"First say to yourself what you would be; and then do what you have to do."

- Epictetus

PROLOGUE

Spaghetti westerns, a cornerstone of 20th century filmmaking, were often characterised by a self-assured, mysterious at times (in fact nameless), anti-hero. 2020 offered multiple backdrops in the guises of international assassination, global warming gone ugly, viral contagion, political brinkmanship as a raison d'être, and woke cancel culture, that could have potentially served as a foundation for the story of said anti-hero to develop, whether that hero be an individual or a personification of something less organic.

In the Middle East, it was a year of extremes, which started concerns of WWIII in January, and ended with a giant step towards the normalisation of Middle East's geopolitical landscape. The anti-hero of these developments and many others is not one individual, but rather a series of culminations of historical trends that peaked in their individual impacts. With that in mind, the anti-hero is best referred to as "Nameless" in honour to Sergio Leone's most popular trilogy. And in the vein of the final instalment of said trilogy, we present our review of the year, and thematic outlook, in the form of what is/was good, what is/was bad, and what is/was horribly ugly.

OVERVIEW

But before that, a quick overview.

MENA has largely loomed as its own mislocated version of the Wild Wild West since our launch in the region nearly 14 years ago. The reality is that the cycles have erred on a downward structural trajectory despite positive underpinnings. Thus optically, the region has not boded well, particularly when it is viewed through the undeniable lens of Mr. Mackintosh in his book *Arabs*. He writes, "the Arab world is home to 5 percent of humanity, but generates 58% of the Earth's refugees and 68% of its battle related deaths." The residual toll of a so-called "Arab Spring" and an inflection to the 100-year hydro-carbon boom may not inspire confidence in the landscape; however, in a year where we have come to appreciate silver-linings, we continue to believe there are massive pockets of potential in the Middle East emanating against this historically challenging backdrop. In this vein, since inception our compounded return of 7.8% has been below our expectations and while we have had fantastic legs of returns, our latest performance in 2020 was well below our potential, closing the year down -10.4%. However, it is important not to define oneself by success, as it often lends itself to hubris, nor do we define ourselves by recent failures as that leads to chronic under-achievement. The goal is to take stock in our combined skill set as a team, and a new vantage point to iterate on learnings while keeping our eyes wide open on the opportunities that lie ahead.

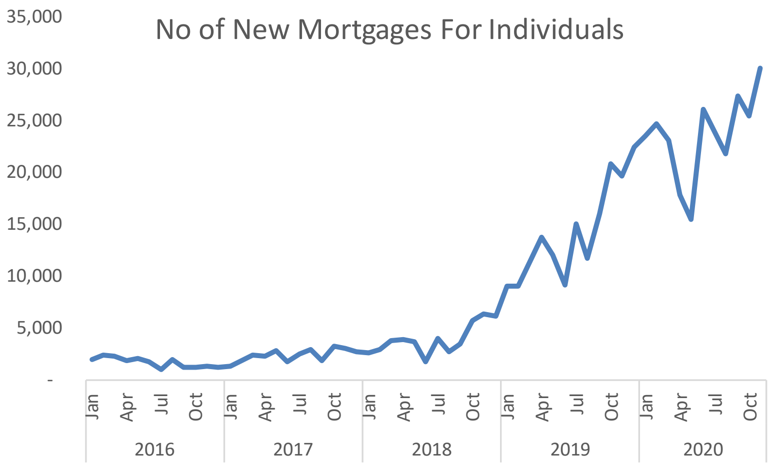
As we enter 2021, many are perplexed on how valuations are disconnected from reality and whether there is a permanent step ladder change based on a new paradigm pricing of equities given persistent and chronically low RFRs; as such, we need to evaluate how our region is priced and better define the opportunity set across MENA. So as many global analysts are positioning for a shift from virus to vaccine, lockdown to re-opening, recession to recovery, rotation vs rally and commodities reflation over credit, we need to overlay this to the multiple themes which offer interesting opportunities in our region. Barring Saudi Arabia, MENA in 2020 was a laggard, and while a potential rotational trade may ensue with fundamental recovery, we also need to highlight the positive structural changes that have taken place in 2020 provide a strong foundational change for broader governance, translating to a favourable economic backdrop – especially in Saudi Arabia and the

UAE.

While some may have considered that Saudi Arabia's unlocking of a welfare state would constitute a hard landing, particularly with grandiose plans encumbered with quantitative KPIs that made little sense, the ethos and change which has propagated throughout the nation has truly taken the country by storm. Lest we get caught up on achievements of quantitative markers, etc., it is the philosophy of a meritocracy and awakening from the slumber of a welfare state in which everyone has subscribed to JFK's most famous adage. Instead of focusing on the explicit quantitative attainment of Vision 2030 (still a short-sighted name choice), the psyche and pride of the new Saudi renaissance has evolved to a be a foundation for the creation of a stable middle-class developed market. 2020 challenges did in fact lead to positive developments in the Kingdom, by creating captive demand domestically (*in part by restricting Saudi citizens' travel*) and continuing with progressive services to elevate share of leisure (*at elevated pricing with increasing VAT to 15%*); this was a multi-faceted approach by the government on increasing revenue without altering domestic spending and further fuelling the renaissance of an improved modern Saudi way of life. On the flip side it will still take time to completely break away from transfer subsidy to public sector as reflected below:

Saudi Budget - Salaries / Barrels								
	Oil Production (mln Barrels)	Oil Revenues (mln SAR)	Oil Rev/ Barrels (USD)	Avg Oil Price (BBG)	Salaries (mln SAR)	Salaries Barrel (USD)	Salaries/ Oil Rev	Salaries/Avg Oil Price (BBG)
2008	3,366	983,369	77.9		228,381	18.1	23%	
2009	2,987	434,420	38.8		244,683	21.8	56%	
2010	2,980	670,235	60.0		284,271	25.4	42%	
2011	3,399	1,034,362	81.2		342,946	26.9	33%	
2012	3,573	1,144,818	85.4		418,968	31.3	37%	
2013	3,518	1,035,048	78.5		429,859	32.6	42%	
2014	3,545	913,347	98.7		482,301	36.3	53%	
2015	3,720	446,432	32.0		464,575	33.3	104%	
2016	3,828	33,698	23.2	45.1	409,000	28.5	123%	63%
2017	3,635	435,899	32.0	54.7	440,000	32.3	101%	59%
2018	3,765	611,239	43.3	71.7	484,000	34.3	79%	48%
2019	3,580	594,424	44.3	64.2	505,000	37.6	85%	59%
2020	3,373	412,000	32.6	43.2	492,000	38.9	119%	90%

A great bulk of transfer subsidies, in the form of government salaries, has ballooned since 2008, creating a huge burden on the country where effectively the first USD 39 per barrel of oil revenue is utilised to pay for the +1.4mln public sector employees. Compared to 2008, it is clear how this burden has increased in direct transfer subsidies; however, with the implementation of an elevated VAT and a more meritocratic public sector ethos, what has been achieved is increased public sector productivity and a taxed citizens base at an average annual run rate of SAR 257 billion, alleviating said burden somewhat. In short, building a middle-class society that encourages household formation, promotes progressive lifestyle spend and increases fuller employment through developing the service economy has set the country on a trajectory significantly less reliant on oil price in defining the cyclicality of the economy (who would have thought?). A case in point, the monthly boom in mortgages as shown in the graph below is unbelievable:



Moreover, the Public Investment Fund ("PIF"), Saudi's primary SWF, is encouraging an urban dream through projects like Roshn (https://www.roshn.sa/en/) that ensure a continued drive of home ownership targets towards 70% of Saudis by 2030 and advocate a shift to a balanced and modern society that is moving forward in full force. Thus, an obvious and sustainable theme that makes Saudi look attractive is the infrastructure rollout predicated on the theme of modern society, and its knock-on impact related to tourism, enhanced share of leisure and other sub-themes supportive of a progressive society and the normalisation of Saudis in white collar jobs. Ultimately, this will lead to the broader modernisation of services and trade, and a return of mega-projects that aim to capture inbound and domestic tourism. So, while the valuations look rich relative to history, understanding the transformations will be pivotal to taking advantage of these shifts within Saudi.

Moving over to the other side of the Red Sea, we must briefly comment on Egypt. Egypt has been an Achilles' heel for the portfolio, not only in 2020, but for some for much of the past 3 to 4 years (although 2019 was somewhat of a reprieve that was supposed to signal a longer term inflection) and while there have been certain strands that have played out well in this market, it has been a source of frustration, mainly attributed to a realisation thesis that keeps getting deferred due to a combination of interest rate cuts, dollar access, inability to ignore the importance of the T-Bill trade, parallel army economy, fickle regulation, delayed privatisation and ultimately a heavy COVID economic toll. Of course, the over-hang of many of the factors mentioned and an alignment to get all ducks in a row would lead to a long overdue rally for the market that should be broad based across many sectors. With that being said, we do not necessarily expect a broad-based rally (we have been bitten before), but rather we believe strongly in the specific themes in Egypt, where unlocking value is increasingly likely with a COVID recovery tailwind, overcoming the regulatory malaise/hangover and having different names compound earnings at levels well above the expectation of the markets. In this regard, we expect to keep our high exposure to Egypt, with various rotations based on realisation thesis primers and take advantage of broadening access to services whether financial, healthcare or education. We expect to reverse the overhang of a 9% negative contribution to our portfolio in 2020 and build further alpha beyond this watermark as the nature of the portfolio has changed leading into 2021.

The UAE, and specifically Dubai, which had been waning coming into the COVID crisis, despite an imminent Expo 2020, has once again managed to create silver linings around dark clouds that had cast their shadows across the region and much of the world, and therefore been able to catapult its branding from strength to strength. The execution and handling the COVID crisis, from lockdown - to recovery - to oasis, was step-laddered very well upon understanding on how to iterate efficient testing, tail risk medical management and finally top tier vaccine management. Moreover, we have now normalised political headwinds with neighbours near and far, with a return to form as the Switzerland of the Middle East, with the potential of vices of Las Vegas on the horizon. Adding further credence to the UAE story are the steps taken in personal law that remove vagaries to residents and citizens alike, giving greater clarity on matters associated longer term stable societal norms and freedoms. With the imminent change of foreign investment laws and offering an array of different residency schemes, the allure for white collar expats and investors is also visibly on the rise. Ultimately, the Dubai complex and AD government alignment of spending has built a strong foundation for the near and foreseeable future.

We started 2020 saying that this should be the year to watch, and frankly from a fundamental standpoint of our investable universe (COVID notwithstanding) it should have been. Today, the macro picture is the most attractive it has been in over a decade, and our universe and portfolio continue to be poised and ready for a strong run. The difference being, we now have a tailwind, vs. the headwind hailstorm of 2020. We look forward to a strong recovery in our portfolio and our ability to rotate the portfolio in the next few years with depth of backlog to invest behind and have a remarkable run. Please find below the extended metaphor of *The Good, The Bad and The Ugly* where we cover the more pertinent themes in more detail.

THE GOOD

KSA Healthcare

2020 was a year of positive surprises for the listed KSA healthcare space, thanks largely to the impact of COVID-19 on consumption of bed space in the second quarter, and on catch-up demand and captive demand during the second half of the year, as Saudis remain restricted to their homeland, and have taken that opportunity to engage in lucrative elective procedures at home rather than in Geneva, London, Beirut or Boston. Unlike in some other markets, the Saudi MOH realised in May/June that it lacked the capacity to manage COVID outbreaks among its citizenry, and the large private players reaped the benefit of high rate, low cost (simply bed care, little medical care) COVID+ patients for 8 weeks in Q2 and early Q3. Unfortunately, and unsurprisingly, none of the private sector players have been paid for this service (as of our writing); we expect they will be paid in 2021. Receivables with MOH remain stretched across all players, but the problem is only acute for Hammadi and SGH, given their larger exposure to historically unpaid receivables. Mouwasat and Habib have a more limited exposure and thus were able to easily absorb extended payment terms this year.

Beyond operations, the listing of Sulaiman Habib at the start of the pandemic provided a strong valuation anchor to Mouwasat, long the top operator operationally and in terms of profitability in Saudi, given that Habib's metrics were quite similar, even at double the size of Mouwasat. While we benefitted from Mouwasat's significant appreciation through the year, we exited too quickly from Habib, lacking the foresight that domestic Saudi traders would push it to trade at a premium in recognition, not only, of its growth outlook and profitability, but also (according to local sell side) because these punters head to Habib for medical care and it benefits from a 'familiarity premium'. Amongst the other players, returns both financial and market were more mixed, although all players ended the year up. The smaller Riyadh-focused institutions continue to suffer from a lack of bargaining power with insurance companies and the MOH. Furthermore, with the announcement of a new 'ease of movement' for expats, allowing them to shift employers without prior permission, it seems likely they will now begin to suffer from a lack of bargaining power with their staff as well, who will likely (according to the players themselves) shift towards the larger medical groups offering more training, better salaries, and better working conditions. From a fundamental perspective,2020 largely confirmed our thesis that the big 3 (Habib, Mouwasat, and SGH) will continue to capture market share and profitability as the sector matures.

Egypt's Payment Systems:

Over the past four years, we have been enthusiastic about the development of the fintech ecosystem in Egypt, a country of about 100mn people with mobile data penetration of 41% but banking penetration of 30% and credit card penetration of 4%. Nearly 96% of the payments as percentage of GDP are in the form of cash with over 90% of people paying their utility bills in cash till today (literally a government employee will knock on your door once a month to check the metre and collect your payment), the opportunity for conversion is significant and growth in the sector could last for many years to come. Not only is the payment space attractive to us, segments such as microfinance, insurance and other forms of consumer credit remain vastly underpenetrated and NBFIs are coming up with innovative, digitally enabled much needed products to reach the mass market.

Consumer finance services are also picking up significantly after discovering the opportunities in this unpenetrated segment. The business model is simple and targets both banked and unbanked populations, with a phone application which can be used for many things, from applying for a loan to purchasing goods at one of the company's merchants across the country. Some of the more advanced innovators, such as EFG's ValU, do their credit quality assessment and determine limits based on proprietary algorithm that account for variables such as your salary, car, age, occupation, residence, sporting/social clubs, etc. to maximize the risk-adjusted return. Others, like Fawry and Ebtikar, instead make microfinance loans to their merchants who are part of their existing ecosystem and POS network, hence controlling risk exposures that way. The NBFIs that rely more on data analytics of transactions and client information can help further improve the services they offer, fine-tune, maximize risk-adjusted returns and market more effectively with AI-driven engines.

The regulatory framework (or lack thereof) has been a major impediment for sustained growth of Egyptian companies across several sectors, however, in the case of NBFIs the government is pushing in the same direction with financial inclusion through digital channels being a priority. Egypt had been chosen as a model country for the World Bank Financial Inclusion Initiative in 2017 and since then has issued quite a few licenses in the space including a recently granted financial technology experimental permit (ExPermit) to Sarwa to experiment robo-advisory service. The government has been especially active into pushing a cashless economy, it started with paying out public sector employees through a payments network known as "Meeza", which is secured by contactless card chips and can be used to pay and withdraw money from a broad range of POS machines, ATMs, QR codes, and even online gateways across the country. This is further supported by the Central Bank of Egypt's own initiative to bring more people into the formal financial system and cut out the use of cash, launching a multi-billion-pound program to finance and target 1mlnPOS machines within three years, already having reached 350k today showing north of 100% annual growth since end of 2018. Incentives to jump start the behavioural shift across the population have been put in place as well, such as "cash-back" bonuses to users of up to 0.5% of the transaction value for those who scan via QR codes, and EGP 3,000 (around USD 200) to merchants for every 150 QR codes scanned. We've even seen the traditional microfinance "lend-and-collect" brick and mortar model like Tanmeyah and Reefy take a turn towards e-payment solutions, now being granted access to POS machines across the country to provide for collection points, improving the cash collections cycle and integrating into their IT infrastructure. We expect further government initiatives to remain supportive as this will enable them to access significant amount of consumer level data and eventually expand the tax base.

There are a number well known, agile players including EFG, CI Capital, Fawry, Sarwa, Amaan Holding, GB Capital and Ebtikar. We have exposure to some of the biggest consumer finance and microfinance players in the market, such as EFG and CI Capital, and other pure e-payment segments through MM Group which has a 50% stake in Ebtikar, one of the pioneers in its market. The company is a combination of 2 e-payment companies namely BEE and Masary (120k PoS machines), along with a microfinance arm and a leasing/mortgage arm and minority stakes in some fintech start-ups. The company aims to:

- create offerings for individual consumers, hence generating high volumes with low ticket size.
- to create a loop of financial services enabling its microfinance/mortgage customers to pay instalments through their e-payment PoS machines.
- offer credit using the transactions history of individuals and small businesses and cross sell products.

We had invested in Fawry (150k PoS machines), the biggest player in the payments space in Egypt, but exited prematurely on valuation grounds; at the time of writing this letter the stock was trading at well over 100x 1-year forward earnings. On the other hand, Ebitikar's subsidiaries have hired bankers for a potential IPO this year, which should result in strong returns for the parent.

As for the banks in Egypt, in our view, they do not have the passion to grow in this space directly as they are generating strong ROEs (25-30%) by investing in risk-free government instruments and relatively low risk corporate lending. However, the same banks are happy to work with and acquire stakes in these established digitally enabled financial firms that need capital injections to grow scale. A number of these players have tie ups with large banks to facilitate payments. A case in point, National Bank of Egypt recently acquired 24% in Aman Holding at a 2020 PE of 95x. Fawry is also partially owned by National Bank of Egypt and Bank Misr.

The attractiveness of this sector is amplified by the fact that electronic payments/financial inclusion provides opportunities to the underprivileged in the society, works towards reducing red tape and corruption and improves overall productivity of the economy which all help the industry score well in our ESG framework.

THE BAD

Airlines:

2020 should have been a good year for MENA airlines, with the Expo 2020 set to boost arrivals and Saudi opening its economy to tourists broadly for the first time in its history. With the outbreak of COVID, and with international air travel quickly (and rightly) vilified for accelerating its global spread, a rapid grounding of the majority and in many cases all flights was in evitable. Immediately, company balance sheets came under enormous pressure, given the highly leveraged nature of the airline industry. This was compounded by waves of refunds and cancellations coming in during critical months where significant spring and summer bookings were already made and paid for, and expenditures related to these bookings (staffing, fuel) had already begun. Airlines that owned their planes (i.e. Air Arabia) were in a better position than those that were operating under a lease model (i.e. Jazeera Airways and most of the industry). Interestingly, many of these contracts lacked force majeure clauses (according to IATA conference calls), and left airlines to deal individually with their lessors, who themselves had widely varying levels of financial stability. An industry predicated on 2x global real GDP growth faced a severe reckoning in Q2 2020.

IATA continually raised its 2020 industry loss forecast through the year and highlighted the need for governmental aid. Repatriation flights and a pickup in cargo activity were not enough to compensate for the pain, therefore the operators had to turn to salary reductions (up to 80% at Emirates, including one year no pay furloughs) and job cuts as the crisis dragged on. Emirates Airlines made 24.3k employees redundant, and despite this reported a loss for 1H2020 (ending Sept 2020) of USD 3.8bln while carrying just 1.5mln passengers (down 95% YoY). It also received a USD 2bln cash injection from the Dubai government to keep it afloat. Etihad Airways also posted a wider loss in operations by USD 172mln to USD 758mln (loss) during the first six-months of 2020, while carrying 3.5mln passengers (down 57% YoY); interestingly a lot of Dubai-based European expats heading back to their home countries, either for the summer or for good, could only fly out of AD, as Dubai's initial lockdown was much stricter.

Air Arabia fared better during the nine-months ending September, reporting a loss of just USD 58mln, pushing the company to ask for an undisclosed support package from the government. The airline suffered a 70% drop in passengers to 2.17mln. That is in comparison to the other publicly listed air carrier, Jazeera Airways, which reported USD 51mln in losses for the nine-months, carrying 606k passengers (-66% YoY). Jazeera Airways was under tremendous pressure with liquidity to cover less than a year's worth of cash burn before the carrier reverted to cost-cutting measures on top of cancelling dividend payments to investors.

For the airline and international tourism industry more broadly, full sustained recovery is not expected before the end of 2024 (despite Dubai occupancies these past two months). The first step is to focus on markets with domestic routes like Saudi Arabia, which are already ramping up capacity and utilisation, but even that will likely not be enough for the struggling national flagship, Saudia, which received around USD 7bln in governmental support over 2019 and 2020 (combination of payments and loan conversion to equity).

Overall, while we view 2020 as a bottom for regional listed and unlisted airlines, 2021's performance is largely depended on vaccine rollout, relaxation of international travel restrictions and a recovery in tourists' collective propensity to travel. We expect that leisure demand will revive strongly, before business travel; evidence of that is clear in Dubai, where the emirate significantly relaxed travel restrictions in mid-November and saw an extremely strong pick up in December and January tourism, which unfortunately drove up imported COVID case numbers and noticeably increased the ratio of tattoos and Essex accents in the emirate for a couple of months. The UAE's rapid rollout of vaccines (currently 2nd fastest globally after Israel) is part of its stated government policy to the fastest recovered economy in the world, and logically we expect this will benefit airline companies and the broader UAE and GCC travel and tourism industries in 2021. With Expo shifted to open in October 2021, and the FIFA World Cup following in Qatar in 2022, it is possible that GCC airlines will recover faster than their global peers, especially with the increased tilt towards East-East tourism from China and SE Asia.

Pandemic Real Estate

Last year was pivotal for real estate operators and developers in the region, and the tectonic shifts across the sectors we evaluate (GCC developers, GCC mall operators, Egyptian developers, as well as KSA self-build) will have repercussions for years to come. For the UAE based developers, 2020 marked what we believe is a floor following the Dubai market peak in 2014, as off-plan sales fell 60-70%, and new launches halted completely. We saw initial signs of consolidation in the government space, with Dubai Holding taking control of Meraas development projects, while several completed Meraas projects were sold to Brookfield. Within the private space, launches all but halted in early February, with the cancellation of much Chinese New Year outbound travel, presaging wider shutdowns.

In Dubai, developers moved quickly to slash their staffing and SG&A expense by 50%, triggering one of the earliest outflows of residents, while shifting quickly into cash preservation with a focus on inventory sales and mothballing expenditure on 2019 launched projects. As summer came to an end, Dubai witnessed a marked pickup in secondary market transactions, reminiscent of the 2010-12 period where new sales were moribund, but transactions picked up in the secondary 'finished' and secondary 'off-plan' markets as buyers sensed a bottom. Prices in Dubai fell 8-10% broadly in 2020, the slowest decline in 5 years, and that was primarily during the first half of the year. For Emaar, as the year came to a close, we significantly raised our exposure as the forward-looking delivery pipeline has shrunk to its lowest level (30-40k units in the next 4 years) since 2011. Moreover, pandemic-related job losses ended up being (based on our media and local-knowledge derived estimates) only around 600k, rather than the 1m losses projected early in the pandemic. Of these, 80% were in lower skilled, lower paid categories, mainly construction, while our best proxy for real estate addressable market in Dubai (student enrolment, K-12) fell only 5% YoY in 2020 vs. 2019, and half of that decline was due to parents not sending their youngest children (3-5 year-olds) to start learning with masks or school remotely (schooling isn't compulsory in Dubai until age 6).

By contrast, Aldar in Abu Dhabi capped a remarkable year of strong share performance following on its strong 2019 performance, as state support for its cash flows, and in particular its dividend cash flows, continues to crystallize. Aldar shifted to selling land plots to locals as well as mid-market apartments (also largely sold to locals for investment purposes) and benefitted from government support of its hotel capacity as its Yas Hotels were first used for COVID quarantine and then later used for the government sponsored "Fight Island" events. Moreover, continuing restrictions on the movement of AD residents in/out of Dubai meant that its malls an entertainment assets had a reasonably strong summer performance, due to their 'captive' audience, limiting the hit to rental and other recurring income streams. Dividend cash flows, which looked at risk early in the year due to their dependence on recurring income streams ended the year looking robust as Aldar signed multiple large contracts with ADQ (govt semi-SWF) to build and develop Emirati housing and other infrastructure. These cash flows should support dividends for at least the next 5 years, at above the 2019 dividend level.

Moving to Egypt, it was yet another distressing year for the real estate market broadly, as overbuilding and overlaunching in 2015-2016 continues to overwhelm demand, and as extended payment plans continue to suppress ROI for the developers on their projects. The most notable shift in the market in 2020 was a large scale move towards building (or, planning to build) recurring income retail, commercial, and service-oriented (hospitals, schools) projects within existing developments. Falling interest rates have made the CAPEX cost more bearable for developers, and the lower profitability of these projects has 'converged' relatively with the lower profitability of traditional unit sales given the extended payment terms now demanded in the market. TMG has a 5-year head start on the rest of the market in developing high quality, large scale recurring income assets, and as we move into 2021, the strength of this offering and renewed interest in the value of recurring income streams in Egypt, as both inflation and rates moderate, bode well for TMG. Benefits should also accrue to the other large developers (EMFD, in particular) as their cash balances will allow them to add land and negotiate good land payment terms. There also appears to be a 'shift in interest' away from the more heavily developed 'inner New Cairo' between Cairo and the New Capital City, and towards West Cairo where prices remain more moderate and where the government still has significant land tracts to sell. With the removal of the Qatar blockade and renewed interest from AD and Qatari developers in Egypt development 'with local partners', 2021 promises to be a markedly better year than the past half decade in Egyptian real estate.

As for the asset management side of real estate, in the GCC primarily, 2020 was a likewise challenging for mall operators, as brick and mortar retail bore the brunt of COVID related lockdowns and the growing consensus that these businesses are 'old economy' with e-commerce and warehousing being the 'new economy' sectors. Globally, we saw several retailers shutting down thousands of branches and moving to an omni-channel model causing higher vacancy rates. However, regionally the impact has been milder with occupancy rates at Dubai Mall (96%) and Avenues (95%) remaining high. This is not to say that there have not been store closures, but they have not been to the same extent as in developed markets. This is because majority of the brands in the region are run by franchised operators, which are typically large local family offices with diversified businesses. Additionally, mall operators offered rent-free periods and discounts that allowed retailers to survive; and banks were supportive through temporary payment breaks. During the March-June lockdowns, as the case numbers indicate, GCC members generally managed their economies and healthcare systems far better than many developed countries, led by high compliance with rules around social distancing, masking, and sanitisation. This allowed businesses to recover some lost revenues in the 2 months post lockdown, especially during the summer break - when residents (with high per capita income) refrained from travelling outside the region and ended up spending on home improvement/entertainment/sports goods, etc within the GCC. An additional factor that helped malls in the region has been a shift of spending away from unorganized retail towards presumably safer malls, which had thermal cameras and community police volunteers in place to ensure rules were followed to limit the spread of the virus.

We invested in Emaar Malls and Mabanee during the summer as we saw a discrepancy in the pick-up in business activity relative to stock price. Our preferred name, Emaar Malls, not only offers access to the most visited mall in the world, but also offers exposure to the large untapped regional online shopping market through its 100% owned fashion retailer Namshi, which has grown strongly over the past 2 years and is expected to continue to grow moving forward. In our view, the asset could be ready for listing within 2-3 years after turning EBITDA positive this year. This combination allows Emaar Malls to offer omnichannel option to retailers; while the steady cash from mall operations support the weak cash flows of Namshi and allows it access to retailers providing a competitive edge. Emaar Malls' stock recovered significantly in 2H 2020 as tourism recovery became more evident with air traffic and hotel occupancy rapidly rising, alongside renewed optimism on regional travel with the signing of the Abraham accords and recently the cessation of hostilities with Qatar. We continue to believe that the GCC's superregional malls will survive and thrive due to their market positioning and pull for tourists and residents, while consider that smaller malls/unorganized retail will continue to shrink as a share of the market. Malls in the region serve as a leisure venue for residents and tourists versus just a shopping destination, and we will see the mix shifting from trade towards F&B or entertainment in the medium term. In our view, footfall into the region, be it for the Expo 2020[1] or FIFA 2022, should emphasize the execution capabilities and modern infrastructure of these cities in GCC and will continue to support further investment, population growth and tourism.

Banks

Most MENA bank stocks ended the year with negative total returns. The economic volatility and uncertainty brought on by the pandemic, coupled with the near-zero interest rates implemented as governments sought to support their economies (Gulf central banks, with USD-pegged currencies, largely followed the US Fed's rate cuts), pressured revenue drivers and provisioning requirements for banks. Although full year returns remained negative for most bank stocks, many did rebound significantly from their March/April lows, as central banks stepped in aggressively with various measures to provide liquidity and capital relief that would enable the banks, in turn, to give relief to their customers. For example, the UAE central bank reduced the percentage of banks' customer deposits required to be kept as reserves with the central bank, while the Saudi central bank placed billions in zero cost deposits with the banks and allowed them to take fair value gains on those deposits that offset the modification losses they incurred by deferring loan instalments for customers impacted by the pandemic (and breath…long sentence). These and other significant measures prevented major asset quality deterioration in 2020, though they may also just temporarily mask asset quality problems that could emerge when some measures ultimately expire.

On the bright side, there were in fact a handful of positive stories despite the pervasive negative backdrop. Al Rajhi Bank in Saudi benefited from several themes – a loan book exposed significantly to Saudi government employees (lower risk), strong competitive positioning in a fast-growing mortgage market (one of the few loan growth areas for Saudi banks in 2020 – see prior graph earlier in our letter), a positive uptake of digital banking offerings and a shift from cash to card-based (POS) and online spending. NCB and Samba in Saudi agreed to merge to form a national champion bank well-positioned to benefit from retail banking themes such as the mortgage growth and corporate banking themes such as funding for Saudi's "giga projects" and infrastructure developments, and their stocks performed strongly into the close of the year.

But a few positives notwithstanding, it was a difficult year for sector overall. Asset quality concerns that would arise in any economic downturn were exacerbated in some cases by exposures to outright fraud; in the cases of NMC and Finablr (more details on these two gems later in this letter) the amount of outstanding undisclosed bank debt raised questions about how loosely some of these fine institutions were monitoring their lending. As for CIB, a bellwether stock for the Egyptian market, the ousting of the bank's chairman in an apparent feud with the Central Bank governor led the stock to be one of the worst 2020 bank stock performers in the region, ending the year at a price barely above the pandemic-induced lows.

Other themes for the year included a continuation of bank mergers as banks sought ways to control costs and build scale. Apart from NCB and Samba, DIB merged with Noor Bank in the UAE and there were ongoing discussions between Masraf Al Rayan and Khaliji Commercial Bank in Qatar (who agreed to merge in January 2021) and between KFH and AUB in Kuwait (currently delayed for further review in light of the pandemic). The cost control theme extended to banks' efforts to build out digital banking capabilities (both customer-facing and behind the scenes) which in turn has also reduced branch networks, and the successful work from home experiment seems to be leading to a downsizing of banks' corporate office space requirements. To that end, Mashreq Bank in the UAE has recently announced that a significant percentage of its non-customer facing jobs will be relocated to Egypt, India, or Pakistan; and that a minor percentage of its jobs will be on a permanent work from home basis.

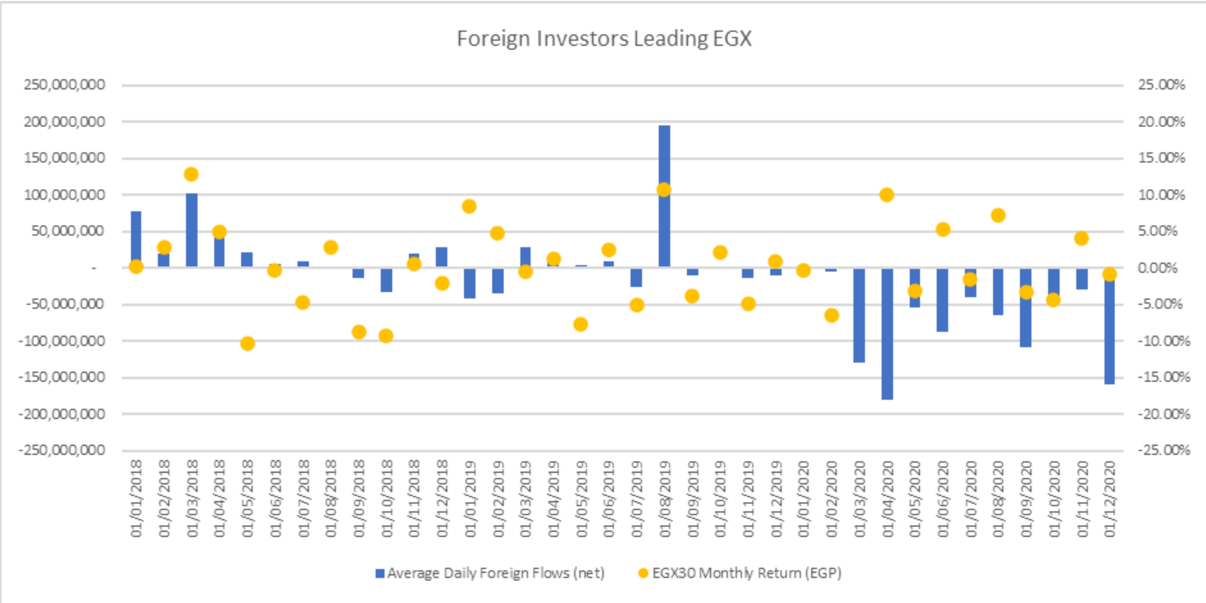
Overall, banks were a negative contributor in 2020 for the AMF in absolute terms, as our exposure to CIB did not recover much from pandemic lows, while we carried some UAE bank exposure into the market downturn and did not benefit fully from the recovery. On the other hand, the portfolio did benefit from exposure to NCB and Samba, as well as from a Qatar thematic played through CBQ.

EGX Flows

The EGX had a hell of year losing 20% in 2020, equal parts pathetic and poetic. The only two markets to perform worse than Egypt were Brazil and Colombia, which were both within striking distance of the EGX30 and driven by more acute fundamental challenges. This was clearly not the right year to be overweight in a market which has regularly disappointed us despite it continuously boasting the best bottom-up stories in MENA. Our frustrations have been exacerbated by the fact that coupled to Egypt's perpetual bottom-up attractiveness, the country has been going through a stellar macro-economic recovery over the past few years, in direct contrast to LatAm comparables as it happens.

So, what happened this time? Well, a combination of global disarray, sprinkled with a smidge of xenophobia, seen through a myopic lense that could only focus on US listed tech stocks, institutional investor flows drove EMs (generally) to take a rougher beating than necessary. Similar to late 2008 and early 2009 when EMs got hammered following redemptions en mass, 2020 created a similar rush to the fire-door, and similarly yet again Egypt got caught up in the chaos. If we look back and recall what happened to the Egyptian equity market following the EM exodus (which had spared GCC markets in 2008/9 as they were either frontier or unclassified at the time), we see that 2010 provided quite the springboard, off which Egypt was able to bounce back nicely and was in fact one of 2 or 3 best performing markets in the world. Back in 2010, we did not take advantage of Egypt's recovery as we were concerned (rightly) with the socio-political picture; however, over a decade later we are witnessing similar global EM investor dynamics at play, and a thinner market like Egypt, logically speaking (and there is a caveat) should be an outperformer in 2021. Now the caveat, Egypt, as are many markets in the EM and FM space, is often not logical, so whatever allocation we will have in place for the year, will be monitored carefully, and will have tighter risk controls attributed to it as well as be positioned in themes that will be fundamentally positive regardless of general flows. The flows we hope will be the wind in our sails.

As quick overview of the impact of foreign flows as a factor to Egypt's outperformance we've included the graphs below. Note on average foreigners will constitute anywhere from 10% to 30% of the daily turnover in Egypt, yet their monthly net buy and sell positions are a consistent leading indicator to the market's performance:



THE UGLY

NMC The Takedown

As we discussed in last year's newsletter, we had invested in NMC since its IPO in 2012. Over the past 8 years, we continually updated and adjusted our target price and views on the company to reflect its rapid organic and inorganic expansion, as well as its increasingly high relative multiples as it emerged as a global EM healthcare play. We largely exited our position in 2018 and then re-entered after the price fell in 2019, but as we learned in 1Q 2020, some (but not all) of what we invested in was a lie. What is perhaps most galling is that as the year progressed and the players in the game became more visible, the assets that we invested in turned out to have been largely good ones, but on these good assets, the founders of NMC, as well as its board members, senior management, and compliant banks built a shaky structure of debt and inflated related party transactions that were used to enrich a few shareholders and stakeholders at the expense of minority shareholders. It is an experience that shook us deeply, and that we will continue to take lessons from as we move forward and learn from our mistakes.

We invested in a single listed entity, NMC, whose revenues / costs / income statement and also whose current assets and liabilities always made sense to us looking at the operating businesses (both distribution and healthcare) and benchmarking them to other UAE and regional enterprises. At their best "reported" NMC was about 15-20% more efficient than these other businesses, which we attributed to scale and to the fact that while medical staffing costs are about 20-30% higher in the UAE, medical care charges are roughly 50% higher than KSA, giving the spread we saw in the margin credence. ***In the end, we were wrong to ignore the circumstantial evidence (while the stock was still trading) of significant unreported debt, and we were wrong to believe management assurances of cash balances and moves towards increased transparency. We were blinded by the UAE hospital operations (which were (and are) above board, profitable, and value generative) and did not see the rot within the finance and treasury department that was being used as a piggy bank to fund private projects of the founders, board, and senior management.***

While we have always focused intensively on governance and board / management dynamics, we have re-doubled our focus on these in 2020 and instituted a red-flag system in addition to our existing ESG scoring and business dynamics scoring to force further discussions on red-flag companies (NMC had been flagged as having poor governance for us by years, but in 2019 – when we re-entered having exited the position at its highs in 2018) we felt that the risk reward given the then 30% decline in the share price balanced out the corporate governance risk to an extent, in addition to the positive moves made by the board on executive compensation and LTIP, which it turns out were fig leaves.

It turns out (to the best of our knowledge as we write this) that NMC was actually 3 entities:

A normal healthcare operator with margins around 10% LOWER than peers due to the drag of excess acquisition costs accumulating from 2015 around the less efficient UAE and KSA acquisitions that occurred particularly in 2017 and 2018. This health care operator continues to operate as normal across all its facilities throughout 2020. Moreover, the IVF business acquired internationally (Clinic Eugin and 20 subsequent smaller bolt-on acquisitions in fertility) were just sold for USD 525m, with and ROI of ~60% on invested capital in the acquisitions, and at a P/E on 2019 estimated earnings of over 40x…clearly a healthy and attractive business (sold to Fresenius, a listed European healthcare player).

What remains in the healthcare business today:

UAE healthcare facilities > 1,000 beds, numerous clinics. These assets are unlikely to be broken up, but control could transfer to another AD entity.

UAE IVF (Fakih IVF) acquired at ~500m USD, and generating around 40-50m USD per annum in net income. This asset will likely be sold.

KSA healthcare facilities ~750 beds, largely loss making, will likely be sold either as a group or broken up to other KSA entities.

Oman healthcare facilities ~350 beds, something of a black box, seem likely to be sold for a small amount.

UAE cosmetics (Cosmesurge) – remains quite profitable, would probably be sold, generates around USD 20m / year net income.

Ex UAE fertility – already sold

Aspen UK – will be sold.

A patsy for an enormous cycle of fraudulent debt build-up where large amounts of debt were run up on NMC subsidiaries and rubber-stamped by the board, while not being included in the consolidated financial statements (balance sheet) and for which the finance costs were passed through NMC, both as finance costs and as operating costs, and revenues (passing back and forth pharma supplies with a sister pharma manufacturer) to conceal the level of debt. The actual debt secured against NMC appears to be around 3x the reported debt, as a benchmark. A lot of this debt (~50%, estimated) was added from 2018-2019, although according to the various restructuring advisors, debt in similar structures had been used since 2010 at least (and was concealed at the time of the IPO in 2012).

A front to upcycle and create fictitious revenue for Neopharma, the large pharma manufacturing business controlled by the Shetty family.

It is important to note that in our opinion, none of this malfeasance occurred in secret from the banks and from the major players in Abu Dhabi. In fact, they appear to have used the Muddy Waters report as an opportunity to take down the Shetty family and to engage in asset capture of a highly strategic and highly profitable asset (the NMC Health UAE operations).

Finablr

While we invested in NMC, we did not have exposure to the other Shetty family company, Finablr. Finablr was a combination of payments, foreign exchange, and remittance businesses operating globally, including prominent brands Travelex and UAE Exchange. The company planned to leverage its various platforms, licenses, and technology to cross-sell payment and FX services to corporate and financial institution clients on a bespoke basis. The company had steady retail-focused remittance and FX business, but sought to grow more materially (and achieve loftier valuation multiples) by becoming a bigger player in the payments technology space. Finablr had achieved some success in this area, winning several contracts with significant players in a variety of geographies, but as the contracts were bespoke it was difficult for us to model this part of the business and we viewed it as something of a black box.

Like NMC, Finablr also ultimately disclosed a large amount of unreported debt. Unlike NMC's medical facilities though, Finablr's operating businesses became constrained when the fraud was exposed, as the UAE central bank and other regulatory authorities took action to reign in and monitor the business activity. Prior to the disclosure of the extra debt, Finablr was already facing challenges from a cyber-attack on its Travelex business. The company was eventually delisted from the London Stock Exchange, and restructuring plans put into place to seek some recovery for debtholders.

Arabtec

Arabtec, one of the gulf's largest contractors that helped build Burj Khalifa, filed for insolvency after reporting another loss in H1 2020 of AED 794mln to bring cumulative losses to AED 1.5bln and a negative equity position of AED 351mln. This was the final nail in the coffin after a series of capital injections between 2013 and 2017, on top of management changes and rounds of restructurings, that started with the AED 2.3bln loss reported in 2015.

Ironically, the company reached its peak valuation a short period before that loss, in mid-2014 when the market cap exceeded AED 32bln, at that time Arabtec was planning listings in London, Hong Kong and New York.

Over the next few years, the stock traded down to a market cap of AED 795mln in September 2020, before being suspended with the announcements for the move to liquidate.

The main driver was its unsustainable business model, which unfortunately is still used by some contracting firms in the region, which namely to sacrifice margin to build-up their backlog, despite said backlog ultimately being value destructive. Basically, they undercut competitors on pricing and sometimes would cost a project at a discount just to win a tender in the hopes of making a profit through additional work when it starts running. This strategy is tricky in a market that is going through its own gyrations, as it results in frequent payment delays by clients, who in turn often put pressure on contracting firms, already bruised by Dubai's 2008-2009 property market crash. Arabtec was largely able to overcome most of its cash flow issues by running several projects at a time, assuming supply would continue indefinitely; basically a back-log Ponzi.

By the end of H1 2020, the company owed the banks AED 1.8bln and AED 5.3bln in payables which included around AED 2bln to sub-contractors. Reports estimate that 8,300 employees (20% of their 40,000 workforce by the end of 2019) were let go.

Only their Oil & Gas entity "Target" might escape the collapse, after the company asked the banks for a three -months standstill on debt repayment. The most interesting part of this story rolling out is, to see how UAE's bankruptcy law plays out on a larger and more public scale.