Qatar Equity Strategy Alert

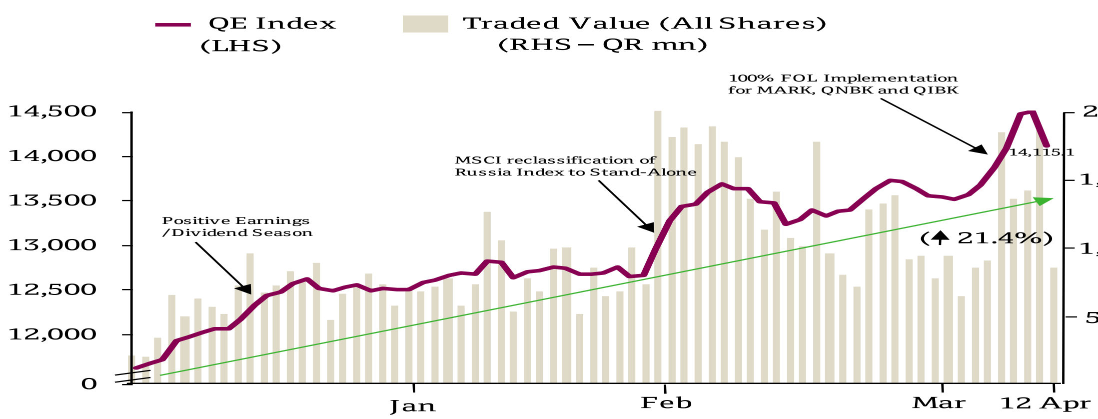
Tuesday, 13 April 2022

Safe-Haven Status Adds to Strong Fundamentals to Attract Foreign Institutional Investors in 2022

The Qatar Exchange (QE) has already outperformed in 2022 with the index gaining by 21.4% (Fig 1) as at April 12, 2022. *The QE Index has been the best performing index in the GCC region (Fig 2). Further, the Index is also currently the fourth-best performing index globally with a total return of 26.4%. Major global central banks' retrenchment of quantitative easing, the recent surge in COVID-19 infections in Asia and the ongoing Russia-Ukraine conflict have roiled global markets. While we expect stocks to remain volatile, we continue to be positive longer-term on the Qatari market.* ***Although Qatari equities have run-up significantly and most of our stocks under coverage have reached/surpassed our price targets, we continue to remain bullish longer-term on several names, including MARK, QEWS, QGTS, QIBK and QNNS.*** *Qatar remains one of the most promising markets in the region and worldwide, primarily due to positive momentum from the following developing themes:*

- **Global safe-haven for investors:** Among the global safe-haven alternatives for investment, the Qatar Exchange has been a key beneficiary of flight-to-safety for investors looking to sidestep the Russian crisis. The Qatar Exchange's net foreign institutional inflows exceeded initial expectations reaching $2,416 million by April 12. *Overall net investment buy activity (foreign +GCC/Arab institutions) reached the equivalent of $2,936mn, already overtaking the entire investment flows of $2,063mn achieved during the full year 2021.*
- **100% FOL implementation to see additional foreign institutional investment of $1.3-1.5bn:** Three banks **(Qatar Islamic Bank, Qatar National Bank and Masraf Al Rayan)** have fully implemented their 100% FOL requirements and the Qatar Central Securities Depository has modified the foreign ownership limit for all three of them to be 100% of capital. In our view, these three banks have firmly beat the deadline for the MSCI and FTSE rebalance. While it is not certain that all major companies will meet their MSCI cut-off (any last 10 business days of April starting from April 18), we remain fairly confident that the market will continue to attract substantial foreign inflows. We note that while any actual MSCI-related flow increase will take place in May at the earliest (and FTSE in June), the market should continue to move in anticipation of this major event. *The MSCI and FTSE rebalance should see additional foreign institutional investment flows estimated at around $1.3-1.5bn with banks making up ~90% of these inflows.*
- **Rising oil and gas prices:** Sanctions by Western countries on Russia are causing global oil and gas supply concerns, which in turn are having a major impact on global oil and gas prices. With Russia being a major global producer and exporter of gas and oil, the already uneven global supply-demand balance has been put under even further pressure, leading to record high oil and gas prices. Brent crude prices averaged $108/b in March 2022, with LNG prices (Japan/Korea Import prices) averaging $16.0/MMBtu in February 2022. *Higher oil and gas prices will lead to higher government revenues for Qatar, enable flexibility in government expenditures and improve overall money supply (liquidity). Moreover, higher commodity prices continue to heighten investor appetite for Qatari equities.*
- **FIFA World Cup 2022:** The World Cup will act as an important catalyst in driving the domestic market. According to Qatar's Supreme Committee for Delivery and Legacy, *this major global event is expected to contribute $20bn to the economy, in sectors such as tourism, sports and construction.*
- **Qatar's huge LNG expansion plan will drive overall demand and growth**: Qatar's significant LNG expansion will drive overall demand and growth over the coming years. *The LNG expansion will see Qatar's overall LNG output increasing by 64% to reach 126 million tons per annum (MTPA), from the current 77 MTPA.* We note that Qatar should remain among largest global LNG exporters. Qatar exported an estimated 80.2 million tons of LNG in 2021; given its current expansion plans, Qatar is expected to be the second largest LNG exporter in the world by 2027 with 126 MTPA.

Fig 1: QE Index Performance and Traded Value (YTD 2022)



Source: Bloomberg, QSE and QNB FS analysis

Stock Recommendations

While Qatari equities have run-up significantly and most of our stocks under coverage have reached/surpassed our price targets, we continue to remain bullish longer-term on several names. From our Qatari coverage universe, we continue to favor several names, including **MARK, QEWS, QGTS, QIBK and QNNS.**

- MARK (Outperform; QR6.100 TP) – **Our thesis remains unchanged: we believe that given Masraf Al Rayan's (MARK) significant exposure to the public sector, the stock deserves to trade at a premium to the market.** MARK is cost-efficient, a strong RoE/RoRWAs generator (although this will be dampened in the short to medium-term due to KCBK's weak RoE but then pick up to 15/16% by 2024), maintains superior asset quality vs. its peers and sustains large capitalization levels. **MARK's merger with KCBK and its FOL increase to 100% (which has been implemented), should help boost MARK's weight in major indices such as MSCI EM and FTSE EM and contribute to increased foreign institutional ownership in the company.** The stock currently trades at P/TB of 2.5x on our 2022e estimates.
- QEWS (Accumulate; QR21.00 TP) -- **We continue to like Qatar Electricity & Water (QEWS) as a long-term play with a relatively defensive business model.** The near-term impact of the COVID-19 pandemic was muted on QEWS' business model as the company is paid based on power and water availability and is relatively unaffected by the vagaries of end demand. QEWS also recently agreed to purchase the 40% of Nebras Power it did not already own for $530mn. We believe this deal (to be financed by a $550mn bank loan) could be slightly accretive (around 3% over 2022-2026e) and will update our estimates once the transaction closes. However, we have already incorporated this acquisition into our DCF-based valuation model. For 2022, we expect a decent 3.1% YoY growth in earnings. This should be fueled by improved power and water offtake, especially during 2H2022, given the FIFA World Cup Qatar 2022. QEWS still enjoys decent EBITDA margins and dividend/FCF yields. As expected, the UAH water expansion (61.45 MIGD) was commissioned during 1Q2021. **LT catalysts (which are not in our model) abound, including additional domestic expansions (like Facility E in 2024-2025, etc.). Nebras remains on the hunt for growth and has plans to increase its capacity significantly, which currently stands at more than 2.1 GW (+6.4 GW gross). Given that Nebras will become a 100%-owned subsidiary, we believe additional color/disclosures regarding its growth prospects could help fuel increases in QEWS' earnings estimates.**
- QGTS (Accumulate; QR3.900 TP) – **We remain bullish on Qatar Gas Transport/Nakilat (QGTS) and consider it as the best avenue for equity investors to participate in the LT growth expected in Qatar's LNG sector. 2022 could be a watershed year for Nakilat if it is chosen as one of the ship owners involved in Qatar's massive LNG expansion program.** We remind investors that QatarEnergy (formerly Qatar Petroleum) is expanding Qatar's LNG capacity from 77 MTPA to 110 MTPA (first production: 4Q2025) and further to 126 MTPA a couple of years later. **To cater to this expansion, back in April/June 2020, QatarEnergy signed major LNG shipbuilding capacity agreements with Chinese and South Korean companies to build 100+ LNG vessels worth +QR70bn.** Furthermore, in 1Q2021, QatarEnergy issued an invitation to tender package to ship owners for the chartering of LNG carriers in relation to this project; QatarEnergy intends to assign selected ship owners from this tender to the shipyards' construction slots reserved in China and South Korea. In October and November of 2021, QatarEnergy moved ahead with the construction of ten LNG ships (four in China/six in South Korea). Given typical lead-times for LNG ship construction, we should expect to hear about final ship owner selections by 2H2022/1H2023; we do note that already on April 12, QatarEnergy announced that it awarded its first batch of time-charter parties (TCPs) with a subsidiary of Mitsui O.S.K Lines (MOL) for the long-term charter and operation of four LNG ships. In a statement, HE the Minister of State for Energy Affairs, Saad Sherida al-Kaabi, also the President and CEO of QatarEnergy, stated that he expected to announce similar contracts in the near future. Considering Nakilat's strategic importance and impressive track record in Qatar's existing LNG shipping value chain, we expect QGTS to be a major beneficiary such future contract announcements. **We also estimate that every incremental vessel (@100%) adds roughly 1% to QGTS' target price and an award of 20-30 ships could significantly affect our price target and estimates.**
- QIBK (Outperform; QR24.176 TP) – **Although the stock has rallied and has exceeded our TP, we remain bullish on Qatar Islamic Bank (QIBK)** due to: 1) strong fundamentals and given that 2) **it is expected to be the biggest beneficiary in terms of flows from MSCI and FTSE as the bank's 100% FOL has been implemented.** QIBK has

consistently reported strong results over the past couple of years; earnings grew by a CAGR of 10.7% (2016-2021) and we expect a further growth of 11.1% (2021-2026e). **The bank's financial performance was strong during 2017-2021 despite the blockade and the COVID-19 pandemic.** QIBK's fundamentals continue to remain robust with strong RoE generation (2018: 16.7%, 2019: 18.5%, 2020: 16.6%, 2021: 18.2%, 2022e: 17.9% and 2023e: 17.6%); the bank is cost efficient, has a strong Tier-1 position and a superior asset quality profile vs. its peers. **As such, we believe the stock warrants a premium.** QIBK is expected to generate superior RoE/RoRWAs vs. peers (>17%/>2.0%) in the medium-term. The stock is trading at stretched valuations with a P/TB of 2.6x on our 2022 estimates.

- QNNS (Outperform; QR10.00 TP) – **We remain bullish longer-term on Qatar Navigation's or Milaha's (QNNS) growth story.** The stock, over 2011-2021, has always traded at a significant discount to its sum-of the-parts, sometimes worth only the value of its investment stake in Nakilat and its equity/bond portfolio. This remains the case currently, with Milaha's "non-core" assets (Nakilat + Investment book), along with its net cash position, making up more than 100% of QNNS' market cap. This implies that investors get Milaha's "core" or operating businesses for almost free. However, what could be different this time around is that Milaha should enjoy several catalysts, which could help in its rerating. **We note recovery in oil prices/sentiment, the lifting of Qatar's blockade, the upcoming FIFA World Cup Qatar 2022 and the massive North Field Expansion project, are all positive tailwinds. Growth snapback, as COVID-19 restrictions ease, should also contribute to easier comparisons going forward. Lack of large impairments in the future should also help QNNS' earnings trajectory and highlight its growth story to investors.**

Qatar Exchange Index Outperforms and Tops GCC in 2022

- The Qatar Exchange index outperforms and leads the GCC markets in early 2022. As at April 12, 2022 the Qatar Exchange index had already gained 21.4% for the year 2022 (Fig 2). Qatar remains one of the most promising markets in the region for 2022 in the build up to the 100% FOL implementation, the FIFA World Cup, higher oil and gas prices and prospective future economic outlook.
- Saudi Arabia's Tadawul index was second best performing market as at April 12, 2022 going up by 21.0%. Abu Dhabi's index went up by 19.0%, while Bahrain's index was up by 17.1% in 2022.
- The Qatar market shows a P/E ratio of 18.4 in 2022 (as at April 12, 2022). Saudi Arabia had a P/E ratio of 25.9, while Abu Dhabi had a P/E ratio of 23.5 in 2022 (Fig 3).

Fig 2: GCC Markets Index Comparison (2022)

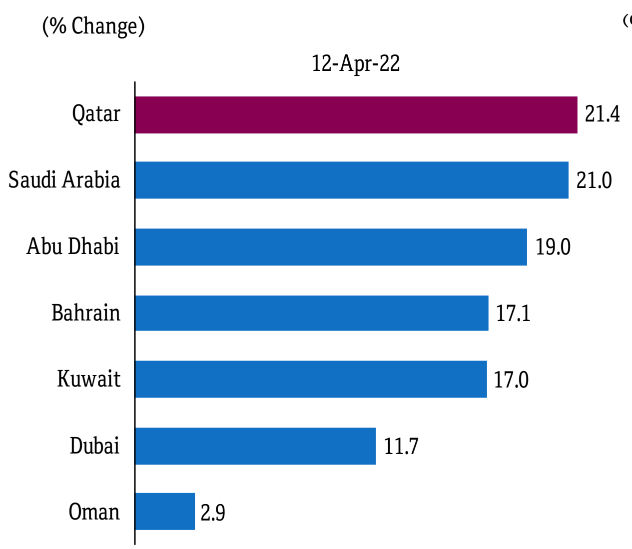
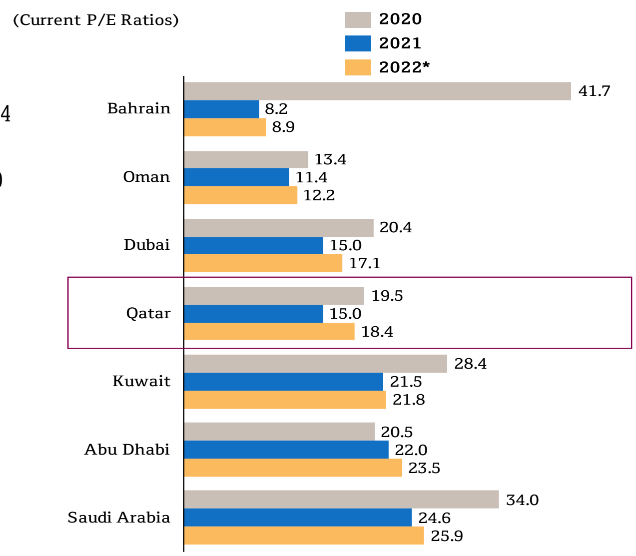


Fig 3: GCC Markets Current P/E



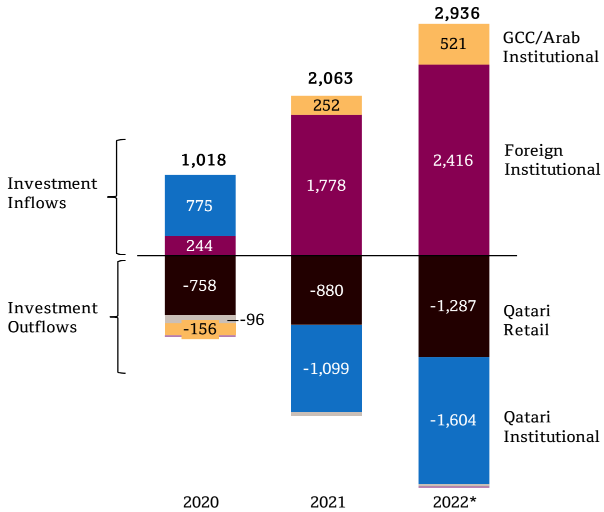
Source: Bloomberg, QSE and QNB FS analysis

Global Safe Haven Qatar Witnesses Huge Foreign Institutional Investment Inflows

The crippling sanctions imposed by Western nations on Russia's financial sector initially led to the tumbling of the Russian ruble (although the ruble has since recovered considerably), resulting in a capital flight by foreign investors from Russia's stock markets. To prevent the capital flight, Russia closed its stock markets at the end of February and early March, its longest extraordinary circumstances closure since October 1998. As the Russian market became increasingly isolated and non-accessible/investable, MSCI began holding consultations on the possibility of reclassifying MSCI Russia indexes from Emerging Markets to Standalone Markets status. On March 9, MSCI reclassified MSCI Russia indexes from EM status to Standalone status. Various analysts estimated that such a reclassification could result in both passive and active outflows from Russia's stock markets to the tune of $32 billion. Among the global safe haven alternatives for investment, the Qatar Exchange has been among the beneficiaries from the Russian exodus in the form of inflows initially estimated at over $350mn. The Qatar Exchange's net foreign institutional inflows exceeded initial expectations and towards the start of April 2022 (as at April 12, 2022) reached $2,416 million (Fig 5). Overall investment flows towards the start of April 2022 (as at April 12, 2022) has reached the equivalent of $2,936 million, already overtaking the entire investment flows of $2,063 million achieved during the full year 2021 (Fig 4).

Fig 4: Qatar Exchange Investment Flows (2020-2022)*

($ Million)

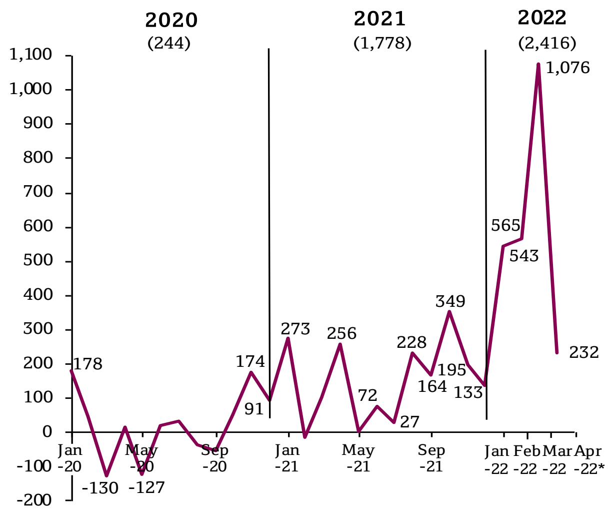


*As at April 12, 2022

Source: QSE and QNB FS Analysis

Fig 5: Foreign Institutional Investment Flows (2020-2022)*

($ Million)

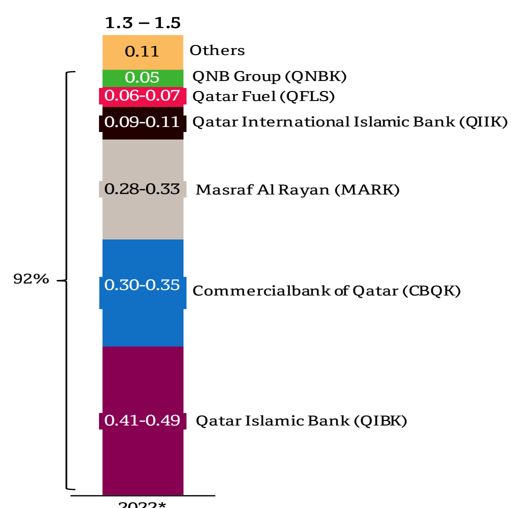


100% FOL Implementation to see Additional Foreign Institutional Investment Flows

Qatar Islamic Bank (QIBK) was the most recent to implement 100% foreign ownership since Qatar's Cabinet gave the go ahead almost a year ago. On April 7, 2022, the Qatar Central Securities Depository (QCSD) modified QIBK's foreign ownership limit to be 100% of capital. On April 6 and April 5, QCSD had similarly modified QNB Group (QNBK) and Masraf Al Rayan's (MARK) foreign ownership limit to be 100% of capital respectively. QIBK, QNBK and MARK have firmly beat the deadline for the MSCI and FTSE rebalance. The MSCI and FTSE rebalance will see additional foreign institutional investment flows to the Qatar Exchange estimated at between $1.3–1.5bn (Fig 6). QIBK will be the largest beneficiary of the foreign institutional investment flows. QIBK stock performance for 2022 has been reflective of the expected foreign investment flows with the stock rising by 38.3% in 2022 (Fig 7).

Fig 6: FOL Top Expected Investment Flows

($ Billion)

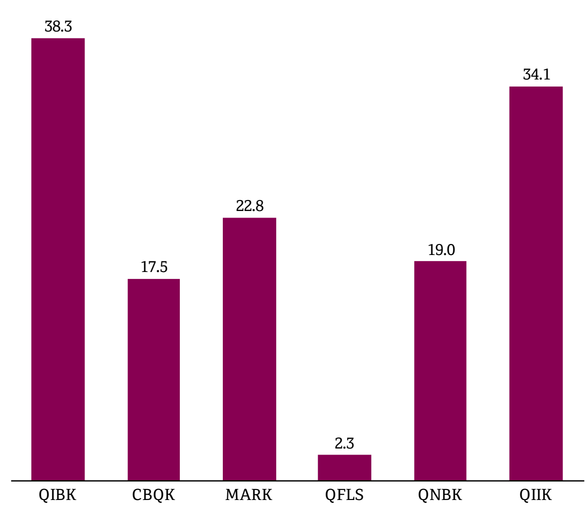


*As at April 12, 2022

Source: QSE, Market Reports and QNB FS Analysis

Fig 7: Stock Performance of Top FOL Beneficiaries

(% Change 2022*)



Rising Oil and Gas Prices

Sanctions by Western countries on Russia are causing global oil and gas supply concerns, which in turn are having a major impact on global oil (Fig 8) and gas prices. With Russia being a major global producer and exporter of oil (Fig 9) and gas, the already uneven global supply-demand balance has been put under even further pressure, leading to record high oil and gas prices. Global oil and gas prices have been shooting upwards, with oil prices reaching record highs of over $100/b towards early March 2022, not seen since 2014. Natural gas prices (Japan/South Korea LNG import prices) reached over $16/MMBtu in February 2022. Higher oil and gas prices will lead to higher government revenues for Qatar, enable flexibility in government expenditures and improve overall money supply (liquidity). Further, higher oil and gas prices should boost overall investor sentiment and confidence in the Qatar equity markets.

Fig 8: Brent Oil Prices (2020-2022)*

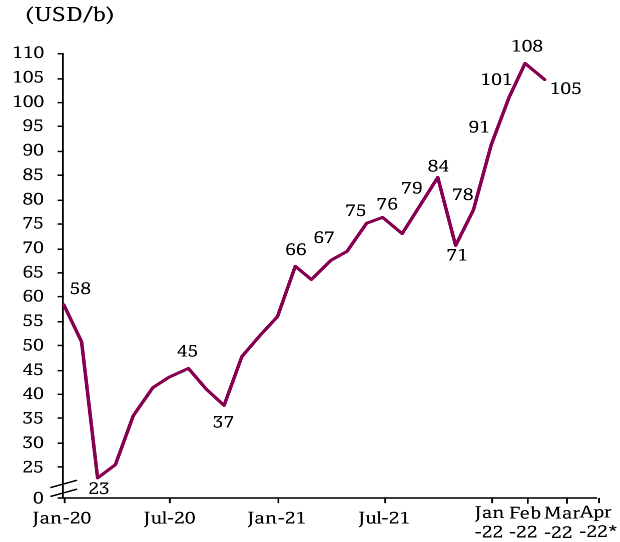
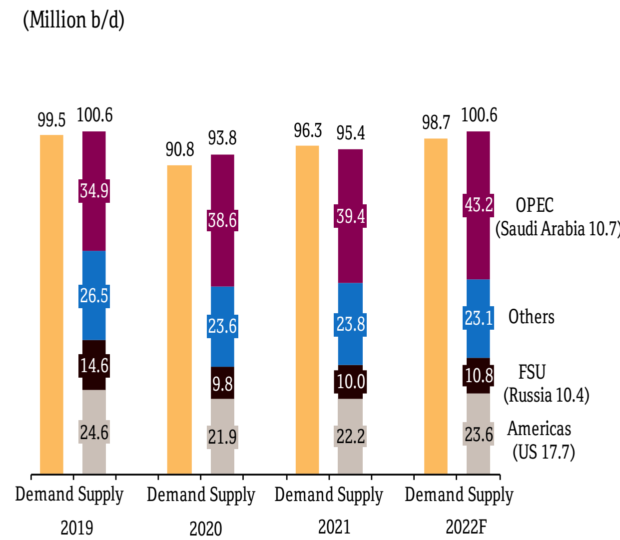


*Fig 9: Global Oil Demand and Supply (2019-2022**)*



*As at April 12, 2022 **Bloomberg Forecast

Source: IEA, Bloomberg

Qatar's Huge LNG Expansion Plan will Drive Overall Demand and Growth

LNG Expansion

- Qatar's huge LNG expansion will drive overall demand and growth over the coming years. Qatar lifted its self-imposed moratorium on North Field gas development in 2017 and QatarEnergy (Formerly Qatar Petroleum) has since announced the North Field Expansion project. The LNG expansion will see Qatar's overall LNG output increasing by 64% to reach 126 million tons per annum (MTPA), from the current 77 MTPA (Fig 10). The first phase of the expansion (North Field East) is estimated to cost $28.75bn and is set for completion by 2025, raising total output to 110 MTPA. The second phase of the expansion (North Field South) will raise overall output to 126 MTPA by 2027. We expect overall demand and GDP growth to be driven by this huge LNG expansion over the coming years.
- Qatar Energy awarded during the first quarter of 2021 the main engineering and construction contract for the planned phase 1 LNG expansion of its giant North Field to a joint venture of Japan's Chiyoda Corporation and Technip.
- Qatar enjoys some of the lowest product costs in the world according to industry experts and with the global LNG market heading for a tighter supply-demand balance, Qatar is expected to partly fill in on the supply side gap to major global consumers in the coming decades.

Expanding Global LNG Exports

- Qatar exported an estimated 80.2 million tons of LNG in 2021, with over 57.2% of exports going to the Asian region (Fig 11). South Korea is the leading LNG export destination in 2021, accounting for 14.2% of overall LNG exports at 11.4 million tons, followed by India with 10.2 million tons, China with 9.5 million tons, Japan with 8.6 million tons and Pakistan with about 6.1 million tons.
- Qatar's export markets have grown significantly over the years and in 2021 Qatar exported to over 25 countries.

Fig 10: Qatar LNG Expansion

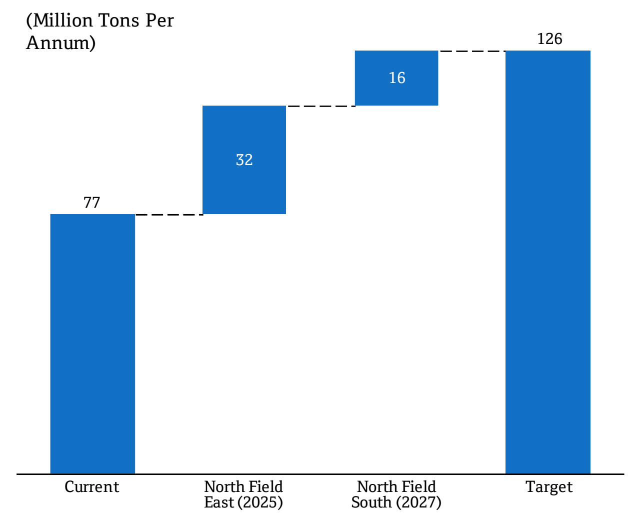
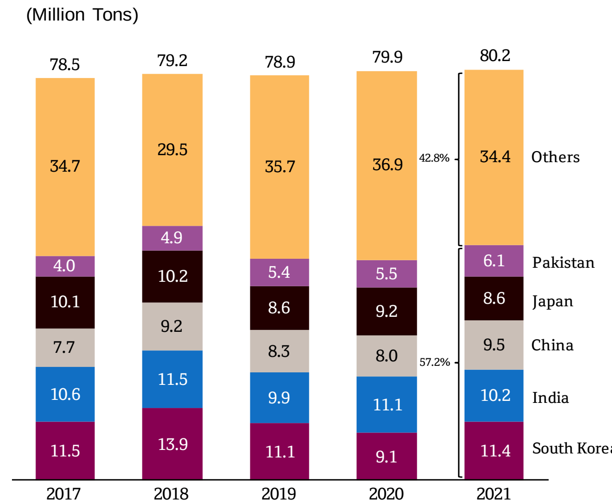


Fig 11: Qatar LNG Exports (2017-2021)



Source: Qatar Energy, Bloomberg, QNB FS Analysis

Qatar to Remain among Largest Global LNG Exporters

- Natural gas prices (Japan/South Korea LNG import prices) reached over $16/ MMBtu in February 2022 (Fig 12).
- Qatar exported 80.2 million tons of LNG in 2021; given its current expansion plans, Qatar is expected to be the second largest LNG exporter in the world by 2027 with 126 MTPA.

Fig 12: Japan/South Korea LNG Prices (2020-2022)*

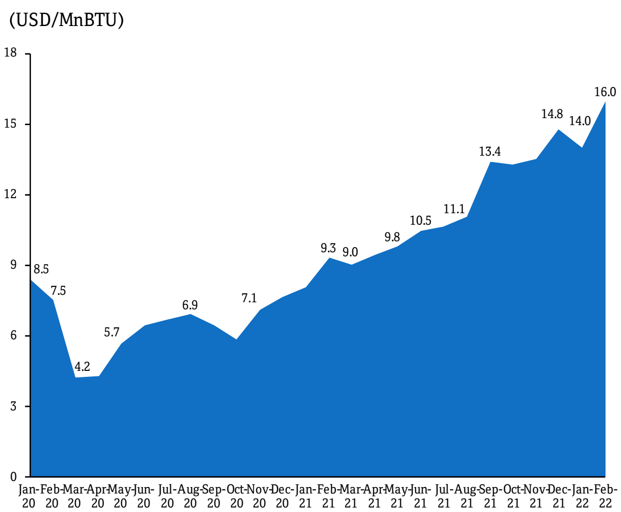
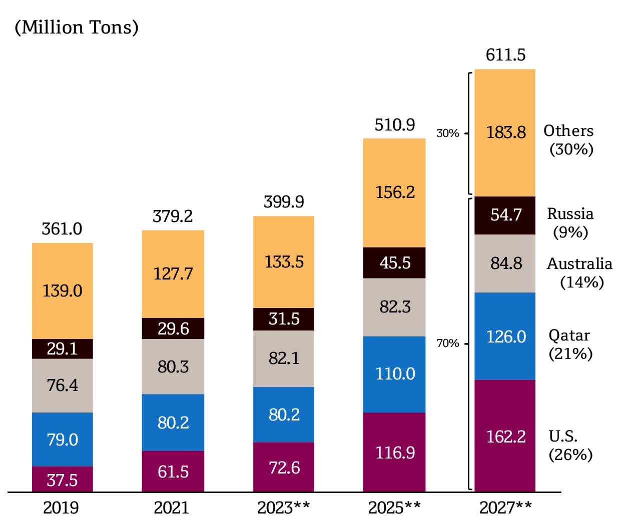


*Fig 13: Largest Global LNG Exporters (2019-2027**)*



*As at January 31, 2022 **Bloomberg Forecast

Source: IEA, Bloomberg

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