

8 June 2017 | Strategy

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Crisis in Qatar

FBM KLCI: 1,785.92

Qatar accused of funding terrorism

**2017 Year-end Target:
1,830 points**

KEY HIGHLIGHTS

- 5 Gulf countries cuts diplomatic and economic ties with Qatar
- Qatar has long be seen as supporter of Islamists group in the region
- Impact Assessment :
 - #1: LNG Supply to Asia is expected to remain at status quo
 - #2: A cut in supply of crude oil from Qatar is a non-event to OPEC
 - #3: Minimal concern for Malaysian companies operating in Qatar

What had happened?

- **Five Gulf nations sever ties with Qatar.** On 5 June 2017, Saudi Arabia together with the United Arab Emirates, Bahrain, Yemen and Egypt decided to cut diplomatic ties with Qatar over its alleged support for Iran and Islamist groups. Transport links to and from Qatar via land, air and sea have also been suspended. Even worse, the export of white sugar to Qatar from the UAE and Saudi Arabia has been stopped, pressuring consumers in times where demand for sugar is high during the fasting month of Ramadhan. As an immediate impact, people residing in Qatar have started to store food supplies in the event that further supply shortages were to happen. Qatar is working with Turkey and Iran to secure food supplies amidst fears of food shortage and accelerated draw down of strategic food reserves in Doha.

Figure 1: Map of the five Arab nations and Qatar



Source: Google Map

- **Qatar has long been seen by the Arab world as the supporter of Islamists groups in the region,** especially the Muslim Brotherhood. And skirmishes in the diplomatic circle has occurred numerous times, including the recall of Saudi Arabia, Bahrain and UAE ambassadors in 2014. The tension escalated amidst reports in the Qatari media last month that its ruler had made a speech that questions US hostility towards Iran, in which Qatar claimed to be the act of hackers.
- **Rapprochement following President Trump's visit.** The severing of ties took place two weeks after President Trump's visit to Saudi. During the official visit, President Trump urged Muslim nations to fight terrorism that may have paved way for Saudi Arabia to take further action to combat terrorism which then resulted in this diplomatic crisis.
- **Qatari stocks went down to eight-year low.** The situation is currently not seen as affecting global energy markets in the short term, as Qatar still has access to shipping routes. However, in response to the news, Doha's QE General Index suffered an 8% loss, the biggest daily loss since the 2009 financial crises.
- **Diplomatic and economic pressure continues.** Saudi Arabia and the United Arab Emirates had stated that the diplomatic and economic relations will only be restored if Qatar withdrew its support of Hamas, the Muslim Brotherhood and Iran. Meanwhile, Turkey and Kuwait have jumped in to mediate the standoff.

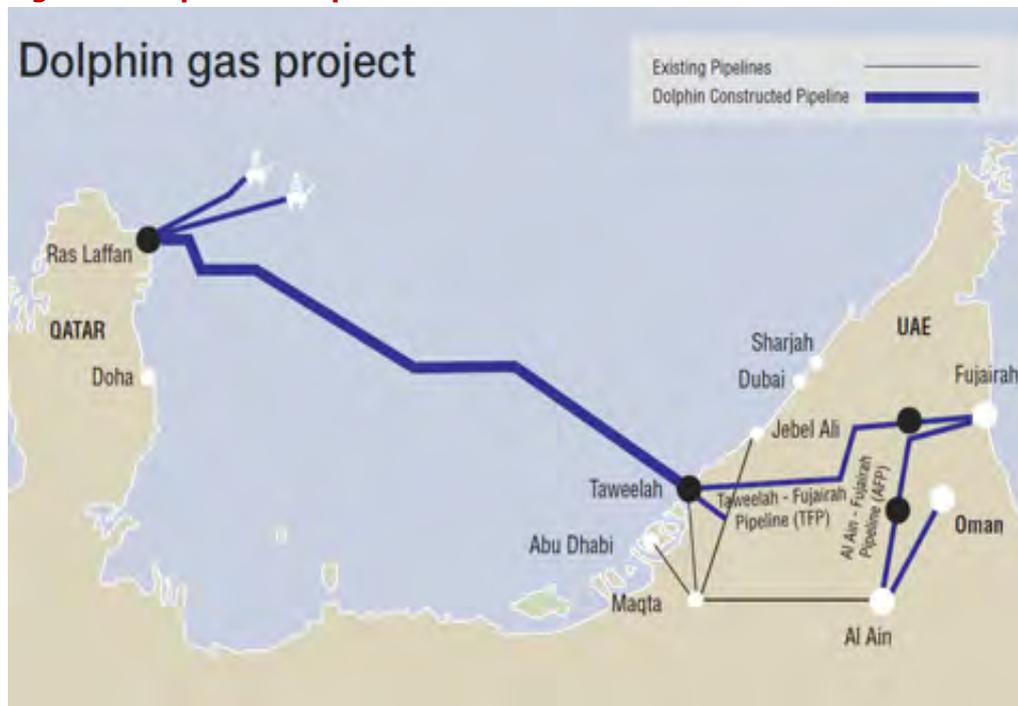
Assessing the impact - 3 key takeaways

Below are our quick thoughts on the situation, primarily looking at the energy commodities space and also initial assessment of impact to companies within our coverage with exposures to Qatar.

#1: LNG Supply to Asia is expected to remain at status quo

- **One of the biggest producer of LNG.** It is important to note that Qatar is one of the biggest producer of LNG in the world, producing 30% of world's supply at 79.6MT in 2016 according to the International Group of Liquefied Natural Gas Importers. Its port of Ras Laffan is home to the world's biggest liquefied natural gas complex, exporting 75m tons per year of cold-chilled methane in giant tankers. Qatar also exports several million barrels per day of oil and natural gas liquids.
- **UAE first to receive impact if LNG supply disrupted.** Although all vessels coming to or from Qatar via UAE's popular anchor point off Fujairah have been barred, 1.8b cubic feet per day of Qatari gas can still makes its way to UAE via the Dolphin pipeline. The Dolphin network takes gas from Qatar's huge North Field via a 364-kilometre pipeline to Abu Dhabi's Taweelah power station, then runs up to the northern emirates, including Fujairah port, and on to Oman. As of now, there have been no reports about any shutdown on operations of the Dolphin pipeline. If Dolphin pipeline were to face a shutdown, UAE would be forced to seek alternative sources as soon as the supplies come short especially during summer when demand for electricity peaks. This is not likely to be part of the embargo as the UAE has relatively limited immediate options to cover the capacity of the Dolphin pipeline is too large to be fully replaced. Even if Qatar were to initiate the supply cut in LNG, it would damage the nation's reputation as a reliable energy provider.

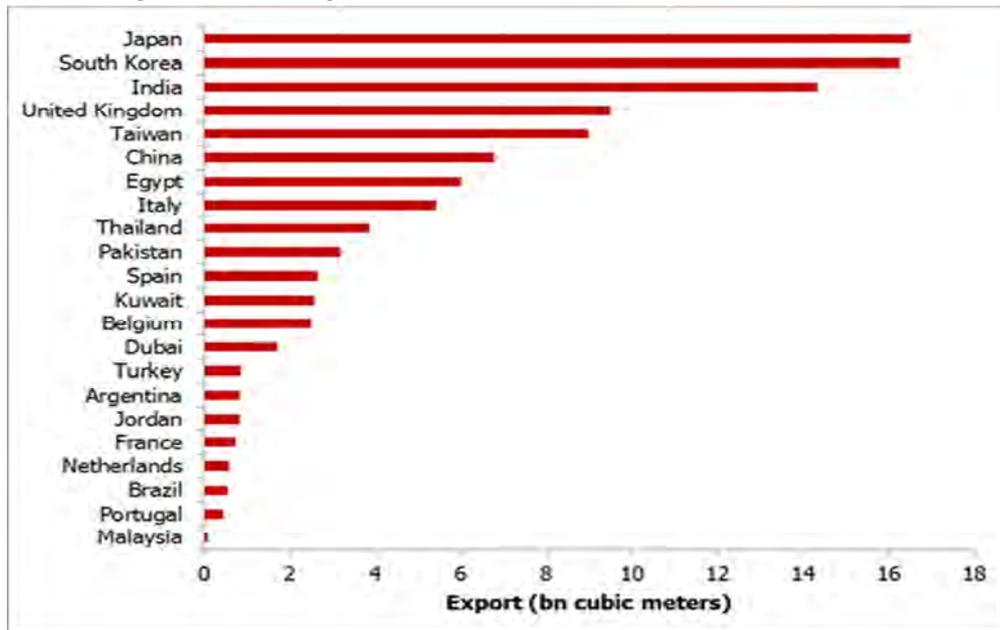
Figure 2: Dolphin Gas Pipeline



Source: Afaq

- Egypt is less vulnerable.** Based on data compiled by Bloomberg, Qatar makes up approximately 84% of LNG imported into Egypt so far this year. The bulk of the Qatar's import plays a huge role as 80% of electricity produced in Egypt is generated from natural gas. However, Egypt does not have direct deals with Qatar as LNG is brought in by Swiss commodity trade houses. For instance, Trafigura, Glencore and Vitol frequently take LNG from Qatar and deliver it to Egypt but they take ownership of the cargoes at the Qatari port and don't use Qatari ships.
- Japan and Korea are Qatar's top LNG export destinations.** Branching out from the Middle East, Qatar's top export destinations for LNG are mainly Japan and Korea. Exports to both countries in 2016 each exceeded 16b cubic metres. Assuming that Saudi and UAE waters does bar Qatari ships from navigating through its waters, Qatari ships still can sail through Iranian waters followed by the Strait of Hormuz via the usual shipping lane in the Omani territory. Even in a worst case scenario if Oman were to join the boycott against Qatar, Qatar ships can alternatively remain sailing through the Iranian sector until reaching waters of Pakistan and India. Henceforth, Qatar's LNG exports to the Asian region will not be affected.

Chart 1: Qatar's LNG Export Destinations



Source: Bloomberg

Figure 3: Shipping lanes via the Straits of Hormuz



Source: British Broadcast Channel

- Downside risk if Qatari exports are blocked to other regions.** However, there is still a downside risk if the Arab nations plot to stop Qatari exports from entering other regions especially Asia. With Japan and Korea being the biggest customers of Qatar's LNG, such blockade of exports will definitely affect the LNG supply in these countries. Comparing between Japan and Korea's dependence on Qatar's LNG, Korea is at higher risk if a supply disruption were to occur. The reason being is that the bulk of Korea's LNG imports comes from Qatar that makes up 36% of total LNG imports compared to Japan which has Qatar as its third largest LNG importer at 14% of total LNG imports.

Chart 2: Japan's LNG Import Origins

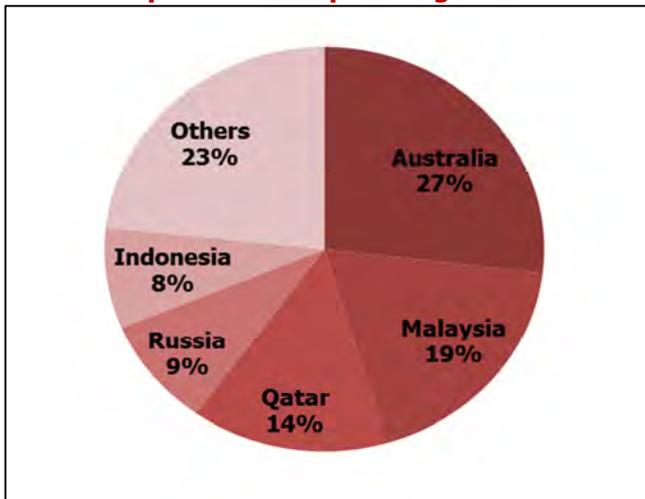
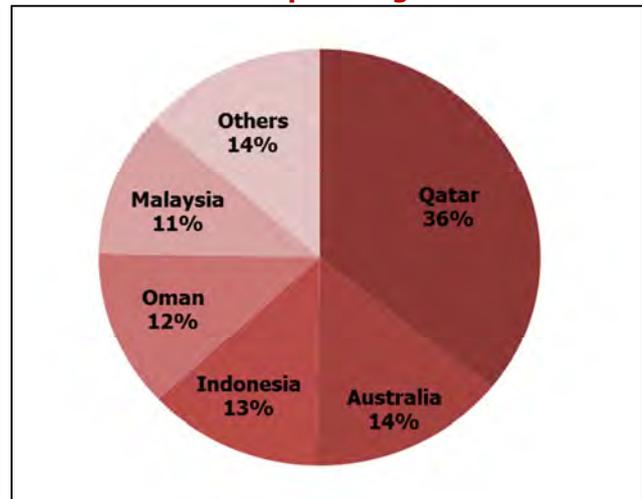


Chart 3: Korea's LNG Import Origins



Source: Bloomberg

- KOGAS to be badly affected if LNG supply affected.** Moreover, Japan's acquisition of Qatari LNG imports is spread over eight buyers as opposed to Korea having one only, which is KOGAS. Therefore, the fact that Qatar contributes the most to Korea's total LNG imports while having only KOGAS as a buyer, poses a big risk in the event of a supply disruption from the diplomatic feud. KOGAS even has one of the largest volume of LNG sourced from Qatar via long term contracts state producer, Qatargas.

Table 3: Japanese and Korean Importers of Qatar's LNG

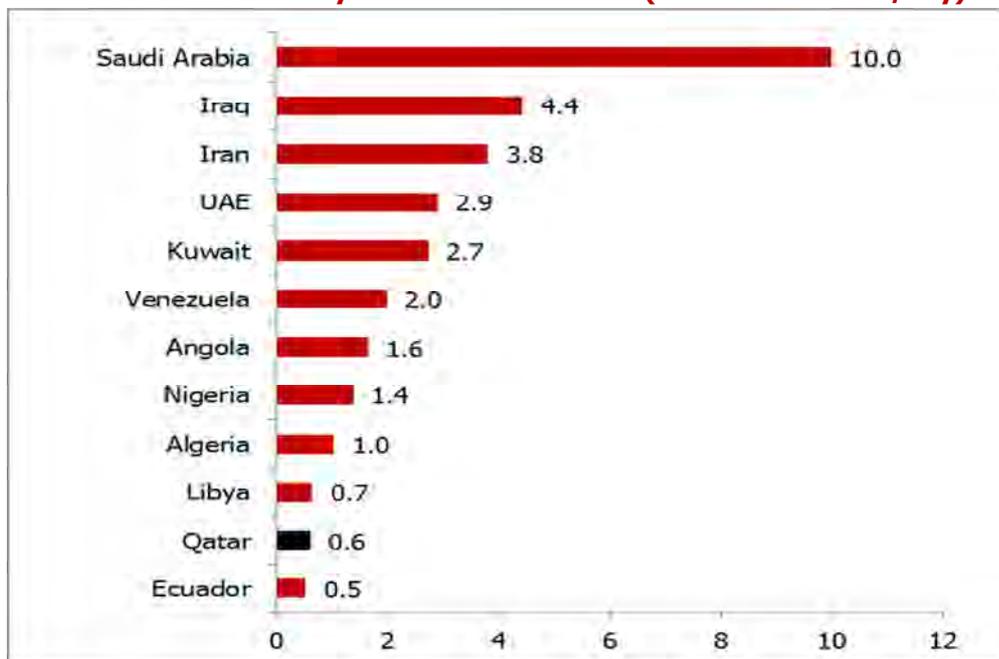
Importer	Buyer	Import Volume (billion cubic metre)
Japan	Chubu Electric	6.4
	Tohoku Electric	1.61
	Kansai Electric	1.29
	TEPCO	1.2
	Tokyo Gas	0.35
	Osaka Gas	0.35
	Toho Gas	0.17
	Chugoku Electric	0.12
Korea	KOGAS	11.97

Source: Bloomberg

#2: A cut in supply of crude oil from Qatar is a non-event to OPEC

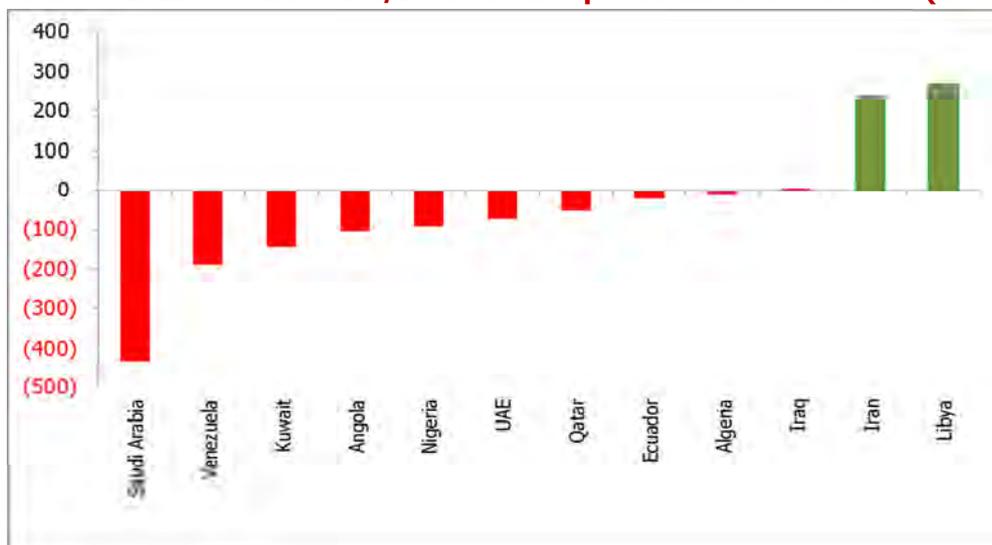
- Qatar is OPEC's smallest crude oil producer.** Qatar's current production capacity of about 620,000bpd in May 2017 which is one of OPEC's smallest. Meanwhile, other OPEC members such as Iran experienced a tremendous increase in crude production from 2.8mbpd in 2015 to the latest 2017 figure of 3.8mbpd following the lifting of international sanctions in early 2016. The increase in Iran's crude production is more than enough to offset Qatar's current output. Apart from that, the U.S's crude production is forecasted to reach an average of 9.3mbpd in 2017 and 10.0mbpd. Therefore, a supply cut in Qatar's oil production is insignificant to push oil prices higher as other oil producers are still ramping up production that would in turn undermine OPEC's efforts to rebalance the oil market.

Chart 4: 2017 OPEC Daily Crude Oil Production (in million barrels / day)



Source: Bloomberg

Chart 5: 2017 YOY Increase/Decrease in Opec Members Production (in '000 barrels/day)

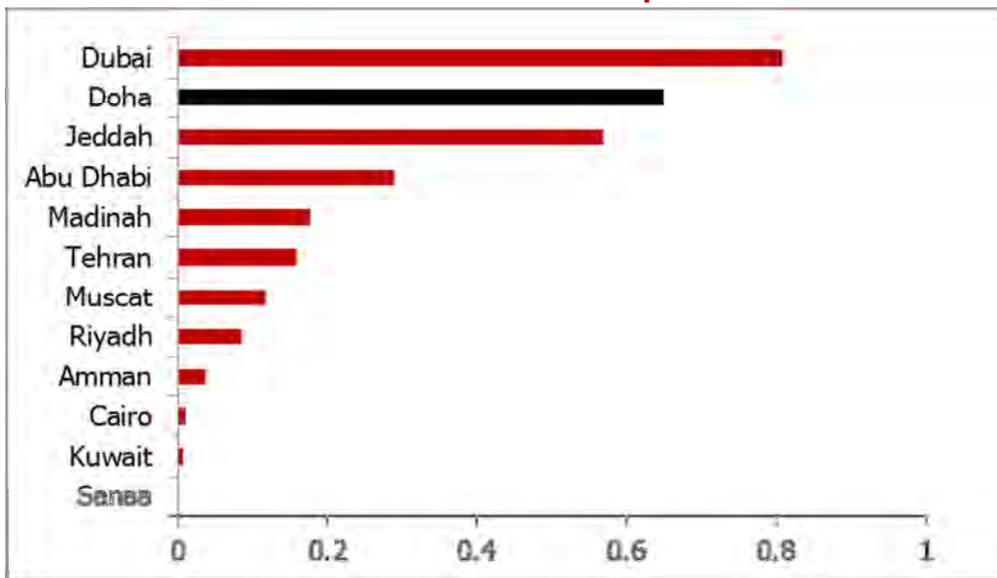


Source: Bloomberg

#3: Minimal concern for Malaysian companies operating in Qatar

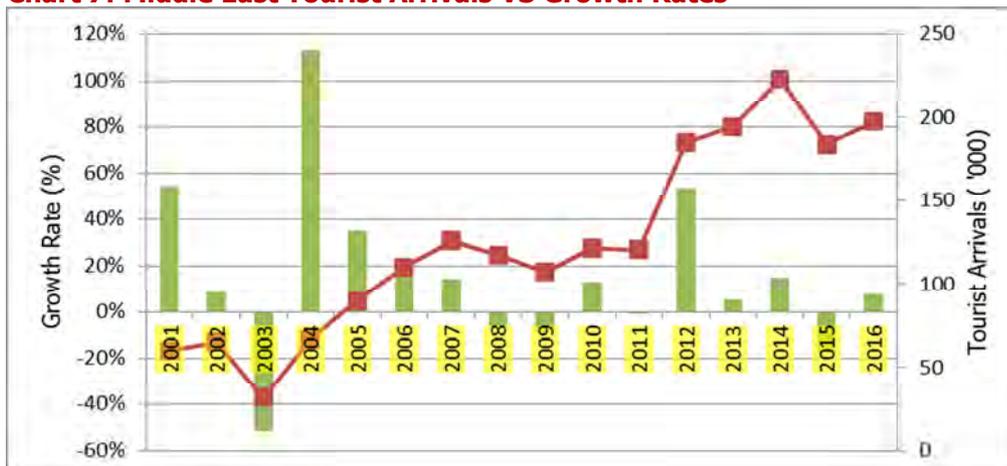
- Airspace restrictions.** Aircraft originating from Qatar have been banned from landing and even crossing the air space of Saudi Arabia, affecting its national airline, Qatar Airways. So far, UAE-based airlines that include Emirates, Etihad, Fly Dubai and Air Arabia have suspended flights to and from Qatar. Qatar Airways on the other hand had also suspended flights to Saudi Arabia. As a result, airlines especially Qatar Airways would have to take alternative routes which may take longer hours and not be economically viable.

Chart 6: Tourist arrivals from Middle Eastern Airports



Source: CEIC

Chart 7: Middle East Tourist Arrivals VS Growth Rates



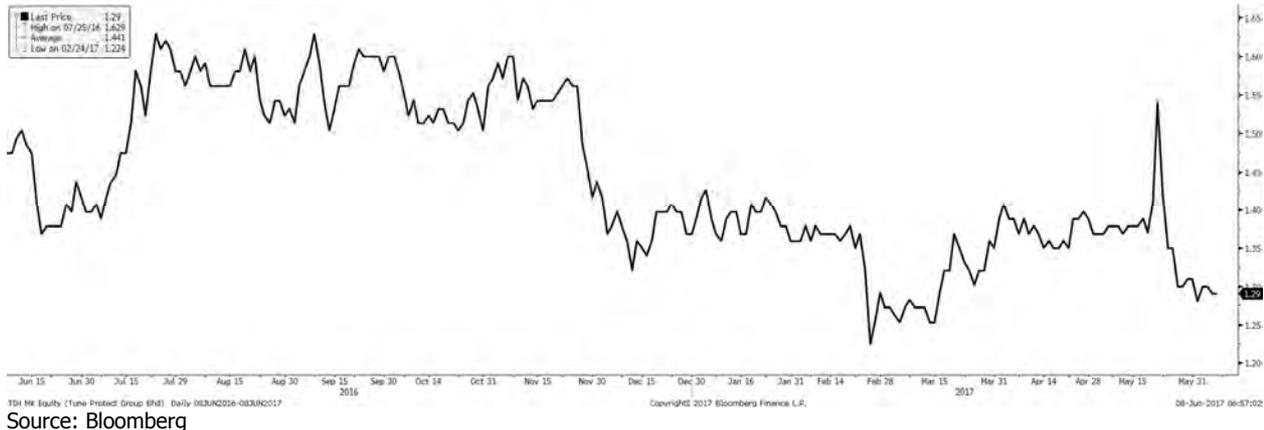
Source: CEIC

- Second largest Middle East tourist arrivals come from Doha Airport.** It is important to note that tourists from Doha were the second largest Middle East group to enter Malaysia in 2016 after Dubai. Although the diplomatic crisis will have a significant impact on Middle Eastern countries, growth of Doha tourists to Malaysia may decline if political fears escalate further to the level where travelling is not advisable. Nonetheless, Malaysian aviation companies such as **Air Asia X (Neutral, TP: RM0.50)** will not be directly impacted as they do not have flights to Qatar but only to Saudi Arabia and Iran. Political uncertainty would then prompt travelers flying to Saudi Arabia and Iran via Air Asia X to purchase travel insurances from Air Asia's insurance arm, **Tune Protect (Buy, TP: RM2.18)**.

Chart 8: Air Asia X

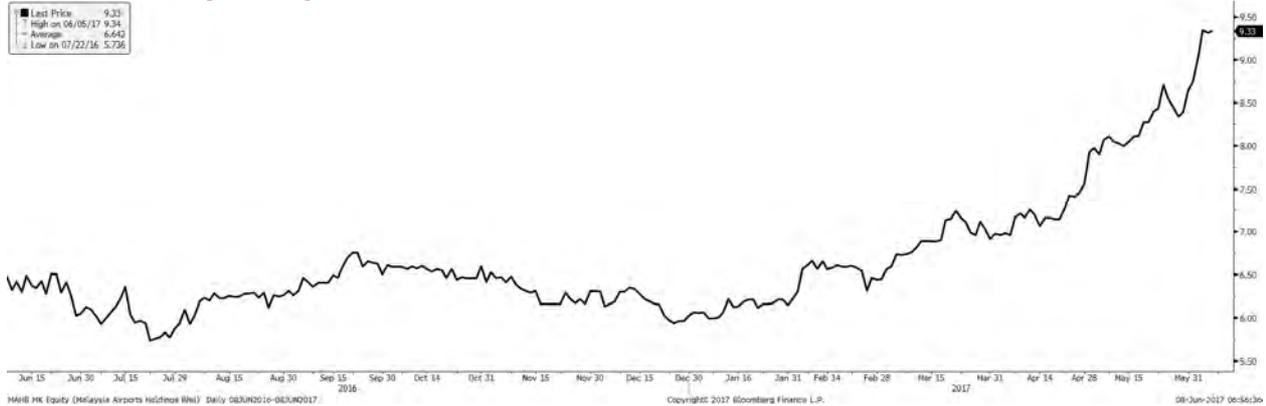


Chart 9: Tune Protect



- Plenty of alternative airlines with reach to Malaysia.** Despite Doha is the second biggest contributor to tourist arrivals in Malaysia, we believe that the impact to **Malaysia Airports (Neutral, TP: RM8.05)** is minimal. Middle East tourists can still find plenty of alternative airlines to fly into Malaysia such as Emirates, which in April announced that it plans to shift its aircrafts to destinations in Malaysia, Oceania and Africa, in response to US travel restrictions. And outbound tourist from Malaysia, also has both Emirates and Ettihad are alternative airlines to travel to Europe and Americas, on top of going through the eastern route through East Asia.

Chart 10: Malaysia Airports



- If tensions escalates within the next 12 months.** Malaysian construction companies with exposure to Qatar include **Muhibbah Engineering (Buy, TP: RM3.24)** and **WCT Holdings (Sell, TP: RM1.61)** may suffer setbacks in project roll-outs if tensions escalates too long as Qatar will put diplomatic rifts on centre stage. Qatar is currently mediating to the logistics blockade by the five Arab nations. Development on infrastructure will not be effected but logistics will be a main obstacle.

Chart 11: Muhibbah Engineering

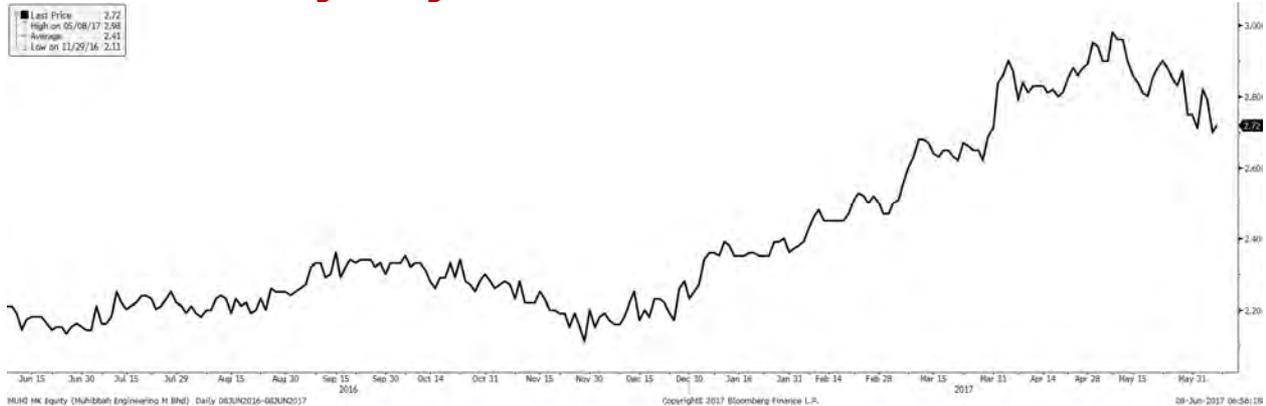


Chart 12: WCT



Source: Bloomberg

- **If tensions fade in the 12 months.** If the political turmoil cools down in the next 12 months, project roll-outs will be faster to start the ball rolling and economy growing. Moreover, Qatar has a strong international credit rating of “double A” so there should be no problem for Qatar government to make payments to the projects awarded to the Malaysian companies.
- **Muhibbah and WCT expected to remain in Qatar.** Despite the ongoing tensions in Qatar, Muhibbah and WCT will remain their businesses in Qatar due to its strong fundamentals that are intact. Hence, we are not changing our calls and making revisions to our estimates for now, unless the crisis involves military intervention.

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STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <-15% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

SECTOR RECOMMENDATIONS

POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.