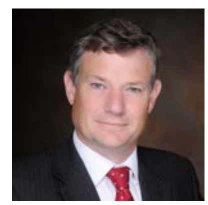
OPPORTUNITIES SCARCE IN A MUTED MOROCCO

DECEMBER 2018



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Argentina and Kuwait, the two largest country weightings in the MSCI Frontier Markets Index, are set to be reclassified to the Emerging Markets benchmark over the course of the next two years. If these upgrades play out as proposed, Morocco's weight in the Frontier Markets Index would increase to 11.2%[1], making the North African country the second largest in the Frontier universe.

We have struggled to find compelling investment ideas in Morocco in the past, as growth rates are low and valuations are expensive. In addition, not many companies regularly publish results in English or have functioning investor relations departments – while few take the time to visit London to try and attract investors.

With all this in mind, our Frontier Markets analysts Seun Oyegunle and Mark Lawrence recently visited Morocco to get a sense of how things felt on the ground and re-review investment opportunities. The October visit was centred around a major conference, allowing Seun and Mark to meet a number of key public companies.

- Morocco is different from the average Arab country. Its geographical location lends itself to strong links with Europe and its managed currency peg is to the euro, as opposed to the common US dollar peg implemented by neighbours.
- While the aftermath of the Arab Spring was tough on Morocco's economy, deficits are now on a narrowing trend as the government moves away from infrastructure spending in favour of supporting export-led growth. Important exports include phosphates, textiles and electric components.
- Consumption, a major driver of the economy, is currently under pressure. The gradual removal of subsidies and efforts to rebalance terms of trade have taken its toll. We see this persisting for some time.
- Our most interesting meetings were with select export-oriented and consumer companies, which are well-positioned for market share gains.

[1] Source: MSCI. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed or produced by MSCI.

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Morocco has been a monarchy for more than 13 centuries. While the Arab Spring was hard on its economy, it managed better than others with the help of sensible reforms and a devolvement of power from the monarchy. This provided a more stable political environment. While still home to twin deficits, balances have trended down from 2012 peaks, with help from the government’s attempts to substitute infrastructure-driven with more export-led growth. Specifically, Morocco has been successful in attracting European car and aerospace manufacturers. These efforts have come alongside the reduction of subsidies and other inefficiencies in the economy, but the side-effect is a weak consumer environment.

While the Moroccan economy has steadied, gross domestic product (GDP) growth has historically been volatile, as agriculture has been an important driver. Growth is set to come in at 3% this year, below the 5% target economists believe is necessary to maintain a stable backdrop for its 35 million population[2] – which has a young median age of 27. Foreign Direct Investment (FDI) has been stuck at the US$3bn[3] mark for a decade, accounting for a small portion of inflows. The government is focused on continuing to boost FDI into export-oriented industries – such as its automotive, aeronautics and tourism sectors. If successful, this could help create jobs for the country’s highly skilled and cheap labour force, and take advantage of close ties to Europe.

First on our agenda was a review of the banking sector. We met with Attijariwafa Bank, alongside an economist from Morocco’s central bank. We used to own the leading Moroccan bank in our Frontier portfolio but sold it in 2017 after a period of strong performance – particularly as our view of earnings growth became more muted given the expensive valuation.

What was evident from our meetings was the fact growth rates across the sector remain low, in large part because there has been little credit demand over the past six years. Most banks are looking to Africa for future growth opportunities, but experience in these markets has been mixed. More positively, non-performing loan ratios show an improving trend across the system, which should eventually feed through to margin improvement.

[2] Source: IMF World Economic Outlook, November 2018
[3] Source: IMF World Economic Outlook, November 2018

We had more exciting meetings in other sectors. We met with food retailer Label Vie, currently our largest holding in Morocco. It operates 75 stores – the bulk of which are Carrefour supermarkets, after Label Vie entered a strategic partnership with the French multinational in 2009. Label Vie ran into issues between 2010-2016 after making a series of metro 'cash and carry' acquisitions. It also launched a hard discount chain, but it struggled to integrate the three formats and business models. However, 2017 was a turnaround year and management has started to open new stores again, guiding for 15-20 new supermarket openings per annum[4]. Carrefour stores are also gaining market share. As organised retail has a penetration level of just 15% in Morocco, Label Vie may benefit as the sector modernises.

We also met with leading port operator Marsa Maroc, where we own a small position, due to its liquidity. The company undertook an IPO in 2016 and since then has vastly improved communication with investors and corporate governance. Marsa handled ~40m tons of traffic in both 2016 and 2017 across it 11-port presence. It has benefitted from multiple infrastructure projects, such as the country's wind farm project and a coal-fired power station – where the bulk of materials were imported via Marsa's ports. It commands a container market share of 42% in Morocco, which it aims to stretch through the creation of a more international presence and offering logistics services to select large clients.

Our Moroccan visit was broadly in line with our expectations and we remain comfortable with our 6% underweight (as at 30 September 2018). Morocco's economy has certainly stabilised, but growth rates are relatively stagnant and lack catalysts – especially as the government reins in spending and as FDI remains muted. Nevertheless, we have still found a few idiosyncratic growth opportunities, which also score highly on corporate governance and transparency. We have topped up our position in Label Vie and continue to research the opportunities and risks for Marsa Maroc, as well as one or two other companies.

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Transactions in securities denominated in foreign currencies are subject to fluctuations in exchange rates which may affect the value of an investment. Returns can be more volatile than other, more developed, markets due to changes in market, political and economic conditions. Investments are less liquid than those which trade on more established markets.

[4] Source: Label Vie Management Team

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