SAUDI ARABIA COUNTRY REVIEW

2018

SAUDI ORIX LEASING COMPANY

Contents

Kingdom of Saudi Arabia - Country Review

Country Demographics

Saudi Arabia is the largest country in Arabian Peninsula with a land area of 2.15 million km^2 and population of 32.6 million as reported for 2017. The Country is home to two holiest cities of Muslims i.e. Makkah and Madinah, which attracts millions of visitors every year, particularly during the Hajj. The Kingdom, conjures up just one image i.e. oil, however is also endowed with a wealth of other natural resources. The Country has spectacular archaeological remains at Mada'in Saleh (a UNESCO World Heritage Site), the southwest region has mountains, forests, exotic wildlife and there is coastline of more than 3,000 kilometers on the Red Sea and the Gulf that includes 1,300 islands.

Economy

Saudi Arabia is the world's largest oil exporter and reportedly has twenty-five percent of earth's known hydro carbon reserves, besides holding largest minerals deposits in the Gulf, including about 20 million tons of gold ore, 60 million tons of copper, 10 billion tons of phosphates and millions of tons of other elements. The Country has an oil based economy with oil accounting for 63% of government revenue and 43% of the total GDP. The Government, through its several five-year development plans, used oil revenue to transform its relatively underdeveloped, oil-based economy into that of a modern industrial state.

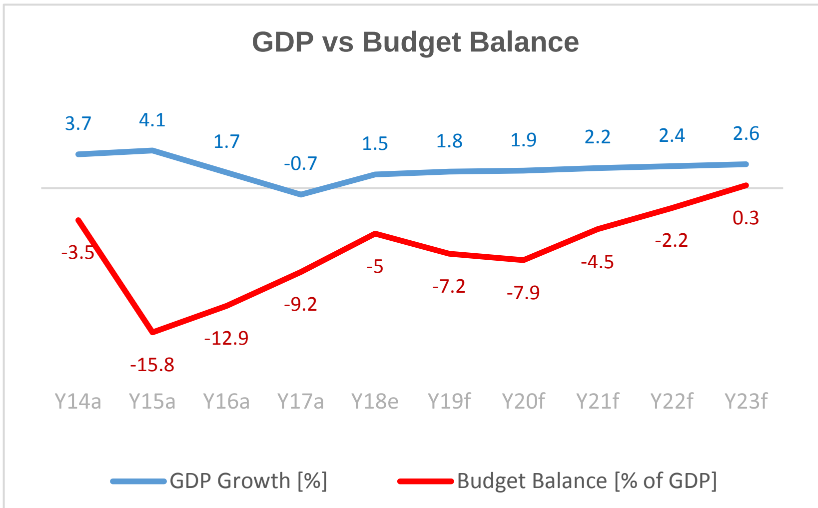
Starting with 2015, Kingdom is facing financial downturn as a result of sharp drop in oil prices, however, with the support offered by its substantial foreign reserves, tight fiscal stance and economic policies, the Kingdom is well positioned to ride out the challenging economic period. The Kingdom has been taking a multi-pronged steps through its radical development strategy that aims to enhance nonoil revenue, promote small and medium enterprises and diversification of exports. In order to reduce its long-standing dependence on oil and move the fiscal position on to a sustainable footing, the Kingdom carried out a number of significant economic reforms to shift from government-led growth to the private sector taking a leading role in economic expansion.

FIGURES IN US $	2012	2013	2014	2015	2016	2017
GDP Nominal in US $ Billions	736.0	746.6	756.4	654.3	644.9	688.6
Gross Fixed Capital Formation % to GDP	21.3	22.2	23.5	28.2	24.5	22.0
GDP Per Capita	25,208	25,413	25,214	21,180	20,289	21,057
Population in millions	29.2	29.4	30.0	30.9	31.8	32.6
Inflation %	2.9	3.5	2.7	2.2	2.1	-0.8
Oil Price US$/b [OPEC basket]	109.5	105.9	96.3	49.5	40.8	52.4

Source: EIU/SAMA

Economic Outlook

The Kingdom's process of fiscal reform is starting to pay off as economic growth is estimated to improve to 1.5% percent in 2018, up from -0.7 percent in 2017, while fiscal deficit for year 2018 is estimated to narrow down to 5% of GDP as compared with 9.2% in 2017. The recent data released by SAMA, also indicates a continuous improvement in Saudi economy; Credit to the private sector rose at the fastest annual pace in more than two years by 3.1% y-o-y in February 2019, while bank claims to the public sector also recorded a rise by 21.2% y-o-y. SAMA foreign reserves marginally declined by 0.5% y-o-y.



Whilst economic reforms are still currently under way, the foregoing numbers suggest that the economy was able to absorb most of the disruptive effects of necessary economic reform enacted last year. Looking ahead, as comparably limited major reform is scheduled to take place during 2019, this should clear the way for a pickup in momentum for the Saudi economy. 2019 expects to see a consolidation of efforts in striving towards the goals of the Vision 2030 (Vision), as well as the targets set under the National Transformation Program (NTP). This effort will be aided by the largest ever budgeted expenditure, for the second successive year, of SR1.1 trillion, which not only includes a twenty percent yearly rise in capital expenditure, but also a number of targeted support measures. Overall, whilst the oil sector's output will be partially trimmed by Saudi Arabia's commitment to the OPEC agreement, non-oil sector is expected exhibiting marginally higher year-on-year growth. Overall economists' forecast suggest an average real GDP growth at 2.2% a year in 2019-23.

Key Economic Indicators' forecast

	2014a	2015a	2016a	2017a	2018e	2019f	2020f
GDP							
Nominal GDP (US$ bn)	756.4	654.3	644.9	688.6	779.2	746.4	754.8
Real GDP growth (%)	3.7	4.1	1.7	-0.7	1.5	1.8	1.9
Expenditure on GDP (% real change)							
Private consumption	6.1	6.8	0.9	3.2	2.0	2.4	2.6
Government consumption	12	-1.8	-17.5	3.2	1.0	2.0	1.9
Gross fixed investment	7.5	3.7	-14.3	-4.0	1.5	4.6	4.1
Fiscal indicators (% of GDP)							
Budget revenue	36.7	25.0	21.5	26.8	32.3	33.7	33.5
Budget expenditure	40.2	40.8	34.3	36.0	37.3	40.9	41.4
Budget balance	-3.5	-15.8	-12.9	-9.2	-5.0	-7.2	-7.9
International reserves (US$ m)	732,353	616,418	535,797	496,423	496,589	486,657	452,591

Source: EIU

Country's Rating

Rating Agencies have anticipated Saudi Arabia's long and short term rating with stable outlook. Further, the agencies expect that the Kingdom will maintain a pace of moderate economic growth and retain strong government and external balance sheets over the next two years.

	Rating before the downgrade	Current Rating	Outlook
S&P	AA-	A-	Stable
Moody's	Aa3	A1	Stable
Fitch	AA	A+	Stable

KSA's Financial Services Sector

KSA's Financial Services Sector consists mainly of Government owned Specialized Credit Institutions, Commercial Banks and Finance Companies which are supervised and regulated by Saudi Arabian Monetary Agency (SAMA), the Central Bank of the KSA, established in 1952. Under the supervision of Saudi Arabian Monetary Agency (SAMA), the banking regulatory and supervisory framework has been strengthened and the payment and settlement systems have become modern and efficient. The government owned credit institutions continued achieving development objectives at the country level and the banking sectors has built-up profound standings.

Specialized Credit Institutions

The industrial infrastructure in the Kingdom has been built by public funds through five specialized credit institutions which provide long term concessionary credit to industry, agriculture and real estate. The institutions, each one operating with certain mandate, include Saudi Industrial Development Fund, Public Investment Fund, Agricultural Development Fund, Saudi Credit & Saving Bank and Real Estate Development Fund. These institutions own total assets of USD 79 billion and disbursed USD 92.5 billion since inception towards the end of 2017. [Note: Previously reported data has been modified due to restructuring of SCI]

Commercial Banks

Banking sector consists of 25 commercial banks, including branches of foreign banks, operating through 2,079 branches across all the regions of the country while employing 47,588 workers. Saudi Arabian banks have been traditionally well capitalized, with good loan-to-deposit ratios and low exposure to foreign debt, as a result of robust financial regulation entailing high reserve and liquidity requirements.

The banking sector recorded a strong activity growth till 2014 amid healthy economic momentum and strong liquidity, before slowing down in the aftermath of the acute drop in oil prices. In following 4-years, total assets just rose by 11% to USD 630 billion with an increase in deposit by 5%. Total claims on private sector rose by 14% to USD 383 billion and accounted for 86% of the total bank deposits.

Consolidated Figures of Commercial Banks – SAMA Report

US$ in million	2014	2015	2016	2017	2018
Claims					
Public Sector	26,386	33,327	60,647	80,303	93,883
Private Sector	334,989	365,847	374,793	371,653	382,638
Deposits	420,154	427,938	431,203	431,750	442,956
Capital & Reserves	66,163	72,257	79,705	84,694	81,037
Profits (Cumulative)	10,709	11,382	10,763	11,647	12,893

Leasing in the Kingdom

The market for leasing in the Kingdom exists across a range of business sectors including manufacturing, oil and gas, construction and contracting, Hajj and tourism, agriculture, medical, transportation and trading. Businesses in these sectors find leasing attractive, not only because of its known advantages, but also because of its compatibility with the Islamic Sharia'h law.

Leasing business was governed by contract law until the endorsement of Finance Laws in July 2012, to regulate finance lease and real estate mortgage business activities and finance companies. In 2013, SAMA also issued executive regulations for implementation of new laws to develop supervisory and regulatory framework with an objective to enhance stability of finance sector, fairness of the businesses and creating a competitive environment contributing towards improved finance services meeting the market needs. Since then several Circulars and guidelines have been issued from SAMA to strengthen the regulatory framework. During 2017, SAMA established a Finance Lease Registration Company, which aims at realizing legislative objectives to ensure fairness of dealings, protection of customer rights and addressing of problems facing financiers when recovering their movable assets. In addition, anti-fraud rules for financing companies were also issued with the objective of introducing general principles and setting the minimum standards to be met by finance companies to detect and prevent fraud.

Market Potential for Leasing & Other Financing Activities

The leasing market in the Kingdom is the biggest in the region and Gross Capital Formation running into many billions of dollars. Saudi Arabia Monetary Authority (SAMA) has issued licenses to 37 Finance Companies, undertaking financing activities which include Leasing, Murabaha, Real Estate financing to SME and large businesses and Credit Card and Automobile financing to individuals.

	2013	*2014*	*2015*	*2016*	*2017*	*2018 [Q3]*
Total Number of Licensed Companies	**3**	**18**	**30**	**34**	**37**	**37**
Real Estate Finance Companies	2	5	6	6	6	6
Non Real Estate Finance Companies	1	13	24	28	31	31
Consolidated Capital (billion US $)	**0.44**	**1,97**	**3,0**	**3.3**	**3.79**	**3.84**

Total Financial Assets of Financing Companies were US$ 9,950 million as at third quarter of year 2018, showing a decrease of 2.27% as compared with 2017, while net financing during first three quarters of the year 2018 was US $ 12.8 billion as compared with US $ 13.6 billion in 2017, having a composition of 21:79 for Real Estate and Non-Real Estate Financing.

Portfolio classification with respect to size of types of customers:

Geographical Classification: Central regions had the biggest share of Finance Companies services with 44% (2017: 44%), followed by Western Region at 27% (2017: 23%) and Eastern Region by 18% (2017: 18%). The Northern Region together with Southern Region accounted for nearly by 11% (2015: 15%).

Consolidated Financial Position of Financing Companies

Main Indicators (USD' million)	2016	2017	2018 [Q3]
Financing Portfolio	14,184	13,617	12,800
Total Assets	10,334	10,181	9,950
Commitments	1,488	1,324	1,403
Equity	3,325	3,258	3,443
Reserves	5,415	5,600	5,104
Profitability	266	314	246

Below are the fundamental financial ratios for the year 2017 & 2018

	2016[A]	2017[A]	2018[E]
ROA (%)	4%	3%	3%
ROE (%)	5%	6%	6%
NPL[1]/Total Portfolio (%)	14%	13%	15%

[1]Non Performing leases

Key Market Challenges

Debt Enforcement Mechanism	Besides having title to the lease assets, Financing companies obtains promissory note from the authorized signatory, major shareholder or owner of the business for payment of exposure amount. However, since debt enforcement mechanism is weak, it takes a long to time recover the money through legal means.
	Enforecement of Bankrupcy law and Incorporation of Contract Registry (which is underway) would improve the concerns
Compliance with Anti-Money Laundering Laws and Regulation	Financing companies are primarily dealing with Small and Medium sized organizations and most of the companies in the segment are not much organized due to their size and scale of operations. The Anti-money law and Regulations prohibits collection of any payment in cash and requires acceptance of payment only from the beneficiary. Financing companies finds it difficult to comply with the requirements especially when it comes to collection of overdue amounts from defaulters or adjustment of payment received from third party on behalf of customer.
	While financing companies are trying to comply with the requirements of Anti-money Laundering laws and regulations, it should be acknowledged that controls and processes are always designed in accordance with the size and scale of operation. Moreover, financing companies neither take deposits from customers nor offer electronic transfer of funds, therefore are exposed to limited risk of money-laundering, therefore Anti-money Laundering laws and regulations applicable for banking companies should be tailored to risks involved and size and scale of operations of financing companies.
Repossession of Assets for Default Cases	Financing Companies provides lease facility to small, medium and large enterprises for assets like Vehicles, Machinery, equipment and Real Estate. Under the lease contract, Financier remains the legal owner of the asset, till payment of all amounts due under the contract. If a lessee defaults on payment of rentals beyond certain number of days, Financier has a right to repossess and sell the asset in the market to recover its exposure. However, Ministry of Interior has recently restricted repossession of assets under default only through Courts. The Courts, which were supposed to appoint repossession agencies, are not ready with the infrastructure as no one applied for establishment of such agency to the court; therefore the matter is neither here nor there.
	Alternate measures should be taken by the Ministry of Interior for the transition period
Saudization	Due to Saudization requirements, there is high demand for good Saudi resouce, which inturn has put pressure on salary cost and increased staff turnover.