator, and one that has over time built upon two traditional businesses (hospitals and pharmaceutical distribution) by adding complementary businesses in long term care, home care, IVF, and cosmetics. NMC's journey over the past 40 years has featured many highs and lows, but its journey as a listed company was one high after another from 2014 onwards. Like any complex entity, NMC has its weaknesses and faults, primarily in the realms of governance and related party transactions. These are characteristics of many companies in the region, given their genesis as family businesses, and NMC is not unique, but the size of the faults seem to have grown with the company's market cap and acquisitions rather than shrinking in relative size to the business.

We and many other investors (if you will, a chorus to continue the Greek metaphor) have continually voiced criticism of the change in some of the company's management team and compensation policies since 2017; this in part led to our decision to exit our positions in NMC in 2018, as these issues went unresolved and the stock reached historic highs. A key further critique we made to NMC (and one that was subsequently backed up by detailed disclosure on profitability of certain acquisitions), is that 2017/18 acquisitions were not as high-ROIC and cash generative as those from 2014-16. The clear uptrend in acquisition multiples and downtrend in incremental bottom line from later stage acquisitions was of great concern to us, as it demonstrated the incentive problem with a management incentivised on EBITDA rather than the bottom line (which more closely reflected the finance and capital costs of certain acquisitions).

In early 2019, we held numerous (at certain points weekly!) meetings with NMC senior management team, as following its 2H 2018 stock price decline we began to look at rebuilding our position in the company. Our near continuous interaction with the management, both around compensation and related party transactions, as well as a commitment to reduce acquisition activity and work on raising the contribution profile from existing acquisitions, gave us comfort; which may in hindsight be cold comfort given the recent removal of several key management figures. Moreover, our extensive discussions on the growth outlook for the business in the UAE and Saudi renewed our confidence in the team's ability to steer NMC into its next phase of growth, with a clear commitment to improving disclosure and restructuring compensation. With these assurances and continued operational strength, we began to slowly rebuild our position in the company.

The fundamental tenets underlying the rebuild of our position were that NMC over the next decade would continue to generate significant cash flow from its legacy hospital and distribution businesses, while there was (and remains) a strong possibility to spin out or otherwise realise value in its IVF / fertility business. Moreover, we continue to see significant scope and scale possibilities in the cosmetics business as well as in the development of NMC's Saudi operations, particularly in the areas of long-term care and certain specialties that are underserved in Saudi, such as maternity and paediatrics, among others. Ultimately NMC has built a unique and highly valuable large-scale company in a region where such large-scale companies are rare outside of government related entities. The company serves an incredibly broad swath of the UAE population (with around 10% market share countrywide in hospital care) across numerous services.

Despite our renewed view of the ultimate value and profitability of NMC, we have proceeded cautiously due to the volatility the stock experienced in 2018-19, at least in part due to the transactions of its 2 largest shareholders who pledged significant portions of their shares to fund their other businesses. While these transactions attracted little attention as the stock appreciated through 2017 and early 2018, increased scrutiny and opportunistic short seller behaviour were major contributors to NMC's volatility. Then, in December 2019, a tsunami of Muddy Water crested over the company; as we write, the water has not yet fully receded, and the damage to NMC's reputation (although not its operations…yet) has been severe.

Unfortunately for NMC, Muddy Water's timing at year end, allowed short sellers (themselves included) to pile in and then clear positions for a tidy profit. Our greatest frustration in reading the Muddy Waters report was that the lion's share of the verbiage related to either inaccurate assumptions or immaterial variables. With that said, and as the tragedy continued to unfold, the accusation levelled against NMC, despite being largely vague and generic in nature, caused enough stress to the stock for real cracks to start appearing, which would have otherwise likely been glossed over.

The tragically 'Greek' part of this saga is the self-harm NMC's main owners / promoters have inflicted on the company, coincident with and prophetically driven by the sneak attack from Muddy Waters, as their share pledging activities have resulted (with NMC's price decline) in a forced sale of the majority of their shares to cover their pledges. This has further rattled the market, despite, again, having little to do with NMC's core operations, as far as we can determine, and everything to do with the overstretched activities of various HNW family offices in the region, whose gluttony for leverage is now crowding out the value of operating businesses.

It is true that NMC provides a level of service breadth and depth, operating efficiency and efficacy, and economic scope and scale that is above par for the region. Corporate governance overhangs are very material, of this we are aware and perturbed; however, if the right measures are taken to purge corruption, perceived or otherwise, it remains our contention that NMC can emerge, as a business, stronger and more deeply committed to governance and transparency. In summary, a protagonist in a Greek tragedy that ends in transformation, where the hero is chastened and humbled, but emerges stronger and wiser.

ESG

Given the saga that we are living first hand with NMC and Muddy Waters, corporate governance is at the forefront of every portfolio discussion we are having these days with a more heightened awareness. So with that in mind, we thought it would be appropriate to highlight to our investors and potential investors what we have been up to recently with regards to our ESG framework and how it is an important part of our DNA.

Five years ago, as part of an annual due diligence for one of our institutional investors there was a question at the end which asked if we were signatories to UNPRI (we are today by the way). We declared that we were not yet, however, we do not invest in tobacco companies and there are no publicly listed weapons manufacturers or gambling companies in MENA. Five years ago that was deemed to be a satisfactory answer, but as with most things "Ajeej", ticking the box isn't part of our standard operating procedure. So we started digging.

Our first step was to speak with anyone who was an ESG expert, knowing full well that expertise in nascent topics is somewhat of a contradictory notion. With that said, we found that the farther north we travelled (basically anywhere beyond the 55th parallel) the more structured our conversations became. The first and most important lesson we learnt was that there was no one-size-fits-all approach, and that we needed to look at it from a perspective that was relevant to Ajeej. Equally as important was the idea that any roll out and implementation of an ESG overlay should complement our existing investment philosophy which has been honed over many years and works relatively well. Finally, responsible investing and ESG implementation does not imply negative screening (it could if we wanted it to, in some cases it does, such as tobacco companies).

So with that in mind, we got to work.

We began analysing ESG aggregators' data sets, and trying to understand how their own standardisation of ranking worked. It quickly became apparent that their own data collection systems relied heavily on automation, which unfortunately (or fortunately in terms of our ability to fill a gap in the market) is not an efficient modus operandi in MENA. With that in mind, we came to conclusion, that as with our own fundamental analysis, we would need to do all our own work on the ESG front in house.

Notably, we had a bit of a head start on the development of a proprietary ESG scorecard, as we had in fact developed our own internal "G" scorecard years earlier. One of the central tenets of our investment philosophy is the ability to build strong conviction in the underlying bottom-up opportunities in our universe, and in turn that ability was driven in large part by our understanding of the governance risk associated with a particular company. From the inception of the strategy, we had always appreciated the importance of analysing shareholder, management and board dynamics, which subsequently led us to build out a structured "dynamics" scorecard which quantified the less tangible parts of the value chain.

Using a framework that was an amalgamation of best practices from global providers and rule writers as well as our own incumbent framework, we developed our own proprietary ESG scorecard which has allowed us to expand on what we have always done in a manner that benefits our investors and the investable universe that we invest in. Broadly, there are two aims of the ESG process - the first is to create a scoring methodology that runs in parallel and complements the fundamentally driven investment process, and effectively guides conviction in the underlying values we produce. The second, is to complement a central ethos of Ajeej, which is to participate in and positively influence the evolution of the MENA capital markets.

With this evolution in mind, it is important to realise that there have been significant improvements in most of our markets and industries on issues related to corporate governance over the past decade, driven from both regulators and an increased institutionalisation of the investor base; where we stand today is in a completely different world than where we were in 2007 when launching the strategy. Notwithstanding the positive developments, we feel that corporate governance prevailing issues are still some of the biggest threats to investing in MENA. These are most evident, in our opinion, when faced with challenges pertaining to minority shareholders' rights, especially when set against government ownership. Equally pervasive are risks around separation of management and the lack of independence of the boards; all too often we find that board members (often shareholders) have overt undue influence over management that goes beyond holding them accountable to predefined strategic goals, etc.

Social issues drive frequent headlines emanating from the Middle East, with that said a few giant (and important) leaps have been taken in recent years; such as the inclusion of women in the work force in Saudi Arabia, or the provision of mandatory health insurance across the GCC; the pace of change, as we have said in our prior write-ups, is nothing to be scoffed at. There is still much work to be done, however, when it comes to human capital investment, and workers' rights in the region, which is where we will try to exert some more influence.

The most pertinent environmental challenges in our region usually revolve around water, whether it is water stress, water management or waste water related pollution. A lot of time, effort and investment has gone into the development of sustainable energy, such as solar and wind power generation in the region, despite the region being the heart of the oil producing world. We think though, that water management is a much more critical challenge that has not had enough attention focused on it yet from global players at large.

Unfortunately, on the front of global players, the tick the box attitude of many ESG process applications from our global peers does not necessarily translate to targeting the most critical issues for our region. Therefore, the onus falls on us (and our peers) to lead this particular charge, which we look forward to doing with gusto.