

## AFRICA RISK CONSULTING

### Egypt Monthly Briefing June 2016

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#### Egypt Summary 1 June 2016

*A state-owned EgyptAir A320 passenger airliner crashes in the Mediterranean Sea with investigators still uncertain of the cause. The downing of the airline is a blow to the tourism sector, with decreasing arrivals numbers increasing pressure on the Egyptian pound. Royal Dutch Shell group and state-owned Egyptian Natural Gas Holding Co (EGAS) reach agreement for the development of the offshore West Delta Marine Block. The National Telecommunications Regulatory Authority (NTRA) will issue 4G telecommunications service licences, which may allow majority state-owned Telecom Egypt to enter the mobile market.*

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#### EgyptAir airliner crashes in Mediterranean

A state-owned **EgyptAir** A320 passenger airliner with 66 passengers and crew crashed off the northern coast of **Egypt** on 19 May.<sup>1</sup> The crash in Egyptian airspace will further undermine the Egyptian tourist sector, a key source of hard currency. EgyptAir flight **MS804** was travelling between **Paris Charles de Gaulle Airport (France)** and **Cairo** when it disappeared.<sup>2</sup> The passengers included 30 Egyptian and 15 French nationals, while the 10 crew members were all Egyptians.<sup>3</sup>

EgyptAir is struggling due to the downturn in Egyptian tourism (see below).

*"The timing is terrible. EgyptAir had recently launched a round of flight promotions, having already suffered huge financial losses over the past two years. There are 'Visit Egypt' billboards posted in **European** capitals as part of the campaign to bring back tourists.... This incident does nothing to aid an already struggling economy. The market reacted as expected, with panic. It doesn't help that markets feed on speculation. But Egypt has rebounded from worse. So we simply have to wait and see."*<sup>4</sup>

The cause of the crash is uncertain. The sudden disappearance of the plane triggered initial speculation that an explosion may have downed it.<sup>5</sup> Subsequent **Aircraft Communications Addressing and Reporting System (ACARS)** flight data indicated that two separate smoke detectors indicated smoke.<sup>6</sup> The first was in the compartment directly below the cockpit where the plane's computers and avionics equipment are located.<sup>7</sup> The second was in a passenger lavatory.<sup>8</sup> Other alerts indicate unspecified problems with flight computers.<sup>9</sup> The alerts lasted over a three-minute period.<sup>10</sup> This is typically longer than in cases where a bomb or electrical failure downed an airplane, but shorter than incidents where fire is the cause. International and Egyptian **Air Accidents**

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<sup>1</sup> Al Ahram, 19 May 2016.

<sup>2</sup> Al Ahram, 19 May 2016.

<sup>3</sup> Al Ahram, 19 May 2016.

<sup>4</sup> Source, finance journalist, Cairo

<sup>5</sup> Al Ahram, 19 May 2016.

<sup>6</sup> Bloomberg, 24 May 2016.

<sup>7</sup> Bloomberg, 24 May 2016.

<sup>8</sup> Bloomberg, 24 May 2016.

<sup>9</sup> Bloomberg, 24 May 2016.

<sup>10</sup> Bloomberg, 24 May 2016.

**Investigation** department investigators say it will take at least one month to publish initial findings into the causes of the crash.<sup>11</sup> However, civil aviation minister **Sherif Fathy** told ARC Briefing that,

*"It seems more likely it [the cause of the crash] would be terrorism than a technical fault."*<sup>12</sup>

It was the third incident involving airlines in Egypt in six months. In October 2015, a **Kogalymavia Ltd (Metrojet) Airbus A321-200** airliner crashed in the **Sinai Peninsula** killing 224 people. The cause was most likely a bomb explosion, for which the **Islamic State**-affiliated **Sinai Province** militant group (formerly known as **Ansar Bayt al-Maqdis**) claimed responsibility. In March, an internal EgyptAir flight was hijacked to **Cyprus** in a criminal rather than political event.

*"The country has been for some time now in an ongoing state of crisis mode. There is a sense of disbelief as to how this could happen. It was even evident in the government response. In past crises, their response has been conflicting and antagonistic, but speaking to officials, you could see they were at a loss, openly saying it could be terrorism and that nothing could be ruled out."*<sup>13</sup>

Tourist numbers declined in the five consecutive months following the Sinai Peninsula crash.<sup>14</sup> According to the **Central Agency for Public Mobilisation and Statistics**, the number of tourists in March was 47% lower than the corresponding month in 2015.<sup>15</sup> Analysts had previously forecast that tourism revenue would decrease \$3.5 billion in 2016, but the MS804 crash may exacerbate this increasing pressure on the currency.<sup>16</sup>

*"People are talking about a plot or a curse against Egypt. Because there was hope that tourism might begin to crawl back once flight restrictions were lifted by the **United Kingdom [UK]** and **Germany** [following the downing of the Metrojet in October]. It's a bad blow, that couldn't have come at a worse time. But we won't know the full impact [on the tourism industry] until the cause of the crash is known."*<sup>17</sup>

The Sinai Province militant group demonstrated its continued capacity to carry out attacks away from its **Sinai Peninsula** stronghold, claiming responsibility for an attack that killed eight police officers in the Cairo suburb of **Helwan** on 8 May.<sup>18</sup> Sinai Province gunmen fired automatic weapons at a van transporting the police officers.<sup>19</sup> Attacks of this scale in or near Cairo are infrequent, with security forces enjoying more success in stopping them than in the Sinai Peninsula. The casualties made it the most significant security incident in Cairo since November 2015 when the Sinai Province group attacked a security checkpoint, killing four police officers. In a statement, the Sinai Peninsula group said the latest attack was part of its **Abi Ali Al-Anbari** campaign, which has involved a series of bombings and other attacks, mostly in **Iraq**.<sup>20</sup> Sinai Province said the attack was a response to the imprisonment of Muslim women in Egyptian prisons.<sup>21</sup> The EgyptAir crash and the Cairo attack may lead to a further government-led security crackdown,

*"If [the EgyptAir crash] turns out to be a terrorist attack, there is fear that it will embolden the government's lack of interest in protecting basic rights and freedoms at home. While president **Abdel Fattah Al-Sisi** (2014- present) is seen by Europe as an ally in fighting terrorism in the region, he will have free reign to do as he pleases.... And already we have seen Cairo's counter terrorism strategy both in the capital and particularly in the Sinai: it's bloody and ineffective."*<sup>22</sup>

<sup>11</sup> Al Ahram, 22 May 2016.

<sup>12</sup> Source, Sherif Fathy, Cairo

<sup>13</sup> Source, journalist, Cairo

<sup>14</sup> Al Bawaba, 10 May 2016.

<sup>15</sup> Al Bawaba, 10 May 2016.

<sup>16</sup> Financial Times, 20 May 2016.

<sup>17</sup> Source, tourism sector, Cairo

<sup>18</sup> MENA, 8 May 2016.

<sup>19</sup> MENA, 8 May 2016.

<sup>20</sup> MENA, 8 May 2016.

<sup>21</sup> MENA, 8 May 2016.

<sup>22</sup> Source, journalist, Cairo

## Shell secures West Delta agreement

The **Royal Dutch Shell** group has for the first time assumed responsibility for negotiations with state-owned **Egyptian Natural Gas Holding Co (EGAS)** for the development of the offshore **West Delta Marine Block** from UK-based **BG Group**.<sup>23</sup> Policy delays and institutional inefficiency jeopardise the realisation of Egypt's offshore gas reserves, prolonging Egypt's natural gas deficit and dependence on liquefied natural gas (LNG) imports. The successful conclusion to negotiations will help Egypt reduce its natural gas deficit. In January, BG shareholders approved Royal Dutch Shell's \$70 billion takeover of the company that will see their assets merged and a probable sell-off of peripheral assets.<sup>24</sup> Both companies have strong interests in gas production and LNG supply, suggesting that Shell will most likely retain BG's Egypt portfolio even though output has declined since 2014.<sup>25</sup> The entire West Delta Marine Block is scheduled to begin production in mid-2018.

The resolution of the West Delta Marine Block standoff will further encourage Shell to retain Egypt at the centre of its group corporate strategy.<sup>26</sup> BG and minority partner **Malaysia**-based **Petronas** were involved in long running discussions with EGAS over the development of **Block 9B** of the West Delta Marine Block in the **Mediterranean**.<sup>27</sup> The main dispute between the parties was the prices that EGAS would pay, and payments owed to the government for previous sales.<sup>28</sup> The gas companies claimed that prices should be higher than in **Block 9A** as reserves are smaller and drilling takes longer.<sup>29</sup> Drilling was suspended at 9B in March due to the dispute.<sup>30</sup> Local media on 10 May reported that the parties had reached agreement on a price formula of between \$2.5 and \$5.88 per British thermal unit (BTU) tied to the price of crude oil on international markets.<sup>31</sup> This remains subject to parliamentary approval, but is broadly in line with other recent deals with gas operators.<sup>32</sup> In February, **Italy**-based **Eni** announced that EGAS had granted a development lease for the development of the offshore **Zohr** gas field discovered in August 2015.<sup>33</sup> The Zohr field will come online before the end of 2017 and reach maximum output in 2019.<sup>34</sup> The Zohr field alone may prove sufficient to meet Egypt's domestic requirements and supply its two LNG export plants. Egypt's LNG plants face an uncertain future due to difficulty of obtaining necessary investment.

*"The problem is that the LNG market is awash with surplus. Even if you're sceptical about the scale and timeframe of **Iran's** resources – and there is no reliable data in Iran – there are LNG projects coming online in the **United States** and **Australia** that will ensure market demand is met for at least a decade. How do you secure capital investment in this context?"<sup>35</sup>*

The West Delta Marine Block agreement is also dependent on the petroleum ministry clearing its arrears with the gas companies, with Shell demanding an immediate payment of \$1 billion and permission to export 100-150mm natural gas daily from its LNG plant at **Edko**.<sup>36</sup> The government had improved its standing with international oil companies by clearing arrears that peaked at \$6 billion in 2013.<sup>37</sup> The debt decreased to \$3 billion at the end of December, but increased again to \$3.2 billion at the end of March due to foreign exchange shortages.<sup>38</sup> The Egyptian natural gas sector has significant

<sup>23</sup> MENA, 12 May 2016.

<sup>24</sup> Source, oil and gas sector executive, Egypt

<sup>25</sup> Source, oil and gas sector executive, Egypt

<sup>26</sup> Source, oil and gas sector executive, Egypt

<sup>27</sup> MENA, 12 May 2016.

<sup>28</sup> MENA, 12 May 2016.

<sup>29</sup> MENA, 12 May 2016.

<sup>30</sup> MENA, 12 May 2016.

<sup>31</sup> Al Borsa News, 10 May 2016.

<sup>32</sup> Al Borsa News, 10 May 2016.

<sup>33</sup> Egypt Independent, 22 Feb 2016.

<sup>34</sup> Egypt Independent, 22 Feb 2016.

<sup>35</sup> Source, business consultant, Egypt

<sup>36</sup> Al Borsa News, 10 May 2016.

<sup>37</sup> Reuters, 12 Sept 2013.

<sup>38</sup> Reuters, 6 Apr 2016.

potential due to the scale of its reserves (3,500 trillion cubic feet according to government estimates<sup>39</sup>), the country's exclusive control over the **Suez Canal** as a transit channel, and potential refining capacity.<sup>40</sup> Nevertheless, the downstream sector is inefficient due to a lack of investment. The government's reluctance to reform fuel subsidies continues to deter investment, as well as government debts owed to international oil companies.<sup>41</sup> The finance ministry on 12 May approved emergency funding for government ministries, departments and agencies as well as state-owned enterprises struggling to meet financing commitments.<sup>42</sup> The finance ministry will pay the petroleum ministry 221.6 billion Egyptian pounds (EGP) (\$24.9m) to remunerate EGAS for extending the national grid.<sup>43</sup>

### Government to issue 4G telecommunications licences

The government, on 4 May, authorised the **National Telecommunications Regulatory Authority (NTRA)** to issue 4G telecommunications service licences to Egypt-based telecom companies.<sup>44</sup> The move may allow the majority state-owned **Telecom Egypt**, which holds a fixed line monopoly, to enter the mobile market. The Egyptian telecommunications sector is broadly subdued due to the failure of the government and mobile operators to secure agreement on the implementation of a unified licensing framework for Telecom Egypt. The government approved Telecom Egypt's unified licence in September 2014, which requires the company to share infrastructure with other providers to offer mobile services. Disputes over licensing arrangements are reportedly delaying its implementation.<sup>45</sup> The government expects to raise EGP2.8 billion (\$315m) from the issuing of 4G licences.<sup>46</sup> The NTRA will probably invite mobile operators **Orange**, **Vodafone** and **Etisalat** to submit bids. It remains unclear whether Telecom Energy – a 45% shareholder in **Vodafone Egypt** – will directly submit a bid.<sup>47</sup> According to an earlier unified licence plan, Telecom Egypt would become Egypt's fourth mobile operator after divesting its Vodafone Egypt stake. In March, **Maged Osman** became Telecom Egypt chairman and **Tamer Gadallah** CEO.<sup>48</sup>

### Implications

If militants downed the EgyptAir airliner, the security failings occurred at Charles de Gaulle Airport rather than in Egypt. However, regardless of the actual cause, the crash of an Egyptian-owned airliner in Egyptian air space has contributed to existing perceptions of the country as unsafe for tourists. This will decrease arrival numbers, exacerbating the continuing foreign currency crunch, raising concerns amongst investors about securing financing and the repatriation of profits.

The West Delta Marine Block resolution will contribute to Egyptian efforts to reach domestic energy self-sufficiency. However, foreign exchange shortages will make it harder for Egypt to clear its arrears with international oil companies. These debts and policy slippage over downstream reform will continue to deter necessary investment in both the upstream and downstream sectors.

Increased access to high-speed telecoms services will increase the ease of doing business in Egypt. It is, however, unclear when 4G services will become available. 3G and 4G subscriptions are expected to increase steadily.

<sup>39</sup> [www.egyptoil-gas.com](http://www.egyptoil-gas.com)

<sup>40</sup> Source, oil and gas sector executive, Egypt

<sup>41</sup> Source, oil and gas sector executive, Egypt

<sup>42</sup> MENA, 13 May 2016.

<sup>43</sup> MENA, 13 May 2016.

<sup>44</sup> Mubasher, 5 May 2016.

<sup>45</sup> [www.developingtelecoms.com](http://www.developingtelecoms.com)

<sup>46</sup> Mubasher, 5 May 2016.

<sup>47</sup> Mubasher, 5 May 2016.

<sup>48</sup> Al Ahram, 31 Mar 2016.

### About Africa Risk Consulting:

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