2023 AJEEJ CAPITAL ANNUAL INVESTOR LETTER

"Where cruelty and injustice are concerned, hopelessness is submission, which I believe is immoral."
— Edward W. Said

TL; DR:

A short rant – MENA, especially the GCC, has transformed to one of the most attractive EM opportunities whilst outperforming across most metrics, yet it is predominantly ignored.

Diverging Tides – The current environment in the region will benefit fundamental allocators with differing dynamics across the region's markets.

DXB + RUH – Dubai and Riyadh have become two of the most exciting and dynamic global cities, with an undeniable gravitational pull for talent and investment.

Saudi Safari – a first person account of a Saudi family vacation taken in Q4 by an Ajeej team member and her family.

Porcelain Jubilee – Contrasting Saudi's positive capital market development over the past 20 years, relative to the devolution experienced by Egypt and Kuwait over the same period.

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Dear Investors,

First and foremost, we are saddened and aggrieved by the ongoing pain and tragic events that continue in our region and beyond. Our hearts and prayers go out to all those who have suffered and are suffering, and we wish peace and health for all in 2024.

The Ajeej MENA Fund Class A and Class L shares returned net +26.9% and 31.5% respectively for the year, driven primarily by Saudi and UAE holdings, vs. the MSCI Arabia NTR Index which returned +7.8%.

Before diving into our annual commentary in earnest, we wanted to take the opportunity to sound out a gripe – the absence of meaningful long term foreign institutional capital in our region, which continues to baffle us. So, please bear with this brief 16-year retrospective ***(in brackets you'll find the most common excuses we heard over each period)***:

2007-2008 *(hot money years – region wasn't ignored)*: We launched the AMF in 2007. In the first 9 months, leading into summer 08, MENA was all the rage, with investors from LA to Geneva to Tokyo allocating to a predominantly Saudi-light MENA opportunity. However, as equity, and more broadly, investing risk appetite waned in the latter half of 2008, it became obvious that most of who had entered the region were playing a dollar/oil carry trade rather than investing for the long term.

2009-2010 *(MENA is off benchmark)*: In the post Financial Crisis recovery, MENA was forgotten as EM markets rallied; Egypt was the exception to this, being an active EM market at the time (more on this towards the end of this letter).

2013-2015 *(not significant enough in the benchmark)*: Fast forward three years and one Arab Spring later, the fundamental value in MENA should have been impossible to ignore, but most large institutional allocators succeeded in the impossible, and wholeheartedly continued to snub the region. This is despite us, and our peers, pushing the value & growth story as much as possible. Through these years, the lower gulf markets topped EM performances, pulling the rest of the region in their wakes.

2017-2019 *(only focused on China & India)*: Then starting in 2017, the regional giant Saudi began stirring, and since then the Saudi market and the rest of the GCC have continued to differentiate themselves from regional peers, EM peers, horizon peers, global peers and generally most groupings investors could silo markets in.

2020-Present *(too much going on elsewhere in our portfolios, no interest in EM)*: Led by Chinese headwinds, EM became increasingly underweight as investors struggled with portfolio liquidities hampered by hyperinflated PE and VC allocations. This time, however, decreased interest in MENA and the GCC was coupled to EM disinterest. This is despite the GCC benefitting from the same global forces that hurt broader Emerging Markets, while providing a largely FX free high growth alternative to global equity allocations.

To summarise our region's degree of outperformance over the past 16 years please note the following. **MENA has returned 82% vs. EM's 25% vs. Brent's -3% vs ACWI's (ex-US) 44%.** Notably, this is while MENA managers, without loss of generality, have consistently beaten a clearly outperforming benchmark in EM.

Ok, rant now over…

Navigating Diverging Tides: 2023 In Review

As we enter the new year, it's a fitting time to reflect on the dynamic landscape of the Middle East, and how our core GCC markets and our portfolio have navigated its choppy waters in 2023. While overarching themes painted broad strokes across the region, it's the nuance within each market and ultimately, as with most years, stock selection that defined our journey.

Regional Tides:

The GCC witnessed a sharp dichotomy in 2023 with a rising tide lifting select boats while others remained anchored. Saudi Arabia's continued rollout of Vision 2030, its economic diversification plan, took centre stage, fuelling small and mid-cap rallies. Investors flocked towards names that embody the kingdom's vision – infrastructure, healthcare, tourism, and modernisation. In contrast, petrochemicals languished, caught in the crosswinds of a weak commodity cycle, while banks remained subdued, impacted by tight liquidity and rising interest rates. Overall, the Tadawul returned +14.2% for the year.

Across the border, Dubai's sun shone brighter than Abu Dhabi's. The emirate's burgeoning real estate sector, the ever-reliable ENBD, and recent high-profile IPOs like Taaleem and Salik led the charge. While Abu Dhabi's IPOs continued their strong showing, the broader market lacked Dubai's vibrancy, with the ADX falling -6.2% for the year vs. the DFM's increase of +21.7%.

Qatar's World Cup afterglow failed to illuminate the market (+1.4%), with subdued activity post-event. Kuwait's performance (-4.7%) painted a picture of stagnation – a lack of catalysts, out-of-favour large-cap banks, company-specific headwinds, and especially the cyclical government structural stalemate weighed heavily.

Navigating the Currents:

Our portfolio mirrored these shifting currents, with thematic alignments dictating performance. In Saudi Arabia, we rode the diversification wave, reaping the rewards of companies like Maharah (human resources), Seera (tourism), Riyadh Cables (infrastructure), Al Arabia (media), and Luberef (refining). These names embodied the themes propelling the small and mid-cap surge, delivering significant value to our investors.

Dubai's development boom resonated with our portfolio as well. We benefited from the ascent of Emaar, Emaar Development, ENBD, Salik, and Empower, all key players in the emirate's transformative trajectory, and its continued gravitational pull from other major global hubs, further cementing its reputation as a global city. These robust performers offset the softer Qatari exposure through holdings like QNB, IQ, and Nakilat, which reflected the market's post-World Cup doldrums.

Looking Ahead:

As we enter 2024, the region's trajectory remains positive relative to potential challenges elsewhere in EM. Saudi Arabia's diversification play will accelerate in 2024, with an expected focus on developing Riyadh specifically, after the announced award of Expo 2030; this will sustain a fertile landscape for continued selective outperformance. Dubai's momentum has slowed from the post-COVID surge; however, we expect it to continue being positive and present further opportunities in its real estate and infrastructure sectors, with a stickier population; this is notwithstanding rumours of several promising IPOs on the horizon. Qatar's potential to rebound post-World Cup remains real, fuelled by its 5-year gas infrastructure buildout from which GISS and Nakilat should be prime beneficiaries. In terms of a value investment in the GCC, there are few better choices at this point.

As those of you who have followed over the years will remark, we have neither discussed Egypt in our 2023 review comments, nor in our 2024 outlook. This is not by error, as we have a negative view of the country's current path economically, fiscally, and politically [evidenced by its over 30% cost of equity]. Despite Egypt's perennial potential, until the picture across the Red Sea dramatically changes, we will maintain our focus on the growing opportunities in the GCC.

In navigating these diverse currents, we remain committed to our active, thematic investment approach. We constantly refine our analysis, identifying the companies best positioned to capitalise on the region's evolving landscape. We are confident that our unwavering focus on these priorities, coupled with our deep understanding of the GCC markets, will continue to deliver superior returns for our investors in the months and years to come.

Thank you for your continued trust and partnership. We look forward to keeping you updated on our progress and the exciting journey ahead.

Dubai and Riyadh's Excellent Adventure

Hungover In Dubai: As the dust settled from the Global Financial Crisis and the Arab Spring, both Dubai and Riyadh staggered under the weight of their early Aughts economies. In Dubai a glut of debt and half-built skeletons of residential and office towers beckoned economic refugees from the Arab Spring, but most saw Dubai as a temporary resting place and by 2015 had returned home to Egypt and the Levant.

Gloomy In Riyadh: While in Saudi decades of bloated government support payments to citizens reached its zenith in 2013, with 'special gifts' to government employees seemingly arriving monthly alongside generous university scholarships abroad, government sponsored vehicles and residences, and more, all aimed at alleviating the gloom of living in a Riyadh where music, entertainment, even simple strolls outside were largely banned by the sclerotic theocracy.

Escape Velocity: The transformations in both cities in the decade since are remarkable and should be remarked upon. Visionary leadership, a steely determination to welcome the world even in the face of external prejudice and the internal resistance of older generations, and of course a little luck has propelled both cities towards gigacity status over the past half decade. The ghosts of the past still loom (the as yet unfinished Riyadh Metro and Riyadh's gruesome traffic, the still mythical Dubai Waterfront project and Arabian Canal), but the conversion of potential energy into kinetic in both cities is a unique, durable achievement.

Hustle Culture: In Riyadh, MBS harnessed the potential energy of the city (its youthful population and petro-wealth) and launched it firmly into orbit as a centre for business in support of Vision 2030, and also as a centre for sports (World Cup 2034), and for international tourism (Expo 2030). More importantly, with the cutback of allowances, the introduction of 5% VAT (raised to 15% in 2020), and the launch of a rate-subsidised mortgage market alongside a revitalised Saudisation campaign across blue- and white-collar jobs, Riyadh's population of sleepy shisha smokers and desperate midnight car-racing drifters transformed into an army of hustlers working long hours in buzzing co-ed coworking spaces and coffee shops. How do you build a gigacity in Riyadh? With 3 million bored 25-year-olds holding university degrees and a surfeit of nationalism!

Saudis Just Want to Have Fun: The social transformation that accompanied the economic transformation of Riyadh is no less important nor less astounding, and in fact without this liberalisation, the economy would have stalled out, unable to shift gears without the lubricants of art and music. The Saudi creatives who traditionally fled to New York or London, the financiers who preferred Dubai, and the families who escaped Riyadh to Kuwait City and Doha at the weekends now firmly prefer Riyadh, with its Season, its burgeoning art and music scene, and the muscular dealmaking that underlies Vision 2030.

Dubai's Vision – Execution Gap Narrows: From the 1960s dredging of Dubai Creek to the launch of Emirates Airline in the 1980s, Dubai never lacked vision, but inconsistent execution and a lack of stable management repeatedly hobbled that vision. This is attributable to the misaligned cultures of Dubai's citizens and its transient residents who saw Dubai as a sort of seasonal fairground where they could work and play before moving on to other, better places. Today, there is no better place in the world than Dubai for its 3.3 million non-citizen residents. The emirate boasts world class infrastructure for both domestic and international travel, a private school system that generates excellent results for students at all tuition levels, long term visas for white collar workers, and short-term visas for those starting out and for entrepreneurs, and an ineffable sense of optimism and drive that permeates the city.

Dubai's Sustainable Future: The world has voted with its feet, and they have voted for Dubai, with the population nearly doubling in the past 15 years and is expected to double again. Moreover, those in Dubai continue to see the duration of their residence extend, and increasingly the emirate is adopting regulations that support retirees as well, although this is still in its earliest stages. Dubai and the broader UAE have also deepened their investment in postsecondary education and now actively encourage international university graduates to remain in the UAE to work. As a place in structural climate crisis due to the boiling summer temperatures, we as a team based in Dubai have great faith that the UAE will provide the world with innovation on the climate front, as it already leads in water recycling, solar energy generation, and district cooling.

A Tale of Two Gigacities: The next two decades will see both Riyadh and Dubai mature as global gigacities, driving innovation, creativity, climate solutions, and infrastructure development. As the Expo 2020 Dubai theme song aptly put it "This Is Our Time."

Porcelain Jubilee: 20 Years of Transformation

The Capital Markets Authority (CMA) in Saudi Arabia recently celebrated its 20th anniversary, marking a momentous occasion for the region's youngest regulator. While celebrating this "Porcelain Jubilee," it's also apt to reflect on the remarkable progress Saudi has made compared to two other darlings of institutional investors 20 years ago: Egypt and Kuwait.

Imagine stepping back in time to 2003. The Saudi market was a fledgling compared to its current form. With barely 100,000 registered trading accounts, it operated as a plain vanilla cash market, reliant on T+0 settlement and devoid of an independent custody structure. Tradeable indices? Foreign access? Forget it. The landscape was dominated by banks, and sophisticated financial instruments like shorting, futures, and programmatic trading were non-existent. IPOs were scarce, market manipulation controls rudimentary, and transparency minimal. Annual reporting resembled cryptic Arabic statements printed in miniature in the morning papers – magnifying lenses were a must! Orders were limited to simple market and limit instructions, and the fledgling Tadawul hadn't even achieved Frontier Market status.

Fast forward two decades, and the transformation is nothing short of breathtaking. Saudi Arabia now boasts the 5th or 6th largest Emerging Market (EM) crown, proudly sitting amongst the G20 giants. It attracts the largest cohort of foreign investors in the region, both public and private, and stands as the only market in the region to harbour active participation from global financial powerhouses like Goldman Sachs, Morgan Stanley, and HSBC. DVP/RVP trading is the norm, programmatic trading thrives, and liquidity steadily climbs. Most importantly, Saudi achieved the unprecedented feat of bypassing Frontier status entirely, landing directly in the coveted EM realm. Today, it ranks as the 6th largest EM, eclipsing established names like Mexico, South Africa, and Thailand.

This meteoric rise hasn't exhausted the orchard – Saudi, arguably, presents one of the most enticing EM opportunities globally. The "low hanging fruit" of progress has yielded sweet returns, and plenty of ripe apples remain for the picking.

Now, let's rewind to a contrasting picture: Egypt in 2003. With nearly 20 names gracing the MSCI EM roster, it found itself under the watch of the same portfolio managers who navigated the waters of Greece and Turkey. Having weathered the storm of a historic devaluation (2001/2) under astute technocratic leadership, the country exuded an air of outward-looking economic and trade potential. It was regularly touted as one of the top EM investment destinations, witnessing a currency appreciation from 7.5 to 5.7 EGP/USD between 2003 and 2008. This vibrant era attracted global heavyweights to its shores, eager to tap into the potential of telcos, cements, banks, and fertilisers in the MENA region's crown jewel.

However, this renaissance proved tragically short-lived. The double whammy of the financial crisis and the Arab Spring dealt a devastating blow, ushering in an era of decline and irrelevance. With the technocrats ousted and a military despot at the helm, Egypt's EM allure faded into dim memory. Today, it remains in EM only as a legacy, with only 1 listed company meeting broad EM inclusion criteria; and even that lone survivor will ultimately capitulate as devaluations continue into the foreseeable future.

The continuously weakening Egyptian Pound has arrested most economic development, as well as reduced remittances by Egyptians abroad. Capital controls have stifled local spending, with the only exceptions being direct investments in real estate and the stock market – both artificially propping up prices in EGP. Sadly, the conflict in Gaza has improved El Sisi's political position internally, with security trumping the economy in the short term, and alleged billions being funnelled into the country to maintain elements of the status quo at the Rafah border.

Across the Arabian Peninsula, Kuwait in 2003 presented a contrasting picture. It reigned as the GCC's most active market, renowned for its forward-thinking approach and sophisticated investor base. The Kuwait Investment Authority (KIA), established in 1953, held the esteemed title of the world's oldest sovereign wealth fund. Its largest blue chip financial institution, National Bank of Kuwait, was endearingly termed the Goldman of the Middle East. In terms of politics and governance, it was ahead of its time in the GCC, with a meaningfully influential parliament, and one of the most diverse ministerial rosters globally.

However, while Saudi Arabia soared, Kuwait's trajectory diverged. Regulatory hurdles, a risk-averse culture, and limited economic diversification weighed heavily, leaving the once-vibrant market struggling to keep pace with its ambitious neighbour. Today, while Kuwait continues to be investable, there is a distinct shortage of attractive opportunities available to fundamental investors, made all the more poignant when meeting companies on the ground, as C-suite executives are more often interested to discuss the merits of investing in Saudi or the UAE.

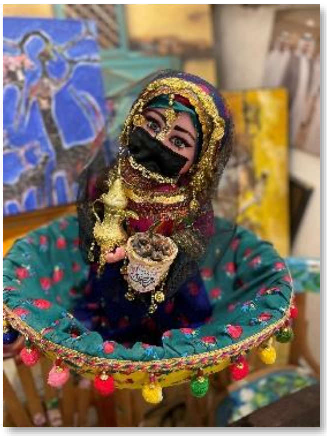
The stories of these three markets offer a compelling lesson in the dynamic nature of economic and market progress. While initial promise doesn't guarantee sustained success, decisive reforms and visionary leadership can propel seemingly nascent markets to dizzying heights. As Saudi Arabia celebrates its Porcelain Jubilee, its future appears dazzlingly bright, with the potential to continue outshining its former regional peers. The low hanging fruit has been savoured, but a bountiful harvest still awaits – a testament to the transformative power of ambition and strategic execution. Egypt and Kuwait, 20 years ago, may have been the darlings of foreign investors, but driven by poor leadership and weak long-term thinking, both have lost their lustre. The former has become uninvestable despite real fundamental potential. The latter’s black-box status has only darkened, and with the apparent lack of economic top-down zeal, it has become uninteresting to investigate further for many investors.

Saudi Safari – Frances’ Family Trip Diary

“I took my family on a 10-day trip to Saudi Arabia, and it was the trip of a lifetime.” A sentence I couldn’t have imagined writing 3 years ago, yet alone 5 years ago. And yet it stands. That sentence, and the experience, best captures how much Saudi Arabia has already transformed itself, but also how much remains to be done in developing secular domestic tourism and consumer services, generally.

In late November, we travelled as a group of 10 to Saudi Arabia for my father's 70th birthday, ranging in age from 1 to 71. We visited five cities and numerous museums, restaurants, petrol stations, and playgrounds as we used planes, trains, automobiles, and even a telefrique to explore the Arabian Peninsula.

And while Al Ula was visually stunning and historically rich, and moreover a testament to how wonderful thoughtfully planned touristic development can be (looking at you, hideous Giza plateau), the stars of our trip were the delightful Saudis we met; a demonstration that Saudisation done right is amazing. From Saudi hotel chefs who awoke at 5am to prepare a fresh breakfast for us before an early departure, to our fantastic female Saudi tour guides in Taif and Jeddah, to the friendly Saudi waiters who didn't bat an eye over toddler antics, and to my children's favourite Saudi fishmongers in Jeddah who let them help arranging the catch, we felt welcomed everywhere.

Moreover, we felt Saudis themselves celebrated with us as they enjoy the re-awakening of their country to its own rich history.

Of course the public equity markets were never far from my mind, and we used the products and services of numerous Saudi listed companies…booking travel with Mosafer (Seera Group), rental cars from Budget Saudi, sampling catering on the Haramain High Speed Train from Catrion, searching for SADAFCO ice cream and Almarai croissants (7 Days) in rural petrol stations, late night visits to a Hyperpanda (Savola), photographing Riyadh Cables' cables being used to expand rural power lines, and visiting several Aldrees petrol stations on rural highways. Product quality, service, availability, and value for money was good overall, making me even more bullish on the Saudi economy.

Without further ado, as is our family tradition when travelling, I present the High / Low / Buffalo (unexpected) of visiting Saudi Arabia as a tourist:

Highs: too many to count, of course, that's why we can't wait to go back!

- **Diriyah / Turayf (old Riyadh)** and the many thoughtful, small museums scattered through the complex. Our crew loved the weaponry museum and the museum dedicated to the Arabian horse.
- **Caravans by Habitas / Habitas Al Ula:** we had heard and seen so much about the resort, but it surpassed our high expectations. While Hegra was incredible, it was playing dominos on oriental rugs under a giant communal tent at Caravans that was a highlight for us all, prompting my father to say this was the most relaxed he could ever remember being.

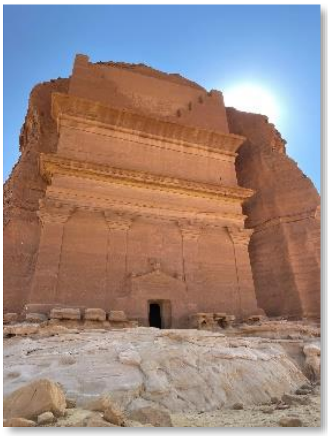
Lows: a few, more to do with the perils of travelling with small children than with Saudi itself.

- **Basic tourist infrastructure** such as site maps, detailed guidebooks, and just general instructions for tourists was lacking. I imagine that it's all in progress, though, since there was much more at Al Ula than in Riyadh or Jeddah.
- **Weirdly rigid baggage rules on the Haramain train from Jeddah to Madinah** although an employee explained that they are directly penalised if non-standard luggage is allowed, so we ended up complying, of course.

Buffalos: magical trampoline canyon at Habitas Al Ula would be the universal choice of the younger half of our party.

- **Meeting Saudi female artists, chefs, writers, and other creatives** was incredible for all of us. These women break every stereotype about Saudi and should be the country's cultural ambassadors.

- **The Strawberry Farm of Taif.** No words can describe how utterly kitsch, charming, and fun this tiny strawberry farm and associated 'village' was for all. Highly recommend their homemade strawberry ice cream!
- **The Khaybar Oasis** is halfway between Medinah and Al Ula. The recently re-developed oasis was a highlight of our trip, especially the Saudi concert pianist playing 'Baby Shark' on a piano under the date palms for my 1-year-old.



In conclusion, as the Saudi e-visa website says: Visit Saudi!