October 3, 2016

Devaluation this week?

Media has gone haywire about devaluation within the next few hours, with analysts and reporters asking the same questions over and over again. Is it really this morning or through Tuesday's FX auction or Wednesday before the long weekend?

What we know and what we don't know

Let us put things into perspective before answering these questions that mostly focus on the timing, which in our view comes secondary to how devaluation would happen and how effective it will be.

USD funding pledges were made, but have the funds been transferred?

The government has agreed on several funding packages with Saudi Arabia (USD2-3 billion) and China (USD2 billion), but as far as we know, those funds have not been transferred yet, and had not reflected on NIR. If the funds have been transferred, then no announcements have been made 'in an attempt' to surprise the market with devaluation timing.

Does it have to be 'before' the IMF annual meetings or 'around' that time?

The IMF annual meetings are scheduled for October 7-9, but it is not a must that we devalue ahead of the meetings to prove to the IMF good faith. If devaluation is part of the deal with the IMF, which we know it is, there must have been an agreement between the government and the IMF on the devaluation rate and timing. There has to be a plan. We do not see the IMF request a devaluation ahead of their approvals over concerns the CBE would not devalue post-package approvals. Devaluation would be around the IMF annual meetings and not necessarily before.

The foreign exchange rate is closely tied to the timing

If devaluation did happen this week, or as far as we know, pre-transfer of the pledged financing packages, the rate has to be high enough to blow the parallel market and attract supply of USD into the banking system (EGP12.50+). If the government has an 'edge-closer' plan for devaluation, with a rate of EGP11.00-11.50 in mind, a solid buffer of USD liquidity within the banking system is needed to convince market participants that this is a fair market clearance rate. We do know that the IMF agreement entails NIR build-up, which means that the funding packages have to be well-rationed and not utilized in currency defense. We reiterate that our theoretical FV for the EGP/USD rate is around 11.75, and even if overshooting in rate did happen, eventually the rate should come down to these levels.

Reiterate: 'When' is not the focus; 'How' is our key concern

We reiterate our view. It is not about devaluation or its timing. It is already too late. It is about availability and rate or how devaluation will be executed to blow the black market and attract the FX supply into the banking system, since it is currently circulating through parallel market channels.

EGX to rebound in anticipation of currency movement; Financial institutions and real estate sectors in focus

EGX should start the week on a positive note in anticipation of the currency movement this week. Farther trend will be dictated by the actual devaluation rate versus rate expectations and signs of foreign investor confidence in the system. The market will trade within the 7,900-8,500 range and foreign participation will be a key catalyst to drive another EGX spike. Banks' margins will continue to benefit from the hike in rates, given the high allocation to treasury investments. If FX shortage is resolved, balance sheet growth will revive. We like CIEB and HDBK. EFG-Hermes and EK Holding are well positioned in their respective space and offer good value/growth dynamics. Real estate developers (TMGH, PHDC, OCDI) will continue to deliver strong results, driven by higher inflation/devaluation concerns. Do not forget land bank owners (MNHD). High infrastructure spending beneficiaries including Orascom Construction and El Sewedy Electric are amongst our picks. ORWE is another industrial player, shielded from FX shortage and a direct beneficiary of export incentivizing programs. SKPC and AMOC revenues are USD-based and driven by tight PE and refining markets, respectively, which creates a decent upside, in addition to potential attractive dividend yield.

Radwa El Swaify
Head of Research
radwa.elswaify@pharosholding.com

ANALYST CERTIFICATIONS AND REQUIRED DISCLOSURES ON LAST PAGE OF THIS REPORT

Sales and Trading

Mohamed Radwan
Head of Equities
+202 27393680
mohamed.radwan@pharosholding.com

Ahmed Raafat
Local Institutional Sales
+202 27393687
ahmed.raafat@pharosholding.com

Sherif Shebl
Regional Sales
+202 27393679
sherif.shebl@pharosholding.com

Ahmed Abutaleb
Foreign Sales
+202 27393684
ahmed.abutaleb@pharosholding.com

Seif Attia
High Net Worth
+202 27393682
seif.attia@pharosholding.com

Disclaimer

This Report is compiled and furnished solely for informative purposes to be considered by the intended recipients who have the knowledge to assess the information contained herein. Pharos Research (‘Pharos’) makes no representation or warranty, whether expressed or im¬plied, as to the accuracy and/or completeness of the information contained herein or any other information that may be based on the data/ information enclosed. Furthermore, Pharos hereby disclaims any and all liabilities of any nature relating to or resulting from the use of the contents of this Report. This Report shall not be approached as an investment solicitation nor shall it be considered as legal or tax advises. Pharos highly recommends that those viewing this Report seek the advice of professional consultants. None of the materials provided in this Report may be used, reproduced or transmitted, in any form or by any means, electronic or mechanical, including recording or the use of any information storage and retrieval system, without written permission from Pharos.

This report was prepared, approved, published and distributed by Pharos Securities Brokerage company located outside of the United States (a “non-US Group Company”). This report is distributed in the U.S. by LXM LLP USA, a U.S. registered broker dealer, on behalf of Pharos Securities Brokerage only to major U.S. institutional investors (as defined in Rule 15a-6 under the U.S. Securities Exchange Act of 1934 (the “Exchange Act”)) pursuant to the exemption in Rule 15a-6 and any transaction effected by a U.S. customer in the securities de¬scribed in this report must be effected through LXM LLP USA.

Neither the report nor any analyst who prepared or approved the report is subject to U.S. legal requirements or the Financial Industry Reg¬ulatory Authority, Inc. (“FINRA”) or other regulatory requirements pertaining to research reports or research analysts. No non-US Group Company is registered as a broker-dealer under the Exchange Act or is a member of the Financial Industry Regulatory Authority, Inc. or any other U.S. self-regulatory organization.

Analyst Certification. Each of the analysts identified in this report certifies, with respect to the companies or securities that the individual analyses, that (1) the views expressed in this report reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly dependent on the specific recommendations or views ex¬pressed in this report. Please bear in mind that (i) Pharos Securities Brokerage is the employer of the research analyst(s) responsible for the content of this report and (ii) research analysts preparing this report are resident outside the United States and are not associated per¬sons of any US regulated broker-dealer and that therefore the analyst(s) is/are not subject to supervision by a US broker-dealer, and are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with US rules or regulations regard¬ing, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account.

Important US Regulatory Disclosures on Subject Companies. This material was produced by Analysis Pharos Securities Brokerage solely for information purposes and for the use of the recipient. It is not to be reproduced under any circumstances and is not to be copied or made available to any person other than the recipient. It is distributed in the United States of America by LXM LLP USA and elsewhere in the world by Pharos Securities Brokerage or an authorized affiliate of Pharos Securities Brokerage. This document does not constitute an offer of, or an invitation by or on behalf of Pharos Securities Brokerage or its affiliates or any other company to any person, to buy or sell any security. The information contained herein has been obtained from published information and other sources, which Pharos Securities Brokerage or its Affiliates consider to be reliable. None of Pharos Securities Brokerage accepts any liability or responsibility whatsoever for the accuracy or completeness of any such information. All estimates, expressions of opinion and other subjective judgments contained herein are made as of the date of this document. Emerging securities markets may be subject to risks significantly higher than more estab¬lished markets. In particular, the political and economic environment, company practices and market prices and volumes may be subject to significant variations. The ability to assess such risks may also be limited due to significantly lower information quantity and quality. By accepting this document, you agree to be bound by all the foregoing provisions.

LXM LLP USA assumes responsibility for the research reports content in regards to research distributed in the U.S. LXM LLP USA or its affiliates has not managed or co-managed a public offering of securities for the subject company in the past 12 months, has not received compensation for investment banking services from the subject company in the past 12 months, does not expect to receive and does not intend to seek compensation for investment banking services from the subject company in the next 3 months. LXM LLP USA has never owned any class of equity securities of the subject company. There are not any other actual, material conflicts of interest of LXM LLP USA at the time of the publication of this research report. As of the publication of this report LXM LLP USA, does not make a market in the sub¬ject securities.