Ajeej MENA Fund
Annual Letter, 2013

Ajeej Capital
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FUND INFORMATION

Pricing:
Monthly NAV

Fund Classes:
Issued Shares
Class A Shares

Current NAVs (USD):
Issued Shares 153.05
Class-A Shares 144.25

Fund Custodian:
Deutsche Bank

Fund Lawyers:
Walkers

Fund Auditors:
KPMG

Fund Administrator:
Apex

Bloomberg Ticker:
AJEEJMN KY Equity
AJEEJMNA KY Equity

ISIN Code:
KYG016361027
BBG0057SCST3

Fee Structure:
Management 2%
Performance 20%
Hurdle Rate 8%
High Water Mark

Min Subscription:
Initial USD1m
Subsequent USD100k

January 2014

Dear All,

Happy New Year and best wishes for 2014 from the Ajeej team. As we reflect on 2013, the MENA market's performance was impressive on both an absolute and relative basis. Strong returns, EM graduation (UAE, Qatar), and EM malaise have elevated the MENA brand from a foreign flow perspective which should bode well for 2014. One of the obvious manifestations has been the trade volumes increasing over 120% y-o-y, with the exclusion of Saudi. The global investor influx coupled with renewed retail equity fervour will most certainly add spice to the markets as we move forward with the potential to further exacerbate the fundamental and pervasive fault lines in the MENA landscape.

"Experience Teaches Only the Teachable" - *Aldous Huxley*

The AMF returned **57.4%** compared to the S&P Pan Arab at **21.7%** for the year. Whilst this is a solid performance it only provides a lagging indicator to the portfolio; leaving the hard work ahead of us to perpetuate value from our investment universe and ensure we are running at a 25%-40% discount to intrinsic value. The ability to utilize our knowledge is tantamount to the consistency of generating alpha, whilst simultaneously understanding the implications of the fault lines of the risk on our portfolio ranging from global factors to company specific issues. It is only natural for investors to be concerned about continuous strong performance after the portfolio re-rated strongly in 2013. In short, and in the words of Mr Clapton, *"It's in the Way That You Use It"* as we plough through a continuous improvement cycle addressing the balance between depth and breadth in pursuit of risk adjusted value. We can assure you in retrospect there were many easier methods to make money in these markets through trading momentum etc., however our fundamental knowledge of companies keeps us grounded as we profit on the back of the respective companies' business plans which are continuously being re-iterated against our underlying theses. In 2013 a high proportion of our portfolio earn out thesis played out, as conveyed by healthy earnings growth of over 45% for our top positions. One cannot deny that market momentum does not discriminate between good and bad companies; however, we are comforted with the substantiation that much of the portfolio growth was predicated on company specific factors. The MENA markets are back in style and as Jack Palance would say, "Believe it or Not".

WHAT DO YOU MENA!? - Name that Tune…

"Career opportunities are the ones that never knock" (hint: classic punk rock tune)

Saudi Arabia was up 25.5% for the year and 2.5% for the month. It was truly a bi-polar market in 2013; in the guise of beta vs. non-beta. The beta exposure of banks were obvious laggards to the market, with leaders such as Rajhi up just over 11% for the year. Yet non-beta banks performed very well on earnings beat and were rewarded handsomely (SABB, SHB, Al-Bilad, SAIB) with returns well over 40%. Petrochemicals were more in-line with market returns making a late run in the latter part of q3 and q4 as demand and pricing firmed up across the broader product mix. As for the true stars of the market, these were the consumer plays which generally performed very well with market returns over 70%. However, price momentum slowed as concern on labour reforms added complexities for many of these companies on short term earnings expectations. This is an important theme to watch for and will certainly separate the men's from the boys' management across this sector, based on how they are able to deal with labour challenges moving forward. On the regional political front, the role Saudi Arabia has been playing is very proactive. It would be premature to describe the US/Saudi relations as being tense; however, clear lines have certainly been drawn, namely the US's re-engagement with Iran. Ironically, whilst it serves to de-risk the perceived political environment, it places increased strain on the US's most important ally in the Middle East. We don't expect this to weigh to heavily in the short term from a market perspective; that being said, it should not be ignored.

“Oh, what a feeling / When we're dancing on the ceiling” - *(hint: he closed 1984 Summer Olympics)*

The UAE, for the second year running, has been the best performing market in the region (Dubai 107.8%, Abu Dhabi 63.1%), with December recording a catch up to the muted expo win (Dubai 14.5% and Abu Dhabi 11.4%). It was a blow out performance for the markets with everybody sharing in this wild bonanza of a market. What could have gone right, did, and the country once again serves as a safe haven both in the physical and stock markets. As we had discussed previously, the Expo 2020 serves to reduce re-financing risks and aid in the urban planning of the city. Moreover, the physical real estate market has served as a fiat currency for many of the folks from neighbouring countries. As long as we take lessons of the past and apply, one should expect better management of a heated economy. Whilst many scream bubble, we would contend, if it is one we are still in the early stages of it. We will speak to the market a little later in the letter, but we feel there continues to be value driven by a macro re-rating and fundamental bottom up economics on the services sector. Psychologically, it is difficult to come in to a market over 100% later, but from a five year perspective the case is much more compelling with better fundamentals and regulations, in addition to the advantage of an experience curve. Whilst it is not our largest exposure in an absolute sense, it is the highest it has ever been in our portfolio.

"You're a good soldier / Choosing your battles / Pick yourself up / And dust yourself off / And get back in the saddle” - *(hint: one of the cheesier recent football anthems)*

Qatar had a reasonable performance for 2013 up 24.2% for the year and flat for the month. Whilst the political aspirations regionally were lost amidst what has transpired in the MENA landscape, one is hopeful with the generational shift of power institutionalisation will set in. With focus now on the "big spend" as we get closer to 2022 much is to be done. 2013 was not without its wins; the MSCI upgrade and likely World Cup date shift would cement debate on Qatar as the host. Theoretically if shifted to the winter; the fees paid to the various leagues may be offset by the air conditioned stadiums that no longer need to be built!!! On a more serious note, the economy keeps on strengthening its balance sheet with its annuity income coverage fortifying the potential of down-stream and the development of non-oil/gas dependent industry. Ironically and to a lesser degree the inclusion into the EM may in fact provide greater flows than expected as allocators are likely to over-weight EM exposure given the unique traits of the market being small, rich, currency protected and high annuity coverage. The market continues to provide great value with robust visibility making it an important market for the fund.

“So don’t delay act now / Supplies are running out / Allow if you’re still alive / Six to eight years to arrive / And if you follow there may be a tomorrow / But if the offer is shun / You might as well be walking on the sun” - *(hint: for the 90s child in you)*

Kuwait had a solid year up 27.2% despite having a challenged December down 3.3%. Unfortunately the market continues to be known as the "false positive" of markets. It is sad to see the self-deprecating nature of the market, but there is still hope with various projects in the power sector reflecting a project kick off, which is reason to be excited. An overhanging concern we have though, is that trouble in the Kharafi house-hold may send ripples across the banking sector. One may interpret that the general provisions across the sector being mandated by the Central Bank are prudence based actions, on the back of how the restructuring of this family business is in fact playing out. With that being said there is likely more upside than downside in this market overall, and we have a few scouting positions which could grow larger within the portfolio.

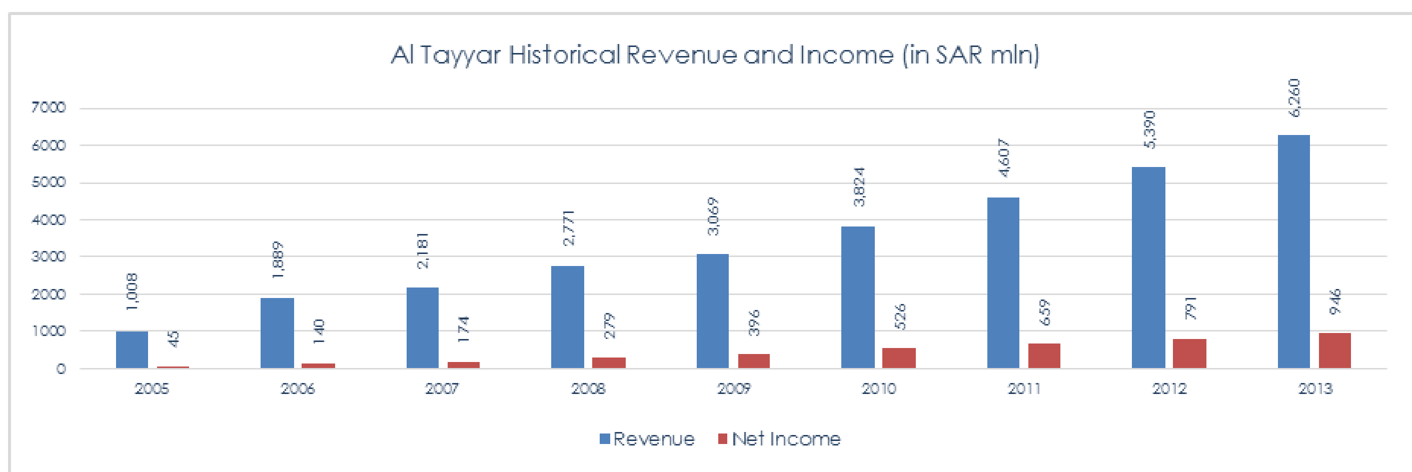
“Tomorrow you will wake up to find that your whole life has changed / Although nothing looks different a revolution took place” - *(hint: for the 80s/90s child in you)*

Egypt certainly had a year of two halves, but ultimately ended the year strongly with a 24.2% return for the year supported by a strong December return of 9.7%. This was certainly a "trade for stability" as the so-called re-revolution on June 30 reinstated the legacy powers back in the driver's seat. Whether the MB reign was the world's greatest set-up or sheer folly of governance extraordinaire, visibility and stability are the modus operandi once more. The market bounced back 55% in the second half of the year even outpacing the UAE market during this period. So with no tangible economic benefits beyond the “GCC put” of funding, a great deal of expectation lies on the political road map and its effect on the underlying companies in the index. It remains an uphill battle, but clear demand abounds in the Arab version of the Marshall plan on infrastructure and rebuilding the country from the lost half decade (compounding of financial crisis + revolution). Whether the inherent risks are worth it in Egypt, any investment would need to be predicated on a fundamental paradigm shift or substantial earnings growth to justify a meaningful exposure to the Egyptian market.

2013 was a year in which not much went wrong on an absolute level so re-assessing at this juncture wouldn't be necessary; however, we thought it would be worthwhile to highlight some details on and remind you of the investment that had the highest attribution to the Ajeej MENA Fund in 2013, and then provide you with a preview of the themes for 2014.

Al Tayyar: As you know, we had and continue to have a core position in Al Tayyar, Saudi Arabia's leading travel agency and tour operator. Al Tayyar, which started with humble beginnings in 1980, was founded by Dr Nasser Al Tayyar with only SAR 1mln in capital. Today this same company boasts approximately 300 outposts in Saudi Arabia and internationally, generated 2013 net income of SAR 943mln (USD 251mln) up 25% from SAR 755mln in 2012, along with top line growth of 16% in a market that has been experiencing air traffic growth of around 10% per annum. Al Tayyar Group took advantage of a highly fragmented industry and managed a successful consolidation strategy; this coupled with organic growth, led it to become the clear market leader with a 35% slice of the corporate pie, and 14% of the retail segment; notably, the second largest player is around ½ its size. This leading position has allowed the company to accurately forecast the demand of the flourishing Saudi consumer, who is exposed to unique holiday seasons that are very different to those in the West (or East for that matter). Leveraging this informational advantage, Al Tayyar would purchase excess capacity early on at attractive discounts, and later resell this capacity to the end consumer when high season approached. Furthermore, the leading market share that the company enjoys, allows for significant negotiating power with airlines resulting in a more advantageous rebate. In recent years, Al Tayyar has established an international infrastructure which made it the only service provider capable of meeting the needs of the Saudi government's substantial scholarship program that today caters to 85,000 students and their families who are sent abroad. As a result, Al Tayyar is able to generate a net margin of 15%, an outstanding achievement for this industry.

While Al Tayyar had a phenomenal 154% run-up in 2013, amazingly it still trades at a 2014 P/E of around 10x. This 10x earnings is for a business that grew its net income form SAR 43mln in 2005 to SAR 943mln in 2013 (see graph below). A business that still has a solid 20-25% earnings growth profile. A business that, along with its tourism and travel market growth (it continues to increase its market share in the corporate services), has a huge growth opportunity in the USD16bln religious tourism market which continues to be highly underserved. This is made all the more attractive given the government's investments in capacity increases of the two major religious cities, Mecca and Medina. In reality, today Al Tayyar is the only major player that will be able to provide a full range travel services/solutions for people visiting Mecca and Medina, which would eventually include serviced apartments and hotels, another major growth opportunity (although one that would likely only become substantial in 2016 and 2017).



Themes: as promised, here is a quick look at our take on themes for 2014:

Favoured	Opportunistic	Less Favoured
UAE Macro	Petrochemicals	KSA Banks
Qatar Macro	Manufacturing	Contractors
Energy services	Consumer Goods	Fertilisers
KSA infrastructure ex contracting	Telcos	

Dubai Boom Version 2.0 – Should We Be Worried?

As we mentioned earlier, 2013 was a phenomenal year for the UAE financial markets as has been the subsequent start to 2014. As such, we feel this justifies a slightly more detailed commentary, on both our holdings and the market, than what was briefed in the opening pages of this letter. Dubai's stock market closed 2013 up 108%, while Abu Dhabi's stock market appreciated by 63% for the year and volumes traded on the exchanges increased throughout the year as investor confidence improved. Q4 2013 trading in Dubai reached levels last seen in Q2 2009, and so far in January 2014, the average volumes are again significantly higher than the average for Q4 2013. In recent days, volumes on many blue chip stocks have been subdued on a relative basis as local and regional investors have been more active in smaller-cap or more-speculative names, causing us to wonder if the UAE retail investor is finally 'back' having weathered nearly 5 years of subdued returns, the closure of many brokerage houses, and liquidity so limited that for periods in 2010 and 2011, a good day was when combined market value traded for Dubai and Abu Dhabi barely surpassed USD 25m – a distinctly paltry number relative to the recent string of billion dollar trading days in January.

This strong market performance and the potential return of fast-money regional speculators require us to thoroughly reassess our UAE stock holdings. For example, ADIB (Abu Dhabi Islamic Bank), a company in which we have now invested for more than 4 years, had a stock price increase of over 80% in 2013 – do we view the stock as fully valued now, and should we sell a part or all of this position? In general, have the UAE markets gone too far, too fast, or is this the natural recovery of a battered equity market buoyed by a burgeoning real economy?

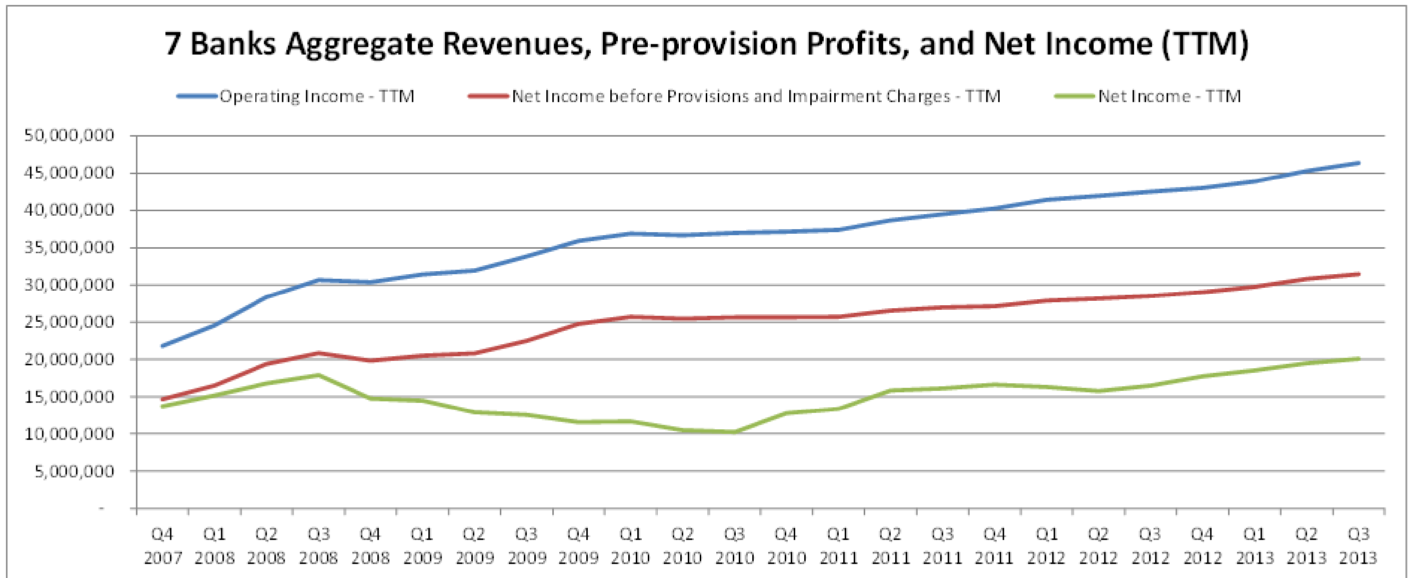
Before addressing these questions, it is worth a brief aside to summarise some of the drivers for the UAE markets that brought them to where they are today. The safe haven status of the UAE, and of Dubai in particular, was reinforced by the Arab Spring which drove additional tourism, trade, and money flows into the UAE beginning in 2011 and particularly in the second half of 2012 and the first half of 2013. Political stability, a USD peg, well-capitalised banks, favourable tax policy, a luxurious lifestyle with numerous leisure options, and low crime levels have attracted expats from the region and beyond. Demand to place cash safely has led to deposit growth for UAE banks and to a significant recovery in Dubai's residential real estate market over the last two years (prices are up 60% from September 2011 lows, per Deutsche Bank). The rise in real estate prices has given local investors greater confidence, improved collateral values and cash flow profiles, and reduced concerns on asset quality for the local banks. There have been a large number of real estate and infrastructure project announcements that have reinforced the positive sentiment toward the real estate sector and the wider economy, including a number of stalled projects launched in 2008 in addition to truly 'new' developments. Since early 2012, there have been strong economic indicators in the UAE in general (growth in airport traffic, trade flows, tourists, etc. all growing steadily, and often at double digit rates), and this is underpinned by ongoing robust oil prices. These various factors have combined to lead stock analysts to lower the discount rates used in their valuation models, while distressed valuation multiples are no longer seen as fair given the lower perceived risks to company operations. MSCI's decision to upgrade the UAE to emerging market status and Dubai's winning bid to host Expo 2020 have further boosted sentiment among residents at large. Finally, in 2013 there were very few prolonged global concerns to attract the attention of UAE investors; instead, those investors were able to focus on the improvement in their own markets. In short, there have been real, tangible improvements in the UAE economy (for Dubai in particular) and the outlook for individual listed companies, and investors have bid up UAE stock prices accordingly.

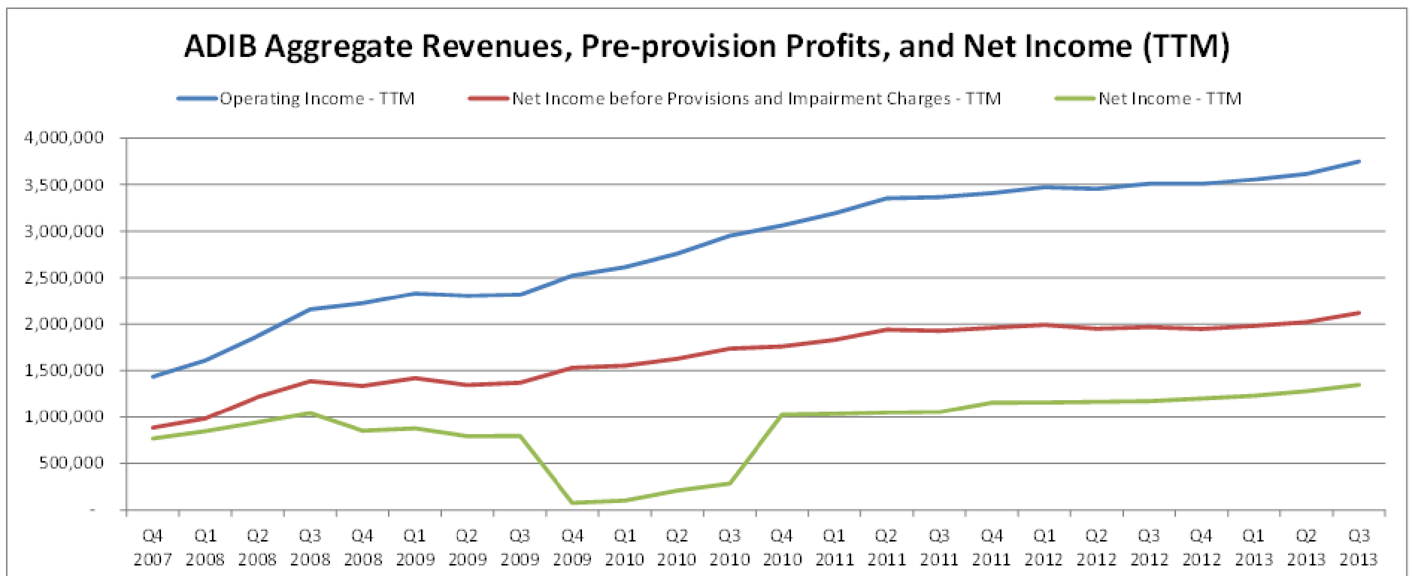
While there have been real improvements in the economy that have helped to drive up real estate and stock prices, we recognise that there are risks of overheating. Frequent announcements of grand real estate developments and elaborate infrastructure projects raise concerns of eventual oversupply and overspending. An obvious question would be, did Dubai not learn anything from the last property market crash? We think that both the authorities and local investors did learn. The authorities have put in place several real estate regulations including mortgage LTV limitations, off plan development limitations, rent caps, and higher transaction costs to reduce the ability of speculators to ladder up prices. Banks are more liquid (sector loans/deposits ratio of 93% in September 2013 vs. 110% in September 2008) and better-capitalised. With that said, we continue to pay close attention to developments on the ground, staying in touch with our contacts and continually assessing the landscape for potential concerns.

Returning to the question of whether the UAE stock markets have moved up too quickly such that valuations are no longer attractive relative to the fundamentals, our view is that prices for many companies have recovered from deeply-discounted levels to levels at which earnings growth and other fundamental factors will take on greater importance in keeping investor sentiment positive. Sentiment remains an important driver for these markets, and as a result we would expect volatility to stay elevated in 2014. We still feel that valuations for a number of companies remain attractive at current levels, though the margin of safety on valuations vs. earnings has declined.

As an example of further potential for earnings growth, if we look at the combined income statement figures for 7 large UAE banks (5 in Abu Dhabi, 2 in Dubai) over the last several years, we see that revenues for those banks continued to grow throughout that period despite the global financial crisis and local real estate crash. Profits for the banks did not see

the same growth due to higher provision charges. TTM revenues for the 7 banks as of Q3 2013 were 51.2% higher than TTM revenues as of Q3 2008 (last quarter pre-crisis). Pre-provision profits were also 51% higher in that comparison. However, earnings were up only 12.1% due to high provisions. Continued revenue growth along with lower provision charges should help UAE banks to achieve good earnings growth over the next two years. For ADIB, the comparable historical point-to-point growth rates are 74%, 53%, and 29%, respectively; and ADIB has the potential for both lower credit provisions and lower property-related provisions going forward.





Our thesis is this: We believe that the UAE markets remain an attractive place to invest with a long-term view. We believe the country has a clear vision, and a clear target date to meet in hosting Expo 2020, such that long term stock price appreciation is likely for the best companies regardless of intermediate price volatility. Valuations are not deeply discounted in the way they were at the start of 2013, but if we look at a two to three year time horizon then attractive valuations are still available. In addition to these tangible drivers of growth and price appreciation, there's no doubt that an important intangible, namely investor (and even to an extent 'man on the street') confidence, has returned to Dubai, buoying spirits and markets simultaneously. As long as this confidence doesn't morph into unsustainable hubris, we see few roadblocks on the UAE's growth path in 2014.

SNL - (Saudi new Labour)

"Reform is not pleasant, but grievous; no person can reform themselves without suffering and hard work, how much less a nation" **– Thomas Carlyle**

"The labour market in Saudi is going through a transitional phase" is somewhat of an understatement, as the picture is more of a "pan to fire" persuasion; however, the end goal definitely makes good sense. The pan: historically, labour laws were being abused by rent-seekers taking advantage of the huge supply of unskilled workers targeting Saudi Arabia for the large governmental spending programs, which has led to an unsustainable structure that in turn has fuelled an increasingly dependent populace. With this in mind, it is certainly true that the need for reform has been urgent for some time, and after much rhetoric the opportunity eventually presented itself with the passing of the previous labour minister, opening the door for the recent reforms lead by Dr. Adel Fakih.

The ministry of labour has swiftly rolled out a number of initiatives that have been viewed as aggressive towards the private sector especially (hence the fire metaphor). As they try to correct problems that have been rooted in the economy for a couple of decades, certain pains are unavoidable, and the route that seems to have been mapped out is perhaps the most direct, albeit most painful. In short, private sector companies are now forced to deal with employing Saudi nationals at a higher cost, and finding legal expats to employ after the deportation of 1.2mln foreigners (mostly illegal undocumented labour), or quite simply shut down. Harsh? – yes. Necessary? – probably.

However, what many critics do not vocalise, is that it is very important for the long-term welfare of the nation that its people start to learn initiative and ultimately be able to work independently. Cultivating a sense of purpose in a population that has long been pampered and has suffered from an acute sense of entitlement was never going to be an easy task; and disappointingly, we will not be proposing any revolutionary solution to this quandary in this letter. The truth is that we don't know; but whatever shape or form the answer takes, one thing is for certain, it will take a long long time.

Despite the harshness of the current plan, there are definitely changes that we are happy to see take place. Critically, the government is pushing for more development in education and training, increasingly investing in the development of human capital, which has been ignored for far too long. A good example of this is the King Abdullah Scholarship program where any Saudi national can go and study at a reputable university of their choosing, in the west or the east, with full government backing that includes tuition, housing, stipend and travel (the latter point is one of the drivers for our investment in Al Tayyar which we discussed earlier in the letter). The hope is that this platform will launch a generation of open-minded Saudis who will serve as the building blocks of a more sustainable and prosperous Saudi Arabia.

Of course with any programme that is this revolutionary, criticism will hail from all directions. However, as we have suggested, we don't feel there can be a simple answer, and we are certainly not prepared to offer an alternative solution. What we do feel however, is that there is a need for better coordination between the government initiatives and the programmes they are implementing, as this would lead to increased efficiency and hopefully quicker results. In an unprecedented move to increase transparency (another positive change), the ministry of education disclosed recently that the majority of its annual budget (87% or SAR 102.6bln) covers salaries of teachers, instructors…etc. While the infrastructure of schools and universities require a lot of catch-up to be up to standards, we have often thought that Saudi has never spent enough on the human capital. Perhaps it's a not a case of how much is spent, but rather whom it is spent on.

On the other hand, these labour reforms are hitting some sectors more severely than others. In particular, as a result of the shortage of unskilled labour and the ensuing ripple effect along the supply chain, a distinct slowdown in construction activity has been witnessed. However alarming this reaction may be, it is expected to be a short term glitch as contractors adjust to the new market dynamics. The long-term hurdle will take the shape of lower profitability as G&A expenses rise on the back of evolving Saudisation rules; the expectation is that there will be a 2% margin compression.

Over the next stage of this young country's evolution, we would like to witness two developments. The first is that the private sector needs to come to terms with the new norm, and embrace this transition instead of treating it as a tax for operating in the Kingdom (the truth is, that it has been too easy for too long). Secondly, Saudi youth must realise that the mantel of responsibility falls squarely on their shoulders (after all, around 50% of the population is below 25 years of age), and the reality is that Saudi cannot afford to run with the same welfare state as do its neighbours. Today's younger Saudi's will have to lead very different lives to those of their parents.

Portfolio Review:

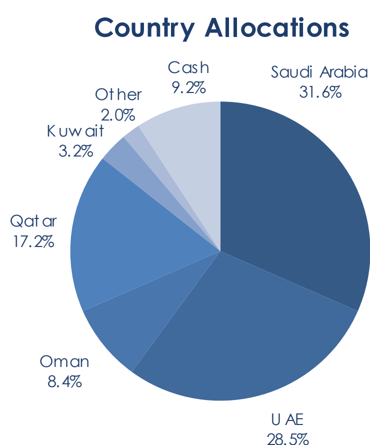
Many stories blossomed in the portfolio this year and out of the top five positions that we held at the beginning of 2013 only two remain in the top five; the first is Tayyar and the second ADIB which has held a consistent spot in our top five for three years now. Ironically, the top five currently represent the lowest concentration within the portfolio since 2009, with only 37% concentration; however, we continue to find breadth that we are developing in order to play a more major role within the portfolio. Today's market velocity is making the role out of these developing stories more challenging, but there are certainly great potential companies which will represent important attributions within the portfolio over the coming three years. We thank you for your continued support as investors in the fund.

Ajeej MENA Fund Historical Performance

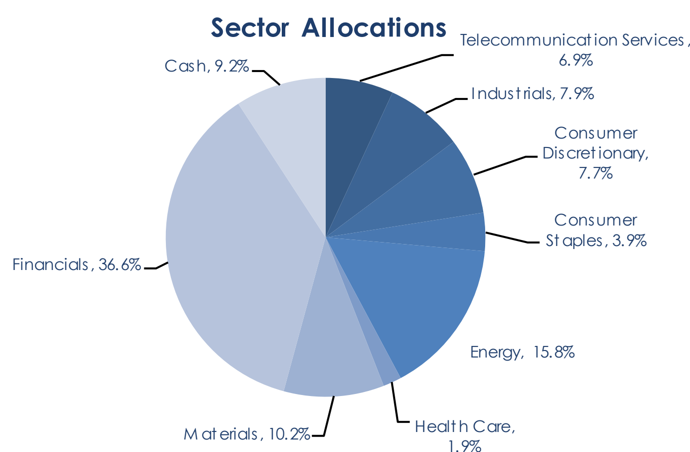
Annual Returns	2007	2008	2009	2010	2011	2012	2013	Since Inception
AMF %	25.7%	-47.4%	16.1%	6.6%	6.3%	11.6%	57.4%	53.1%
S&P Pan Arab %	23.5%	-51.6%	13.6%	11.4%	-12.7%	3.6%	21.7%	-16.8%

2013 Monthly	J	F	M	A	M	J	J	A	S	O	N	D
AMF NAV	104.2	106.4	111.7	119.9	128.0	126.1	137.7	136.0	138.3	141.6	145.1	153.1
AMF %	7.2%	2.2%	5.0%	7.3%	6.7%	-1.5%	9.2%	-1.3%	1.7%	2.4%	2.5%	5.5%
S&P Pan Arab	687.2	681.8	682.9	695.9	716.5	704.2	741.4	729.1	749.9	763.5	780.9	806.4
S&P Pan Arab %	3.7%	-0.8%	0.2%	1.9%	3.0%	-1.7%	5.3%	-1.7%	2.9%	1.8%	2.3%	3.3%

Country Allocations



Sector Allocations



Top 5 holdings in the Ajeej MENA Fund

- Gulf International Services, **8.7%**
- Abu Dhabi Islamic Bank, **8.2%**
- Al Tayyar, **7.7%**
- Saudi Telecom Company, **6.9%**
- Emaar Properties, **5.2%**

Ajeej MENA Fund	December-2013
Return, MTD	5.49%
Return, YTD	57.44%
Return Since Inception	53.05%
Annualised 30d Volatility (on NAV)	3.80%
Sharpe Ratio Absolute	9.40
Alpha Benchmarked on S&P Pan Arab Composite YTD	35.70%
Value at Risk (VaR) - 95% (for the monthly holding period)	1.90%

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