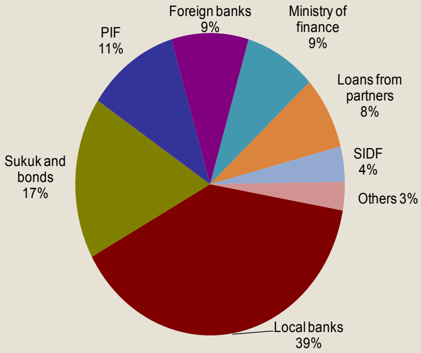
جدوى للإستثمار
Jadwa Investment

August 2010

Financing trends for listed companies

Sources of long-term financing
(end 2009; total SR330 billion)



Access to long-term financing for companies listed on the Saudi stock market has been hit by the greater risk aversion of local commercial banks, but companies have utilized other sources of finance to make up for much of the shortfall. In particular, borrowing from governments and sukuk issuance has risen. We conclude this after an examination of the annual financial statements between 2004 and 2009 of all the 143 listed companies. Although this only captures a portion of total corporate borrowing in Saudi Arabia, we think the key findings are valid across the whole private sector.

- **New commercial bank lending has fallen significantly:** Historically, listed companies have sourced more than half of their long-term borrowing from local banks. This has changed recently as banks have become more cautious about lending. Last year local banks accounted for just 14 percent of net new long-term lending to listed companies.

- **Governments have increased their lending:** Government specialized credit agencies in the Kingdom, particularly the Public Investment Fund, have stepped up long-term lending to cover the shortfall in bank finance. Foreign government lending, through export credit agencies, has also become a more important source of financing.

- **Sukuk issuance has grown, but debt is underutilized:** Sukuk issuance was one of the leading sources of funding for listed companies last year, though it is dominated by those with large government ownership. Overall corporate borrowing is low. The total debt to equity ratio for listed companies is around a quarter of that in leading global markets.

- **Stock market conditions have hit equity financing:** Funds raised through initial public offerings and rights issues slumped during 2009 owing to less attractive stock market conditions. There has been a modest improvement so far this year.

- **Borrowing is concentrated in certain sectors:** The bulk of the borrowing was undertaken by companies in sectors that are engaged in major expansions. Petrochemicals, telecoms and energy account for more than 80 percent of the current outstanding long-term debt of listed companies.

We do not think that the recent shift in sources of finance is a structural change. When market conditions improve bank lending will recover and public sector support will ease. However, growth in bank lending will not be as fast as it was in the years up to 2008 and listed companies are likely to continue to diversify their financing base.

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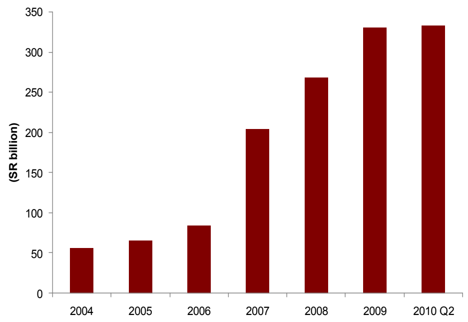
Long-term financing

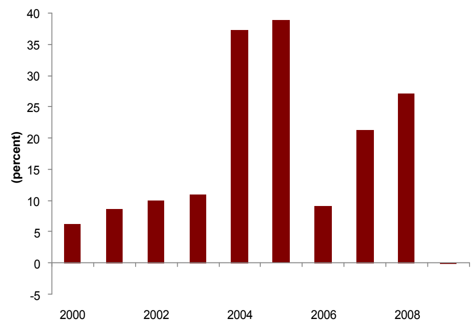
We have examined the financial statements of all listed companies since 2004. They show that long-term debt (defined as debt with a maturity of more than one year) of listed companies climbed to SR333 billion at the end of the second quarter of 2010, up from SR58.8 billion at the end of 2004. After jumping by 143 percent in 2007, growth in outstanding long-term debt slowed to 31 percent in 2008 and to 23 percent in 2009. Over the first six months of 2010, total long-term debt rose by just 1 percent (SR3 billion) The recent decline is due to heightened caution among lenders and tougher economic conditions dampening demand. In addition, the bulk of funding for many large projects, notably in the petrochemicals sector, was secured prior to the global financial crisis, so the funding requirement has been smaller in recent years. In absolute terms, the increase in net long-term debt has fallen from SR120 billion in 2007 to SR64 billion in 2008 and SR62 billion in 2009.

Long-term debt of listed companies



Historically, listed companies have sourced the bulk of their long-term funding from **local commercial banks**. Local banks accounted for SR130 billion of the outstanding long-term debt of listed companies at the end of 2009, equivalent to 45 percent of banks' total long-term lending (Sharia-compliant debt products account for 30 percent of this total). In recent years the role of local banks has diminished. They accounted for just 14 percent of net new long-term lending to listed companies in 2009 and at the end of that year were the source of 39 percent of total long-term debt, compared to 52 percent two years earlier.

Bank lending to the private sector
(annual change)



The shift away from bank financing is because the global financial crisis and high-profile defaults by local companies have made banks more cautious toward extending credit. Listed banks have raised their provisions for non-performing loans by just over SR17 billion since the end of the third quarter of 2008 and have overhauled their lending policies, requiring greater transparency from borrowers. The reduction in the growth of lending to listed companies is also attributable to companies hitting their individual borrower limits. Banks are limited in the amount of money they can lend to a single customers to avoid a concentration of risk, so when overall lending is barely rising, banks have little scope to lend more to any borrower that is at its limit.

Long-term debt of listed companies

	Total (SR billion)			Share (percent)		
Source of funding	**2007**	**2008**	**2009**	**2007**	**2008**	**2009**
Local banks	107	121	130	52.3	45.1	39.2
Sukuk and bonds	35	43	57	17.1	16.0	16.7
PIF	11	24	36	5.3	8.8	11.0
Foreign banks	14	24	31	6.9	9.1	9.3
Ministry of finance[1]	28	28	28	13.9	10.6	8.6
Loans from partners	2	16	26	1.1	6.1	7.8
SIDF	7	12	12	3.5	4.3	3.8
Others	-	-	10	-	-	3.6
Total	**204**	**268**	**330**			

[1]Comprised of two loans to the Saudi Electricity Company.

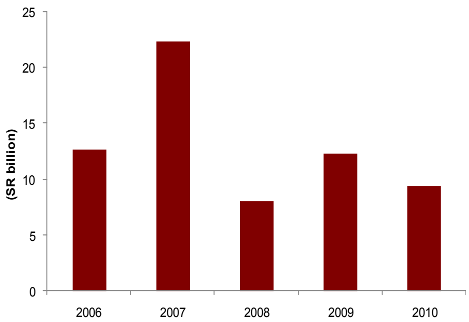
While local commercial banks are significant lenders, they are also borrowers. Local banks accounted for around 3 percent of total outstanding long-term debt at the end of the second quarter. This was largely borrowed either from foreign banks or in the form of locally-issued sukuk. Banks have borrowed in order to extend the average maturity of their capital structure and therefore narrow the mismatch in maturity between their assets (largely short-term deposits) and their liabilities (longer-term loans).

In response to greater caution among banks, government specialized credit institutions have upped lending, with the **Public Investment Fund** (PIF) one of the main sources of new long-term funding to listed companies in 2009. The PIF increased its long-term lending to listed companies by 50 percent last year. The PIF tends to provide long-term funding to strategic projects. It often holds equity stakes in the companies that it finances.

Owing to concerns about the lack of availability of funding from banks, the PIF announced an increase in its support for local projects through higher lending limits and an extension to the duration of its loans in January 2009. Even prior to this, it was becoming more involved in new lending, as outstanding long-term loans more than doubled during 2008. (Note that there is a discrepancy between our data, which is taken from the balance sheets of listed companies, and that on total net lending by PIF published by SAMA, taking into account lending to companies that are not listed.)

Sukuk and bonds were one of the largest sources of funding for listed companies last year. However, issuance has been limited to a few companies. Sabic and the Saudi Electricity Company account for 84 percent of the total outstanding amount and were the source of 73 percent of new issuance last year. In both cases these are majority government-owned companies and there has been strong demand for their sukuk. The environment is more difficult for those companies without significant government ownership. Only two other listed companies, Saudi Hollandi Bank and Dar al-Arkan issued sukuk last year and in both cases they had to pay much more to borrow than the government-linked firms. Dar al-Arkan and Saudi Electricity Company are the only listed companies to have issued sukuk so far in 2010.

Sukuk issuance by listed companies



Debt (both Islamic and conventional) is not as widely utilized as a source of corporate finance in the Kingdom as it is elsewhere. The overall debt-to-equity ratio of the companies listed on the TASI is 1.34, compared to 4.19 for the US S&P 500 (excluding AIG, which distorts the debt number) and 5.6 for the UK FTSE 100. Some steps have been taken to encourage sukuk issuance, notably the launch of a trading platform through the Tadawul last year, but activity has been light (there have been only two trades since May). There are currently six sukuk issues in the pipeline for the remainder of the year; only one is by a listed company.

Loans from foreign joint-venture partners to listed companies were up by SR10 billion last year and account for 8 percent of listed company long-term debt. These loans are concentrated in the petrochemical and telecoms sectors and are likely to decline once operations start at specific projects. The healthy inflow of funds shows the importance foreign companies place on ventures in the Kingdom, as funding for many projects throughout the world was scaled back during the global recession.

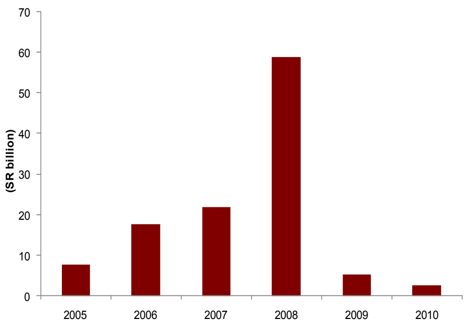
Although **foreign bank** attitudes toward lending have been dented by the same factors affecting local banks, they were the fifth largest source of long-term financing to listed companies last year. Net long-term lending of foreign banks to listed companies increased by SR7 billion (29 percent) in 2009. These loans were almost exclusively to petrochemical companies and largely as part of agreements signed in advance of the financial crisis. Much of this new lending was by export credit agencies (which are categorized under foreign banks in the financial statements of listed companies). Loans extended by foreign banks to local listed companies account for 9.3 percent of total corporate long-term debt. With many of the petrochemical complexes in their final stages of development, foreign bank lending to listed companies is expected to fall.

Net lending by the **Saudi Industrial Development Fund** (SIDF), another specialized quasi-government credit agency, to listed companies was unchanged in 2009, amounting to 4 percent of total corporate debt. SIDF loans have longer maturities than those offered by banks and are limited to sectors that are industrial in nature, including cement and building and construction. Funding constraints have hindered the ability of SIDF to lend, so earlier this year the government increased its capital by SR10 billion to SR30 billion. (As with the PIF, there is a discrepancy between the data we have derived from listed companies and that published by SAMA.)

Other sources of financing

Listed companies have used equity financing, short-term borrowing, retained earnings and other sources of finance to raise funds. During 2009, SR3.9 billion was raised through initial public offerings by ten companies, rights issues were the source of a further SR1.4 billion. In both cases these figures are well down on previous years. Total funds raised through IPOs and rights issues increased in each of the previous four years and reached SR58.8 billion in 2008. The decline was probably due to less attractive stock market valuations and caution about the economic environment. Equity capital market activity has remained subdued so far this year, with the IPOs generating SR2.9 billion and rights issues a further SR0.1 billion.

Funds raised by IPOs and rights issues



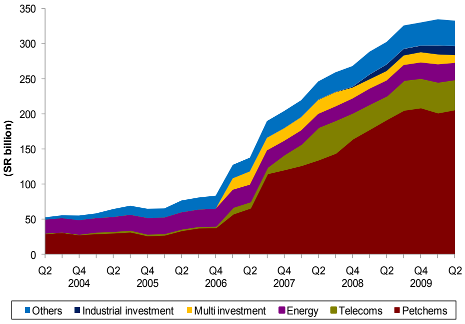
Dividend stocks, whereby companies convert retained earnings to paid capital and issue as stocks rather than cash dividends to shareholders, are another method listed companies have used to maximize funds available to finance their activities. During 2009, 12 companies used this method to permanently retain a combined total of SR8.5 billion in earnings. A further SR1 billion in dividend stocks was issued in the first half of 2010.

Many listed companies use short-term borrowing, through Islamic products, such as murabaha, to fund their long-term capital projects. We believe this practice is widespread and is motivated by the desire to keep their long-term debt down in order to remain Sharia-compliant (companies whose long-term debt exceeds 33 percent of their market capitalization are not considered Sharia-compliant). Finally, some companies are using their own cash to meet their long-term funding needs.

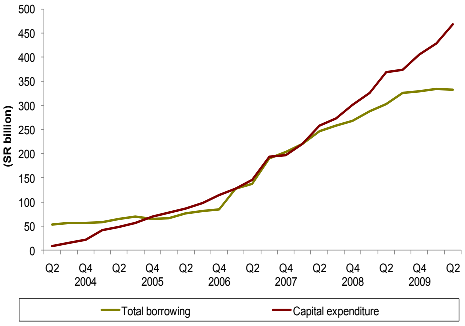
Sectoral breakdown

The Saudi stock market is divided into 15 sectors. The bulk of the borrowing was undertaken by companies in sectors that are engaged in major expansions. Petrochemicals, telecoms and energy

Breakdown of debt by stock market sector



Long-term borrowing and capital spending



(effectively, electricity) account for 82 percent of the current outstanding long-term debt of listed companies. Petrochemical companies accounted for 62 percent of all long-term debt at end of the second quarter, down from 64 percent at the end of 2009. This relative decline is likely to continue as most of the large petrochemical expansions are either complete, or close to completion. Growth in the debt of telecoms companies is also on a downward trend after a spurt of investment that followed the liberalization of the sector. Financing needs of the energy sector will remain high. The Saudi Electricity Company plans a substantial boost to generating capacity in order to meet rapidly growing demand.

The remaining 18 percent of outstanding corporate debt was owed by companies in the multi-investment, industrial investment, banking and agricultural sectors. Borrowing by the multi-investment sector was primarily to finance investments. Industrial investment companies have engaged in large capital investments and are able to secure most of their financing from SIDF. Food processors and other companies that have high cash flows have generally had little difficulty in securing debt. Many real estate developers have large financing needs, but with the projects of several still underway, the absence of cash flows has hindered their ability to raise funds.

Uses of long-term financing

The bulk of long-term borrowing is used to finance capital spending. The graph to the left shows that there was a fairly tight relationship between long-term borrowing and capital expenditure. This began to loosen in the final quarter of 2008, when commercial bank lending dried up. At the end of the second quarter, capital expenditure for all listed companies totaled SR468 billion, SR135 billion greater than total long-term debt outstanding.

Outlook

We doubt that the recent shift in sources of finance is a structural change. When market conditions improve bank lending will recover and public sector support will ease. Nonetheless, there has been a fundamental change in bank lending practices, which will mean that lending will not grow as fast as it has done in the years prior to 2009. Bank lending grew by an average of 27 percent between 2004 and 2008. Over the coming years growth will struggle to reach half of that level. Listed companies should be less affected by this than others in the private sector as they are generally more transparent.

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