



## EGYPT: FACING THE UNKNOWN

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Riots requesting a new beginning continue to grow; army considers people's demands legitimate

Quick transition of power key to stemming concerns; Foreign Investor confidence expected to slowly improve as stability unfolds

Investing opportunities may arise in Egyptian stocks as valuations become attractive on the condition that unrest is not prolonged

### Mubarak concedes but staying in power is not an option

We continue to closely monitor the situation in Egypt and provide an analytical framework of the repercussions caused by the recent upheaval. Opposition groups remain active with their main initiative being the ousting of Mubarak. This comes even after several concessions were made by the long-serving president such as reshuffling the existing cabinet, replacing the interior minister who heads the internal security forces, and appointing his first-ever Vice-President.

The newly appointed Vice-President, Omar Suleiman, is the country's intelligence chief and is viewed as Mubarak's right hand man. In the case that Mubarak steps down, Mr. Suleiman is the likeliest successor to head the state as he enjoys the support of the intelligence community and the U.S and is on good terms with the army. However, he may not be the one that the people are calling for.

Recognizing the gravity of the situation, Mubarak requested from his newly appointed Prime Minister, Mr. Ahmed Shafiq, and his Vice-President to pursue dialogue with the opposition in the formation of a new cabinet emphasizing the need to control unemployment and keep inflation in check. However, we are now inclined to feel that Mubarak is getting ready to step down yet doing what is necessary to ensure his party remains in power. The people clearly stated that they wouldn't negotiate as long as Mr. Mubarak remains in office. Even the Egyptian armed forces which have been a pillar of support for Mubarak have issued a statement indicating that they considered the demands of the people "legitimate" and promised not to use force against them. Additionally, the U.S. indicated that they do not see any scenario in which Mr. Mubarak will stay in power for long.

Another likely outcome we anticipate is the immediate removal of the current Parliament whose election this past fall was viewed as illegitimate due to the government meddling in the election process.

**Quick transition of power key to stemming concerns**

Today marks an important milestone as the opposition braces for a million-strong march while supporters of Mubarak also prepare for a demonstration in Ismailia. We anticipate that the current unrest will likely lead to the formation of a transitional government which will put in place the necessary legal reforms to organize the upcoming elections. A quick transition of power to an interim government is key to stemming financial and security concerns caused by the protests.

As for concerns surrounding the Muslim Brotherhood controlling the new government, while it does enjoy the support of 15% - 20% of the population and will surely constitute a part of the new government, we believe they are unable to form a majority since the army and most of the people do not support them.

**Shut-down of plants and Egyptian Bourse**

On the business front, multinational companies shifted from advising employees to stay home into ordering plant shutdowns and flying expatriate staff out of the country. Operations for most companies are expected to resume once security conditions improve.

Employees cannot receive their paychecks as banks remain closed during a time when most Egyptians receive their monthly salary. With Egypt being mostly a cash society where grocery stores refuse to sell on credit and ATMs are empty of cash, people are ending up with no money in hand and are borrowing from friends or resorting to eating the cheapest foods.

The Egyptian Stock Market remains closed for the third straight session on Tuesday and will shut down on Wednesday with no clear indication as to when it will reopen. The consensus is that it is evaluated on a day-by-day basis and will resume operation once the tensions in the street ease. On its last operating day before the turmoil began, the EGX30 plunged by almost 11%, its second largest drop ever, after dropping 6% the preceding day. This brings a total drop estimated around 16% since tensions began with a final closing of 5,646 for the EGX30.



Source: Reuters

At the current prices, if the unrest does not especially extend for a prolonged period, investing opportunities may arise in Egyptian stocks as valuations become attractive. Several large companies rely for the majority of their revenue on business outside of Egypt which therefore will not have an adverse effect on the company's bottom-line as represented by the plunging share prices.



## Short Term View: Quick fixes and capital outflows to compound economic woes

Regardless of the political outcome, Egypt's economy has already sustained a blow whose short term effects will continue to reverberate at least until the next six months, slowing down the country's growth rate and potentially delaying what could have been a period of further economic reforms.

Primarily, and at the current status quo, Egypt's newly appointed cabinet will likely shift its attention to the country's political setting. Economic concerns on the other hand will be dominated by quick fixes of food and energy subsidies to mitigate the protestors' agitation. Such actions will take their toll on the country's public money, and replace potential longer term plans with short-term and counter-efficient spending. Nevertheless, this form of subsidy and aid spending will only be fitting to quell the uprising for the time being; especially that it was the dissatisfaction with living standards and spiking prices that fueled the protests.

The prices of Egypt's basic foods have moreover soared during the first week of unrest. The Prices of vegetables such as potatoes is estimated to have increased by 75%, whereas staple bread has been put under a purchase quota.

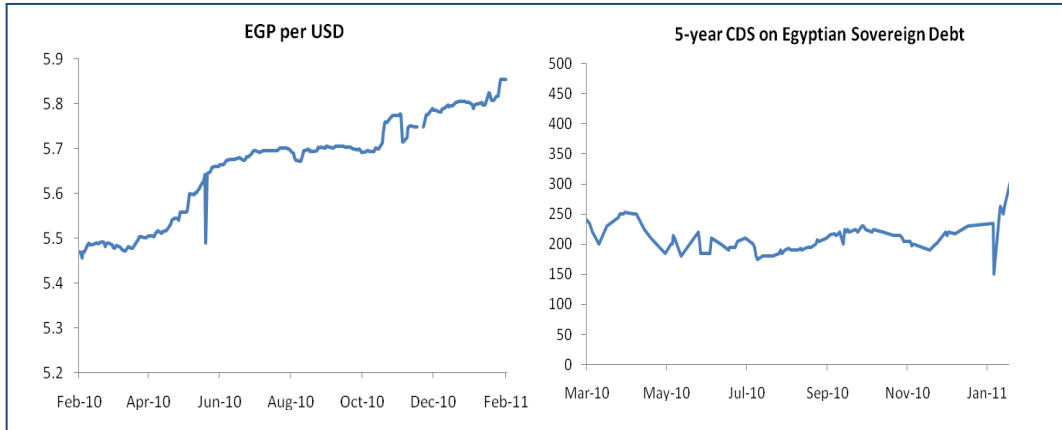
One of the bigger concerns to the economy over the short term lies in the possibility of continued capital outflows. The panic that was seen on the market during the first few days of protest forewarned of a severe liquidity drought that might occur if the uprising is not resolved. Preliminary estimates reveal that almost \$2 billion had flooded out of Egypt's banks and portfolio investments before the markets closed on Thursday. Markets were closed on Sunday due to security reasons, but it is feared that more money will find its way out of Egypt once the financial markets recommence operation. Furthermore, the Egyptian pound is set to face a strong downward pressure as citizens begin to exchange it for more stable foreign currencies, and knowing that, traders bet against its value.

Egypt's Central Bank (ECB) is nevertheless adequately equipped to deal with capital outflows, hoarding an estimated amount of \$55B in foreign currencies. The ECB's interference in the Forex market will nevertheless prove problematic to its foreign reserves, especially if it continues to hedge for the EGP's value against strong sales. Conversely, if the government decides on non-interference, the Egyptian pound will likely witness a severe slump that would spike the prices of imported goods. This would also influence the government's ability to subsidize staple foods as more than 50% of Egypt's wheat and corn demand is imported.

## Medium Term View: Higher interest rates with investor confidence slow to improve

When normalcy is restored over the medium term, Egypt will see a slow recovery in markets and investment confidence of foreigners will likely be the slowest to improve. On the fiscal front, new government debt will be extremely difficult to issue at comparable interest rates prior to the revolt. The government will have to offer considerably higher yields, at least primarily, and tire its public capabilities.

Rating agencies have already begun to downgrade Egypt’s foreign debt. Moody’s has cut Egypt’s foreign-currency bonds to Baa3 from Baa2 and foreign currency bank deposits to Ba3 from Ba2. S&P has similarly hinted at the prospective fiscal troubles of the entire North African Region. Egypt’s short term Eurobonds yield an 8.75%, an already high rate. Short term Egyptian Pound Treasury Bills conversely already yield much higher rates at around 11%. Such setbacks to Egypt’s debt will in turn affect the Banking sector’s rates, veering downwards business lending and potentially slowing the recovery.



Source: Reuters

Naturally, Egypt will also suffer setbacks in several of its international receipts. Foreign direct investment (FDI) will not necessarily flee from the country but new investment will slow down until confidence is restored. Egypt’s Tourism sector, which had become an important source of capital after the number of tourists to Egypt reached the 12 million mark, will be negatively affected. Suez receipts will also depend on the status quo of Egypt’s security. Oil prices for example have spiked over the past week to hover around \$100 per barrel on fears that shipping through the Suez Canal will cease.

On a positive note, international organizations such as the IMF have expressed their willingness to lift Egypt from its downturn, possibly through capital injections that would heighten confidence into its financial system.

**What change means for major Egyptian equities**

Most of the stocks listed in the EGX30 are companies that have maintained extremely positive relationships with the ruling party, which is the National Democratic Party. Board members in many of these companies are members of parliament which is viewed as illegitimate by the people due to the government interfering in the elections. Below we discuss some of the major stocks that may be affected with a new government.

**Ezz Steel** Stock: ESRS.CA

Ahmed Ezz, the chairman and managing director of Ezz Steel, is a close confidante of Mubarak’s son and a member of parliament since 2000, which sets him as a target for protester criticism. According to Al Jazeera, he has resigned from Mubarak’s National Democratic Party after protesters ransacked and burned one of his company’s main offices in the Mohandiseen area. Opposition parties have been accusing Ezz of monopolizing the steel industry in Egypt by holding a major market share, backed by the government.



**Talaat Moustafa Group** Stock: TMGH.CA

Controversy surrounding Hisham Talaat Moustafa, the former chairman and managing director of TMGH, continues as reports of his escape from prison arise on Monday. More importantly, the legal issues regarding the land ownership for Madinaty, which constitutes 66% of TMGH's land bank may regain spotlight as President Mubarak was personally involved in issuing a quick fix that had no material impact on TMGH.

Orascom Group: was founded in 1976 by Onsi Sawiris and was split into three separate operating companies that are now run by his three sons. It is worth noting that Sawiris is a Coptic Christian family that prospered for three decades under Mubarak's government.

**Orascom Telecom Holding** Stock: ORTH.CA

Naguib Sawiris, the chairman and managing director of ORTH, is personally and commercially connected to Egypt's government elite. Mubarak's son is a significant shareholder in Orascom and its affiliates, as well as a personal friend of Sawiris.

**Orascom Construction Industries** Stock: OCIC.CA

Nassef Sawiris, the chairman and managing director of OCIC, is a member of the Business Secretariat of the Egyptian National Democratic Party, the current ruling party.



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