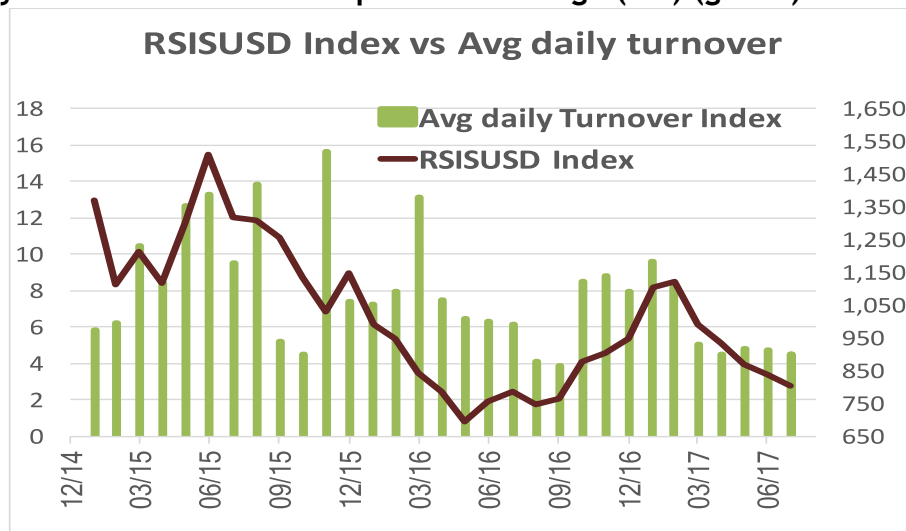


A review of the Iraqi Equity Market for July 2017

Ahmed Tabaqchali 04 August 2017

The equity market, as measured by the RSISUSD index was down -4.4% for the month, recovering from lows of -10.0%, on further declining turnover. The average daily turnover for July was about 10% lower than the average of the prior four months in which the market was declining. The average turnover during the up months, i.e. November-February, was about 1.8 times the levels of those of the down months (chart below) lending support to the bottoming/recovery thesis following the -68% decline from the early 2014 peak to May 2016 bottom.

Avg. daily turnover Index on Iraq Stock Exchange (ISX) (green) vs RSISUSD (red)

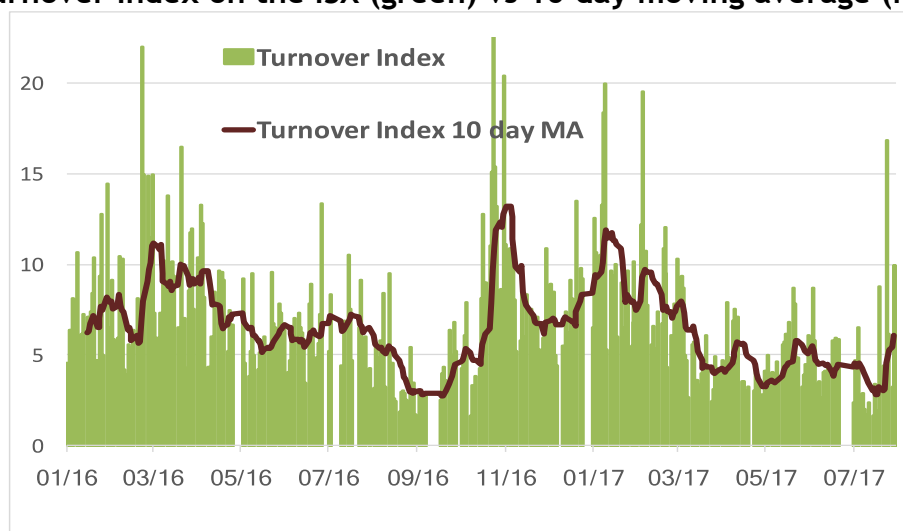


(Source: Iraq Stock Exchange (ISX), Rabee Securities, AFC)

(Note: Regular trading and excludes transactions by insiders/strategic holders whether local or foreign)

The same pattern was seen during the month with the average daily turnover on the days leading to the -10.0% drop was about a third of that during the days in which the market recovered (chart below). While a few days does not make a trend, never the less this is a positive indicator.

Turnover Index on the ISX (green) vs 10 day moving average (red)



(Source: Iraq Stock Exchange (ISX), AFC)

(Note: Regular trading and excludes transactions by insiders/strategic holders whether local or foreign)

Foreign selling continued to weigh on the market with the associated fears of the effects of further selling. In particular, as [reported last month](#), one of the bluest chip banks bore the brunt of selling declining -9.5% in June following declines of -5.3% & -17.8% for the last prior two months respectively. This had a knock-on effect on other banks which declined in-tandem and dragged the market with them given the sector's dominance of trading on the ISX. While this continued in July with the bank declining a further -4.5%, before local investors encouraged by low valuations and a 10.5% dividend yield declared at the AGM, held mid-month, started buying in size, which in turn provided a boost to sentiment with a pick-up in both prices and turnover in other banking stocks. Although, local retail trading is dominated by speculation, yet locals tend to appreciate the true values of local assets especially at extreme valuations and, at least now, seem to have acted upon this. This is the opposite of last year when equally attractive valuations failed to inspire such buying, however, banks then were still facing a difficult year ahead, had much lower levels of profitability which affected dividends and crucially local liquidity was still being squeezed.

The last 3 years were extremely challenging for banks in Iraq, however, the peak of the conflict post Mosul coupled with the reversal of the factors that crushed the economy should have an expansionary effect on the economy and thus provide the banks room to recover further and grow. These were discussed in a [recent article](#) in Iraq Business News. Current local liquidity is in the early phases of recovery and as such even this pick-up will likely be uneven and overtime.

The table below is a snapshot of current valuations of three of the bluest-chip banks, but to appreciate the significance a quick review of the banking sector:

- Less than 20% of the population have bank accounts and out of those that do, about 60% have their deposits & loans with state banks which in turn control over 90% of the country's total assets and deposits;
- Lending is a small part of most bank's income stream which is mostly from trade related fee income, other fee income, interest income from T-Bills, and deposits with the Central Bank
 - *Note: The loan figures used below do not take into account the risk exposure that banks assume in issuing LC/LG's*
- Banks are extremely liquid; most assets are in cash and equivalents
 - *Note: Cash is defined as cash deposits with other banks & with the Central Bank of Iraq (CBI), cash equivalents are mostly CBI & Ministry of Finance T-Bills;*
- Book values are understated vs banks elsewhere given the low interest income generation and the high dividend-pay-out ratio.

Bank	YTD	P/B	Dividend yield	Market cap/ Assets	Market Cap/Cash	Payout ratio	Cash/Assets	Cash + equivalents/Assets	Loans/Assets	Loans/Deposits
Bank of Baghdad	-22%	0.6	10.9%	12.9%	25.6%	86.5%	50.4%	71.7%	10.0%	15.9%
Al-Mansour Bank	-18%	0.7	6.6%	15.2%	21.5%	86.7%	71.0%	88.6%	9.4%	12.6%
Commercial Bank of Iraq	-12%	0.4	6.0%	21.5%	78.7%	85.8%	27.3%	96.6%	2.3%	8.2%

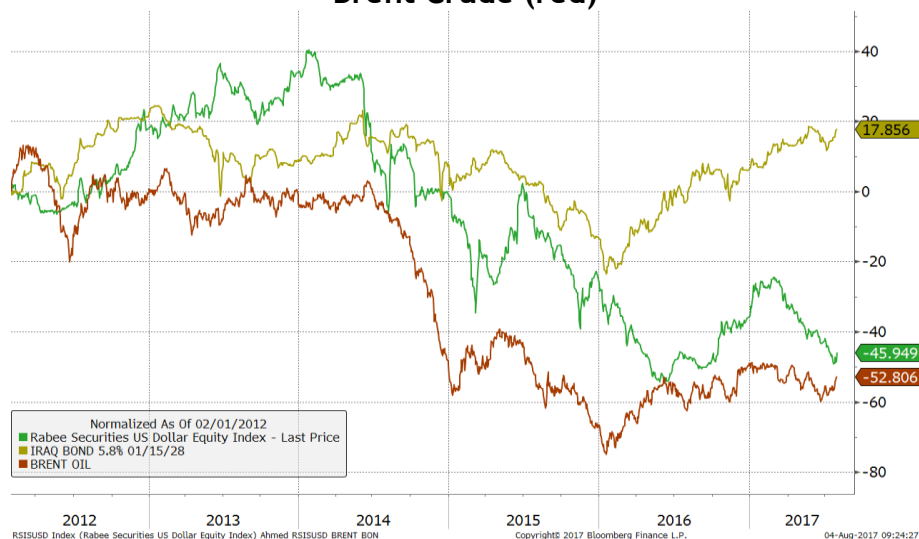
(Source: Company reports, ISX, AFC, Data based on latest trailing 12 month)

(Note: Prices as of 31 July 017. Fundamental Data from the latest quarter (unaudited) and not average of last two years as in the last few quarters some banks have cut their loan books significantly through increased provisions and write-offs & enforcing loan repayments)

In a first for Iraq, the country priced a USD 1 bn of independently fully syndicated 5 year bonds at a yield of 6.75% that was about 7 times oversubscribed. Prior offerings were parts of a support program; in 2006, it issued USD 2.7bn as part of a restructuring of earlier debt while in February of this year it issued USD 1 bn bond guaranteed by the US at a yield of 2.15%. The pricing coincided with the news that the IMF completed the second review of the Stand-By Arrangement with the release of USD 0.8 bn in further loans. At the time of writing, the current bond rallied further to yield 6.5%, clearly implying a favourable interest by global institutional investors, which should lead to an acceleration in the current FDI flows and eventually will be followed by equity inflows.

While it is true that no correlation lasts forever, the disconnect between the equity market action and that of the bond seems to be similar to the same disconnect that took place in the first half of 2016 (see below). The explanation, logically, should be the same, namely that the Bond, which trades institutionally & internationally, is not subject to the local liquidity constraints that continue to affect the local equity market.

Rabee Securities' RSISUSD Index (green), Iraq's USD 2.7 bn Bond (gold) and Brent Crude (red)

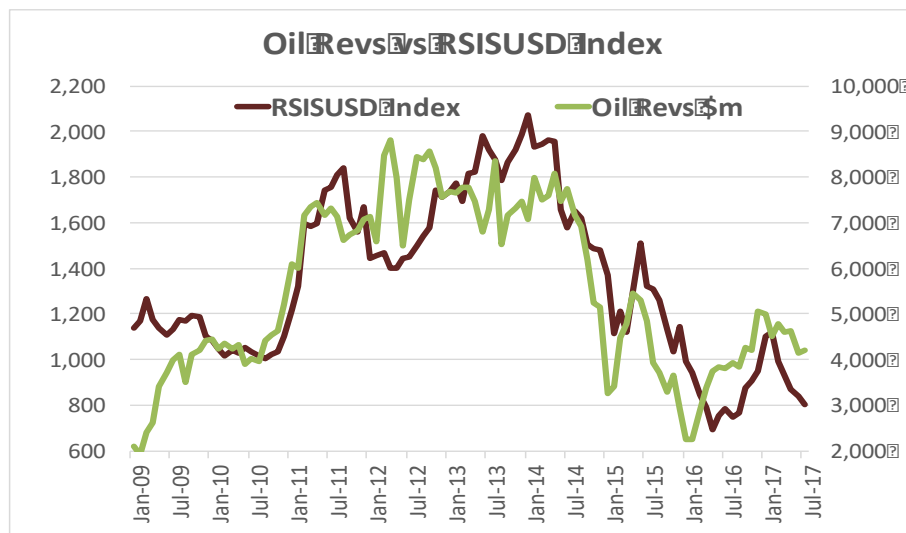


(Source: Bloomberg as of 01/08/2017)

Finally, as if on cue, oil prices recovered strongly during the month with Brent recently trading at over USD52 from a low of about USD 44 adding further support to sentiment towards Iraq. Oil market sentiment seemed to have shifted from the thesis of ever increasing shale oil growth to: (1) of focusing on the effects of decline rates of both non-US & non-OPEC production due to the cuts in capital spending in response to low oil prices over the last few years; and (2) emerging bottlenecks in shale production. In a nutshell, the said decline rates, suggest that the growth last year in shale oil masked declines in non-US & non-OPEC production which will only accelerate in a few years just as shale oil production growth will moderate.

For Iraq, higher oil prices give a boost to government finances, given the sensitivity of the budget to production & prices which was explored in the later

part in [May's market update](#). The chart below highlights the sensitivity of the market to oil revenues especially since the decline in oil prices from mid 2014 onwards as shown in the red shaded areas. While oil revenues play a huge part in Iraq's economy, other factors such as FDI's & economic expansion play major roles as can be seen the weaker influence of oil prices on the direction of the equity market shown in the green shaded areas.



(Source: Iraq Ministry of Oil (MoO), Rabee Securities, ISX, AFC)

(Note: Oil revenues data from MoO as of June, AFC estimates for July)

Disclaimer

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