NORTH AFRICA

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Northern Africa provides a strong economic backdrop for investors looking to capitalize on elevated growth, excess liquidity, improved living standards, buoyant resource prices, economic reform, and increased foreign investment. At present, Egypt, Morocco and Tunisia serve as the primary investment destinations although Algeria, Libya and Sudan have drawn interest as well. It is important to note that Egypt, Morocco and Tunisia have independent stock exchanges with sufficient capital market liquidity (Table 1). This article is designed to provide a brief macroeconomic overview of the region, including forward-looking growth prospects and risk considerations.

NORTH AFRICA - Capital Market Data (USD)

TABLE 1	Market Capitalization	Average Daily Trading Volume	Number of Listings	P/E	Div Yld
Egypt	$164.1 bn	$376.3 bn	425	19.4	2.2 %
Morocco	$77.9 bn	$38.7 bn	75	43.8	2.7 %
Tunisia	$6.2 bn	$2.8 bn	54	19.1	2.8 %

Egypt

Egypt continues to benefit from economic reform and is set to continue its run of impressive real GDP growth having averaged 7% over the past two years. Bullish investment themes include gradual reduction of fuel subsidies, use of privatization to lower public sector debt, arrangements to enhance tax collection, continued consolidation of the banking sector, and a renewed focus on infrastructure investment. Over the past year alone, fuel and energy subsidies have declined -37.5% to 8% of GDP. Privatization remains an attractive means of fundraising as evidenced by the USD 1.6 billion sale of Bank of Alexandria. Tax collection initiatives include implementation of value-added tax, property tax, customs reform, and implementation of single Treasury account to prevent off-budget expenditure. Consolidation within the banking sector has seen weak banks exit the market, large-scale financial restructuring, buyout of non-performing loans, and enhanced banking supervision. Infrastructure investment has primarily focused on energy, health care, and transportation with hospitals and motorways witnessing notable improvement.

EGYPT - Largest Companies by Market Capitalization (USD)

TABLE 2	Sector	Market Capitalization	P/E	Div Yld
Orascom Telecom Holding SAE	Telco	$16.306 bn	7.6	0.9%
Orascom Construction Industries	Industrials	$15.627 bn	22.3	1.3%
Telecom Egypt	Telco	$6.367 bn	14.9	5.0%
EFG Hermes Holding	Fiancials	$15.627 bn	16.6	1.8%
Egyptian Co for Mobile Services	Telco	$6.367 bn	10.9	5.3%

Risks to the Egyptian outlook include accelerating in ation, rising unemployment, and poverty. In ation is presently running at 12%, unemployment at 9.3% and approximately 17% of the population lives below the poverty line. In addition, the current account surplus will continue to deteriorate as a result of domestic absorption growth, increasing import exposure and moderating export demand.

Although tourism, workers remittances and revenues from the Suez Canal will help offset the weaker BoP position, the country's reliance on continued FDI in ow should grow substantially. With a 25.2% trailing P/E premium to the MSCI EM Index, Egyptian equities appear somewhat expensive on a relative value basis. Furthermore, the country's 2.2% dividend yield is low in absolute terms.

Morocco

Morocco suffered below average GDP growth in 2007 as a weather-related drought impacted much of the country's agricultural output. Morocco is still heavily reliant on its agricultural sector which presently accounts for 20% of GDP and 40% of national employment; this is the second-largest non-oil GDP in the Middle East/North African region. Services makes up more than 50% of GDP with tourism contributing significantly to the nation's current account surplus (40% of total receipts). Tourism is expected to attract much of the region's future FDI as evidenced by the recent announcement that France's Pierre et Vacance will invest USD 420 million in a massive resort project in numerous parts of the country. Economic conditions have begun to normalize with many economists calling for 6% real GDP growth in 2008 & 2009.

MOROCCO - Largest Companies by Market Capitalization (USD)

TABLE 3	Sector	Market Capitalization	P/E	Div Yld
Maroc Telecom	Telco	$24.247 bn	22.3	4.5%
Attijariwafa Bank	Banks	$8.575 bn	2.3	1.5%
Douja Promotion Groupe Addoha	Property	$8.278 bn	187.2	0.6%
Banque Marroc. du Commerce Ext	Financials	$6.904 bn	n/a	0.9%
LaFarge Cements	Constr.	$5.506 bn	32.7	2.2%

Risks to the Moroccan outlook include overexposure to highly volatile sectors such as agriculture and tourism. In addition, Morocco will be quick to feel the ancillary impact of a European slowdown as France and Spain are its two largest trading partners. It should be noted that the government has actively attempted to diversify its domestic revenue base away from agriculture and tourism by assisting in the development of small and medium-sized businesses. The country's relative proximity to Southern Europe makes integration with the EU a primary objective. With a 182.6% premium to the MSCI EM Index, Moroccan equities are clearly overpriced. Current valuations also appear stretched on a historical basis, as the CFG 25 has risen more than 300% over the past five years.

Tunisia

Tunisia benefits from a diverse economy with significant agriculture, mining, energy, tourism and manufacturing sectors. Manufacturing industries, producing largely for export, are a major source of revenue. Industrial production accounts for nearly 30% of GDP and primarily consists of petroleum, mining, textiles, footwear and food processing. Historically, textiles have served as a major source of foreign currency revenue although the country's competitiveness has deteriorated since 2005 when the Multifibre Agreement with Europe expired. Nearly 60% of GDP is now service-related with tourism serving as a primary driver of economic performance. It should be noted that Tunisia receives a steady in ow of tourists as it is highly ranked by tourism/travel boards in both Africa and the Middle East. The country's long-term commitment to macroeconomic stability traces back to the 1990s when Tunisia acceded to the GATT and entered into an Association Agreement with the EU. Today, the European Union is Tunisia's largest export partner and serves as a key source of tourists. In short, Tunisia has evolved into one of the region's true success stories as it presently boasts 5 – 6% real GDP growth and relatively benign in ation. Foreign direct investment remains strong and the government has had little trouble raising debt via the global fixed income markets.

TUNISIA - Largest Companies by Market Capitalization (USD)

TABLE 4	Sector	Market Capitalization	P/E	Div Yld
Banque de Tunisie	Banks	$781.7 mn	21.1	1.8%
Banque de l'Habitat	Banks	$579.2 mn	13.4	1.3%
UBCI	Banks	$518.3 mn	27.5	2.5%
Banque Internat. Arabe de Tunisie	Banks	$405.5 mn	28.6	3.3%
Societe Tunisienne de l'Air	Airlines	$276.9 mn	9.3	1.2%

Risks to the Tunisian outlook include rising energy prices (country is a net importer of hydrocarbons) and soft European growth as France, Italy, Germany & Spain are the country's primary trading partners. Furthermore, Tunisia suffers from above average levels of both poverty and unemployment. At present, more than 50% of the population under the age of 25 is unemployed, including many young and well-educated members of the population. With a 23.2% trailing P/E premium to the MSCI EM Index, Tunisian equities are moderately overpriced on a relative value basis. Although Tunisian equities offer better value than those listed in Egypt and Morocco, the set of listed investment opportunities is much more limited and liquidity conditions are considerably tighter.

Algeria

Algeria is a pure play for energy bulls as hydrocarbons account for 98% of the country's export revenue and 77% of government funding. Although proven oil reserves remain modest (12.3 billion barrels; 1.363 million barrels/day), the country's massive natural gas reserves (162 trillion cubic feet) make it the 8th largest player in the world. Algeria is a major gas exporter to southern Europe, and with two new gas pipelines set to come online in 2009 we should see export growth of nearly 40% in 2009. At present, Algeria has estimated FX reserves of USD 105 billion and its USD 43 billion Revenue Recognition Fund is the 13th largest sovereign wealth fund in the world. Because of its large and growing current account surplus, the government has focused on diversification and infrastructure spending while improving its creditworthiness by paying down external debt.

Risks to the Algerian outlook include terrorism as recent attacks have given foreign investors room for pause. Although private sector investment remains slow, we've seen some encouraging signs such as Renault's announcement to build a USD 1 billion auto manufacturing plant. Unemployment remains a problem with nearly 11.8% of the population out of work. The banking sector remains underdeveloped although a plan to modernize the Bourse des Valeurs Mobilieres d'Alger is presently being considered by the Commission d'organisation et de surveillance des operations de Bourse (COSOB).

Libya

Libya provides an attractive backdrop for those looking to play the bullish energy theme as hydrocarbons presently comprise 95% of total exports. As a result of its large proven oil reserves and small population, Libya presently exhibits the largest real GDP growth (7 – 8%) and current account surplus (49% of GDP) of any country in Northern Africa. Economic reform has been a driving force for growth since the UN lifted sanctions in 2003. The country has reduced subsidies, initiated privatization programs and applied for membership to the WTO. Interestingly, Libya enjoys a comparatively low level of poverty and the government provides extensive social assistance by way of housing and education. Of note, the Libya Oil Reserve Fund is the 12th largest sovereign wealth fund the world with USD 47 billion in assets under management.

Risks to the Libyan outlook include reliance on energy sector as declining energy prices and softening global demand could derail future growth. Libya suffers from poor climatic conditions and low-quality soil which limits agricultural output, as a result the country imports 75% of its food. Although non-oil manufacturing and construction accounts for roughly 20% of GDP, the services industry is relatively immature. Tourism is on the rise however and the government has embarked upon a massive overhaul of Libyan airports. Nevertheless, decades of state-dominance have resulted in a weak private sector where entrepreneurial skills are limited. Libya is also marked by high levels of unemployment and an underdeveloped banking sector. Although the Libyan Stock Exchange was established in June 2006, it presently has little to no trading volume.

Sudan

Sudan boasts a highly diversified resource pool although its landlocked status places it at a distinct disadvantage when compared to its North African peers. The economy is driven by the agricultural sector which employs 80% of the workforce and contributes 40% to GDP. Petroleum production promises to take on a much larger role going forward as it presently accounts for 89% of exports. As a consequence of the US trade embargo, Sudan's primary trading partners are Asian with China, Japan, South Korea, Indonesia and India serving as the largest importers of Sudanese oil. Sudan has limited industrial development although there is a small amount of agricultural processing and auto manufacturing, among others.

Risks to the Sudanese outlook stem from a lack of sufficient infrastructure and political instability. Transport facilities consist of one single track railroad with a feeder line, supplemented by river steamers. Similarly, motorways are all but nonexistent and consist of some paved and graveled roads surrounding Khartoum and Port Sudan. Electrical generation is sorely inadequate with the primary source being hydroelectric. Political instability is a key consideration as Sudan is deeply divided between Northern Muslims and Southern Christians. Accentuating the issue is the fact that Southern Sudan is minerally rich relative to the politically dominant North. Poverty is severe with nearly 40% living below the poverty line and unemployment of nearly 20%.

Conclusion

Northern Africa is not a homogeneous group of countries and there are large differences in wealth, industry, competition, regulation, and human capital across the region. Yet while excessive inequality leads to inefficient allocation of resources and possible poverty traps, it also presents ample opportunity for profit. By focusing on fundamental macroeconomic themes, investors are able to consistently capture alpha on a forward-looking basis. Macroeconomic themes which resonate with today's North African investors are global convergence, resource strength, democratization, and urbanization. Global convergence refers to North Africa and its position relative to the rest of the world. Resource strength relates to the region's abundance of energy and commodity-related assets. Democratization suggests the presence of free and fair elections, but also portends reduced political risk, declining incidence of corruption and improving conditions for future investment. Urbanization denotes the rapid growth of metropolitan business centers, and typically heralds shifting patterns in domestic consumption and business investment, among other factors.

Looking ahead, North African economic growth will likely be driven by country-specific economic fundamentals, commodity prices, and domestic policy actions designed to deal with in ationary pressure. Egypt, Morocco and Tunisia should continue to benefit from positive foreign direct investment and improving liquidity. Algeria, Libya and Sudan are poised to benefit from an abundance of natural resources and increased integration into the global capital markets. Overall, we are bullish on the region as the macroeconomic backdrop remains positive and the set of available investment opportunities continues to grow.

Jenni Chamberlain is Director of Finch Asset Management Ltd. ("Finch") and Portfolio Manager for Finch Africa. Finch Africa generates risk-adjusted absolute returns through investment in undervalued African and Africa-related securities. Launched in June 2006, the Portfolio combines fundamental stock picking methodologies, detailed due diligence and a macro view of the continent when considering investments. The primary focus is Sub-Saharan Africa, in particular those nations with active African Stock Exchanges. Returns are denominated in USD.

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