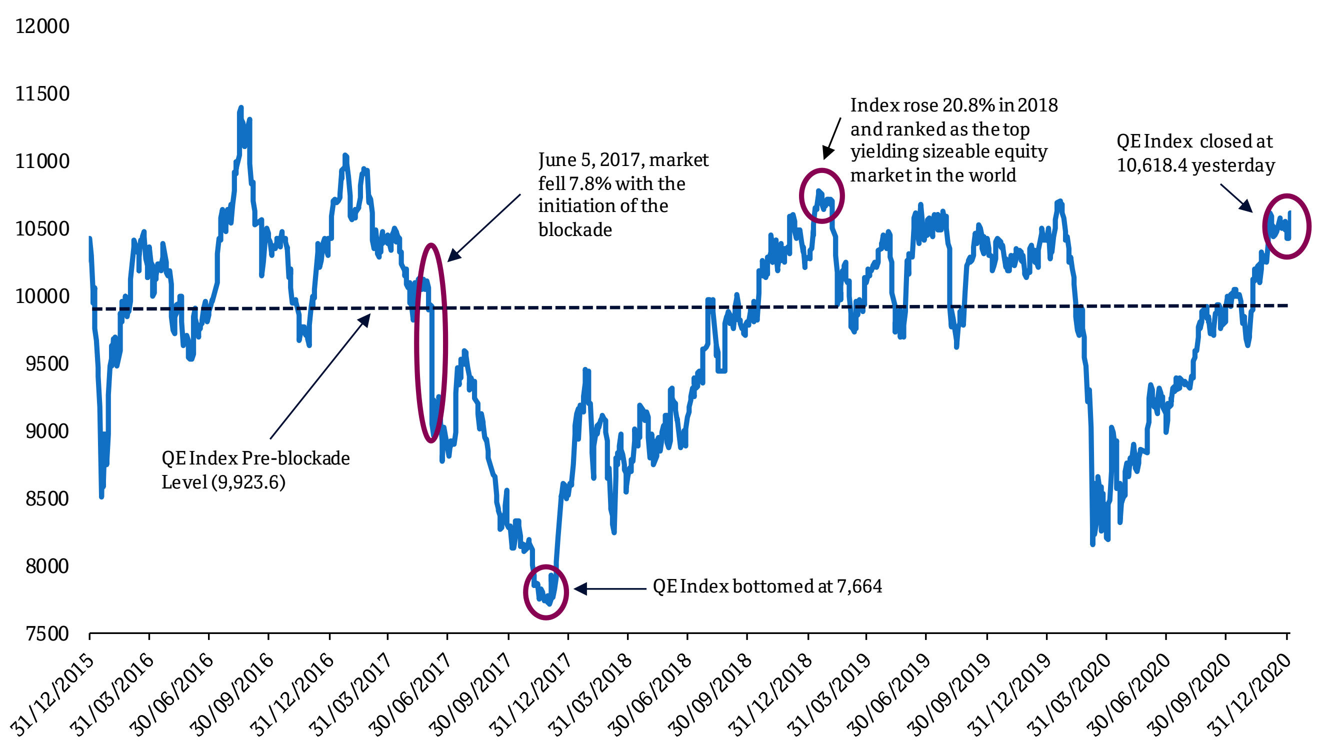
Ending of the Blockade Should be Supportive for Qatari Equities

On the night of January 4th, the State of Qatar and the Kingdom of Saudi Arabia (KSA) reached an agreement to open their airspace as well as land and sea borders to each other. Furthermore, last night (January 5, 2021), the GCC leaders signed a "solidarity and stability" agreement. The agreement resulted in the full restoration of diplomatic relations between Qatar and the Saudi-led bloc; it ended the blockade imposed since June 5th, 2017. The initial news had a positive impact on the local equity market leading to a 1.35% rise in the QE Index yesterday, which is likely to be carried into today's session. We think, Qatar's strong macroeconomic fundamentals, coupled with Qatari companies' effective response to the blockade by diversifying their revenue sources & supply channels as well as increasing their self-sufficiency, have already minimized the impact of the blockade so far. Going forward, we maintain our bullish view for Qatari stocks, with CBQK, GWCS and QGTS remaining our favorite picks. We think once the COVID-19 restrictions are over, Qatar Airways and consequently QFLS could benefit from increased air traffic between KSA and Qatar. We also believe real estate stocks, UDCD, ERES and BRES, could benefit from increased demand longer term.

- **On the night of January 4th, the State of Kuwait announced that the State of Qatar and the Kingdom of Saudi Arabia reached an agreement to open their airspace as well as land and sea borders to each other.** This agreement was announced one night before the GCC Summit. HH The Amir Sheikh Tamim bin Hamad Al Thani lead the Qatari delegation participating in the 41st session of the Supreme Council of the Cooperation Council for the Arab States of the Gulf (GCC), which takes place in Al-Ula Governorate of the Kingdom of Saudi Arabia. **In Saudi Arabia last night (January 5th), Qatar, Saudi Arabia and its three Arab allies (The UAE, Bahrain and Egypt) signed a "solidarity and stability" agreement and settled to restore full ties.**
- **The blockade had an initial negative impact on Qatari stocks in 2017. However, as it became apparent that the blockade did not have a noteworthy impact on Qatar's economic life, Qatari equities made a strong come back in 2018**. Infrastructure projects related to the FIFA 2022 World Cup and the 2030 Qatar National Vision investments have continued to be major growth drivers for local companies during 2017-2020, while the Qatari banking sector has sustained its support to the local real sector. As local business activity continued as usual and Qatar's macroeconomic metrics remain solid, Qatar has managed to protect its top-notch credit notes ratings as Aa3 from Moody's (with a stable outlook) and as AA- from Standard & Poor's (stable) regardless of the blockade. The Qatari equity market (QE Index) declined 7.8% on June 5th, 2017 – the day of the blockade – from 9,923.60 to 9,202.62, slipping further to 7,664.00 by the end of Oct'17 with a 22.8% fall since the beginning of the blockade. However, after the Oct'17 bottom, the QE Index steadily recovered and by Aug'18, it reached its pre-blockade level, maintaining its rally to 10,810.55 by Jan'19. In fact, in 2018, Qatar was the top performing sizeable stock market in the world with its 20.8% rise over 2017 and the third top performer among all world equity markets following Ukraine and Macedonia. **As of last night's close, the QE Index is trading at 10,618.39, already 7.0% above its pre-blockade level, which justifies the mild positive reaction in the QE Index after news of the KSA border opening.**
- **Going forward, we expect recovering merchandise trade & increasing tourism activity between Qatar and KSA-UAE-Bahrain and Egypt should contribute positively to Qatar's non-hydrocarbon growth in the medium-to-long-term.** Following the blockade, Qatari companies diversified their supply channels as well as their clientele effectively, thereby eliminating the blockade's impact rapidly. This was one of the major catalysts for the Qatari equities' 2018 rally. Qatari companies have also invested notably in self-sufficiency over the last three years. Officially inaugurated in 2017, the Hamad Port is expected to become one of the biggest ports in the GCC with its capacity reaching 7.5mn TEU with the completion of its second phase expansion. Nevertheless, restoration of the merchandise trade & increasing tourism activity between Qatar and the previously boycotting countries should be supportive for Qatar's non-hydrocarbon growth as well as Qatari stocks in the coming periods. On the other hand, some stocks, such as **BLDN**, could potentially see intensified competition in the local market from their KSA-based peers in the future. However, in Baladna's case, given the company's competitive strengths, any weakness in the stock represents a buying opportunity, in our view.

QE Index and the Blockade



Source: Bloomberg, QNB FS Research

- **Qatari banks to benefit from the GCC resolution based on general investor optimism as domestic banks had immaterial exposure to the blockading countries.** Prior to the rift, local banks had a total of 6% exposure to regional banks mainly in the form of investment securities and interbank activities. Post the blockade, the exposure declined by 50% to 3%. Having said this, we expect banks to report strong profitability in 2021 driven by healthy growth in revenue and reversals of credit provisions as banks booked hefty precautionary provisions in 2020.
- **We expect local catalysts, rather than regional developments, to continue to be major drivers for Qatari stocks.** Over the longer term, Qatar's economy should benefit from a number of recent measures. Investments could be bolstered by new projects related to the expansion of LNG production and projects aimed at ensuring self-sufficiency and sustainability as well as an expected new law to open up more sectors to 100% foreign ownership. Therefore, we expect the underlying growth rate of both the hydrocarbon and non-hydrocarbon sectors to continue rising into the medium term.
- **From an equity valuation point of view, we think the lifting of the blockade is not likely to create a significant positive impact as well.** While a potential decline in risk free rate could result in lower equity risk premiums thereby higher target valuations for the Qatari equities, we have observed that Qatar's CDS did not react to the positive newsflow yesterday. Just before the rift, Qatar's 10-year USD CDS was at 1.00%, which reached 1.54% after the initiation of the blockade, before normalizing gradually through the end of 2019. Since Nov'20, Qatar's CDS has been trading around its all-time lows, ranging between 0.69% and 0.76%. On the day of the announcement, Qatar's CDS spreads remained flat at 0.754%.

- **From our Qatari coverage universe, we continue to favor CBQK, GWCS and QGTS in the post-blockade environment:**
  - **CBQK (Outperform; QR5.006 TP).** Our top pick is CBQK in the banking universe. We expect strong earnings in 2021, driven by recoveries, lower CoR and reversal of provisions. Given management's strong track record, we believe RoE generation above cost of equity is attainable vs. previous years. CBQK trades at a P/B and P/E of 1.0x and 8.1x on our 2021 estimates, respectively. The stock is trading at a PEG of 0.8x based on EPS CAGR (2020-25e) of 18.0%, which is very attractive. Moreover, CBQK's 2021e P/E is trading at a 19% discount to its intrinsic P/E (10.0x), which we believe is not justified. Hence, we maintain our Outperform rating and PT of QR5.006/share.
  - **GWCS (Market Perform; QR5.10 TP).** We also want to highlight GWCS (Gulf Warehousing Co.) and reiterate our longer-term bullish thesis on the stock. GWCS has withstood the blockade well with freight-forwarding showing significant growth (up 39% in 2019 from 2017); GWCS' logistics business also remains robust driven by contract logistics and increasing occupancy in Bu Sulba. Growth post Bu Sulba (93% occupancy) could decline, but as we had flagged previously, GWCS generates substantial FCF and remains on the hunt for expansion avenues. The Al Wukair Logistics Park contract serves as an example of such a growth opportunity. With the easing of blockade restrictions, we expect GWCS to benefit. For now, we stay Market Perform on GWCS.
  - **QGTS (Outperform; QR3.40 TP).** We remain bullish on QGTS (Nakilat) and consider it as the best avenue for equity investors to participate in the LT growth expected in Qatar's LNG sector. While the blockade did not impact Nakilat's business, its potential removal should further help foreign investor sentiment. In terms of catalysts, we continue to believe expansion of Qatar's LNG output from 77 MTPA to 126 MTPA is a significant driver. Currently our model does not assume any fleet growth and we will incorporate such expansion once more details become available. We foresee significant upward revision to our estimates and price target once we factor in this expansion. We do not envision substantial risks to QGTS' business model due to the ongoing oil price volatility/pandemic.
  - **BLDN (Accumulate; QR1.94 TP).** In reaction to the 2017 blockade, Baladna heavily invested in cow milk-based dairy. With a QR2.7bn capex program, BLDN has expanded its operations significantly since 2017 and considerably grown its milking herd by importing cows, obtaining farmland and establishing facilities in order to produce dairy products from fresh milk. Given its strong brand image and superior product quality, we do not anticipate BLDN to be affected from a possible increase in dairy imports from the KSA. We reiterate our Accumulate call for the name given our expectations for the continuation of its strong growth in the local market with new products. Furthermore, while we have not yet incorporated its potential impact in our forecasts and valuation, Baladna expects to collaborate with the Federal Land Consolidation and Rehabilitation Authority of Malaysia to implement the "Baladna model" in Malaysia. This is an attempt to increase Malaysia's self-sufficiency in dairy products by doubling the volume of local fresh milk production with an increase of 50-55mnLt/pa. We maintain our positive outlook for the company and we believe any weakness in its share price could be considered a buying opportunity.

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Recommendations *Based on the range for the upside / downside offered by the 12-month target price of a stock versus the current market price*	
OUTPERFORM	Greater than +20%
ACCUMULATE	Between +10% to +20%
MARKET PERFORM	Between -10% to +10%
REDUCE	Between -10% to -20%
UNDERPERFORM	Lower than -20%

Risk Ratings *Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals*	
R-1	Significantly lower than average
R-2	Lower than average
R-3	Medium / In-line with the average
R-4	Above average
R-5	Significantly above average

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