

by Jonathan Furelid - HedgeNordic

”Buy when there is blood on the streets...”

Baron Rothschild

Iraq stocks poised for a rebound as ISIS loses grip

The old saying that you should invest when there is “blood on the streets” could not be more telling than in the case of Iraq. The Iraq equity market has suffered under the extreme tensions linked to ISIS and has fallen by 55 percent over the last 3 years. But macroeconomic indicators show signs of a turnaround and rising oil prices together with a weakened ISIS is likely to lift undervalued Iraq stocks higher, according to Henrik Kahm, portfolio manager of the FMG Iraq Fund.

”Iraqi stocks have fallen by close to 40 percent since the Islamic State of Iraq and Syria, ISIS, took control of the country’s second largest city Mosul in July 2014. Falling oil prices have also had a negative impact on stock market valuations. However, we see signs that things are moving in the right direction and have increased allocations to Iraqi equities in 2016. Valuations look very attractive”, Henrik Kahm says when asked about the prospects for Iraq’s equity market.

Kahm and his team launched the FMG Iraq Fund in 2010.

”In 2008 we did our first investment in Iraq as the market opened up for foreign investors and as we deemed the regulatory oversight with regards to the stock exchange had vastly improved. Prior to making our first investment, we had studied the market closely and discovered that there were a number of interesting companies in Iraq of which we were able to create an interesting portfolio. In 2010, we launched a fund focused on locally listed Iraq companies”.

Kahm says that there are alternative ways of getting exposure to Iraq, for example through the bond market or through off-shore listed companies such as the Norwegian oil company DNO, however focusing on locally listed stocks provides for another dynamic, he says.

“Today you can buy Pepsi in the U.S. at 23 times trailing P/E, the corresponding number for Baghdad Soft Drinks, an emerging market Pepsi play where the underlying market is growing, is 8.”

”Unlike the exposure you get from investing off-shore, local investments in Iraq is not linked to the oil and gas sector, simply because the Iraqi oil belongs to the people and is not listed as private companies. A majority of the roundabout 100 companies listed in Iraq are within financials, consumer products or telecommunications. Private banks make out the majority of those with 20 companies listed.”

The portfolio manager highlights that the Iraq stock market is relatively tiny and in many cases illiquid.

”The total market cap of the Iraq stock exchange is around 9 billion USD out of which around 50 percent is tied to a large

telecommunications company offering very low liquidity. The tradeable universe is therefore only around 4 billion.”

Kahm admits to the fact that the media picture of Iraq is not helping when investors are considering frontier investment opportunities. He is however convinced that the market has reached a low-point and that interest will return.

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”In May of this year we released a strategic report saying that Iraqi stocks were near bottoming out, on May 29, Iraq stock had its lowest valuation point ever. Since then there has been an upward movement in Iraq stocks, although with a lot of volatility.”

Kahm sees indications of improving market conditions.

”Going back 6 months we see that there is a better situation in the country. The economy is again growing and the oil price is also recovering. This is good news for Iraq who historically have been very successful in increasing production of oil given low production costs”.

”ISIS is losing ground and there is a potential normalization of profits. If this is being materialized, companies will be trading at extremely low valuations. Mosul will be the trigger. With local investors becoming more positive, more money will also flow to the market. Limited volumes can move the market a lot given that it is illiquid”, Kahm argues.

As an example of the low valuations in Iraq, Kahm mentions Baghdad Soft Drinks, a company that act as distributor of the soft drink Pepsi brand in Iraq.

”Today you can buy Pepsi in the U.S. at 23 times trailing P/E, the corresponding number for Baghdad Soft Drinks, an emerging market Pepsi play where the underlying market is growing, is 8. The Pepsi market in the U.S. is showing more or less no growth during the last five years. In Iraq, the market has doubled during this time period.”

The banking sector also looks attractive according to Kahm.

Henrik Kahm,
Portfolio Manager
FMG Iraq Fund



”The banking sector has shown incredible growth figures up until the ISIS conflict. They used to be growing at 30 percent annually and have low valuations close to a price to book of 1.”

Since bottoming out in May, the Iraq stock market has recovered and FMG’s internal models have been bullish since the summer.

“Mosul will be the trigger. With local investors becoming more positive, more money will also flow to the market. Limited volumes can move the market a lot given that it is illiquid.”

”In a longer term perspective, we see valuations at extreme lows given that many of the listed companies are in relatively good shape. Iraq is producing 5 million barrels of oil per day and that is a lot given the size of the country.”

”Even though there are no listed oil companies, the commodity plays an important role for the overall financial conditions. Now fact that investors expect oil prices to stabilize in the area of 50-70 USD per barrel rather than hovering around 20 USD, this makes a significant difference for investor appetite going forward”.

”Kahm argues that the recent pick up in valuations expresses just how quickly things can turn around in the Iraq equity markets.” – ”We saw that in October when stocks in Mosul Bank, a banking group that has obviously been a big loser following the attacks on the city, gained almost 200 percent and the market followed with a gain of 20 percent in a short time period. Dynamics can change quickly and this time I think for the better. When there is blood on the streets, it is typically the time to buy.”