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SAUDI ARABIA ON THE MOVE
Making of a Trillion Dollar Economy

An Aranca Special Report

2013

PREFACE

The aftermath of the global financial crisis that led to a global slowdown in 2008-09, spared no one. Even the oil-rich GCC countries suffered as canceled or suspended construction projects soared to USD1.74 trillion. Saudi Arabia bore the brunt of it. The Kingdom saw a 42 percent decline in FDI to USD16 billion in 2011.

But, FDI is just part of the story. Saudi Arabia is on the move.

Buoyed by the twin surpluses in the government budget and current account in addition to a solid institutional regulatory framework, the most efficient markets in the region and high macroeconomic stability, Saudi Arabia remains a favored nation for FDI. Last year, it was placed 12th overall as an investment destination, and ranked 22nd as easiest place in the world to do business in the global sweepstakes. Now, the Kingdom is on the cusp of becoming a trillion dollar economy within this decade, and the government is using oil wealth to set some internal priorities right.

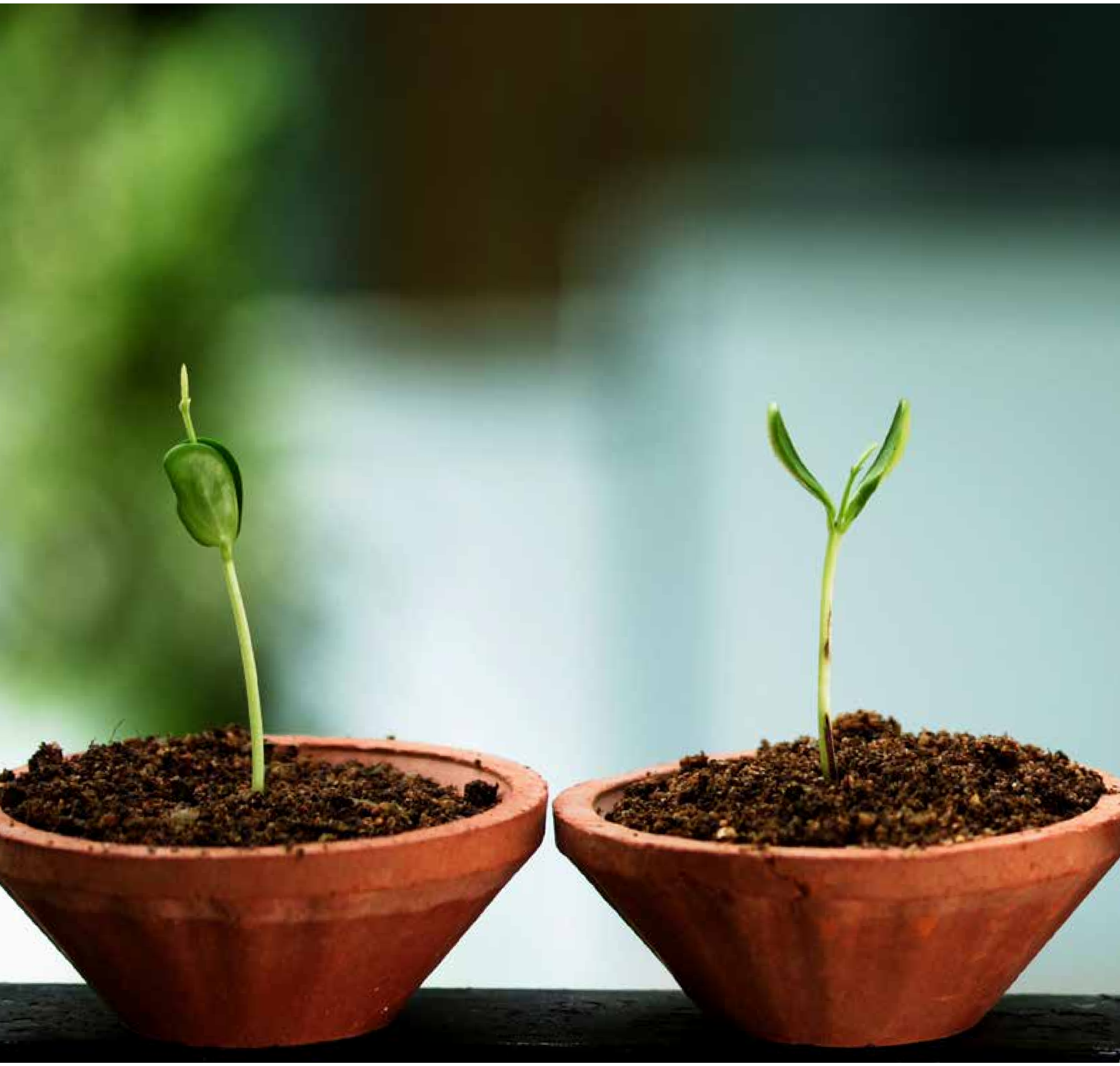
As a buildup to a USD1 trillion economy, plans are already afoot. Massive investments in construction, especially affordable housing, push in the education sector, a revamp of the healthcare delivery mechanism, progressive regulations like mortgage law, and so on, are all steps in the right direction. Externally, the Kingdom's importance on the global scale is improving too. It is the only Arab nation in the G20 and is the eighth most influential member, based on voting power, on the executive board of International Monetary Fund.

The theme for the next few years is clear: strong incentives for the private sector to encourage them to match public expenditure, reduce the stubbornly high unemployment even as the Kingdom moves to create employment opportunities, foray into external markets for non-oil revenues and in search of food security, and a regime determined to balance growth and strong regulation. While putting this report together, we spoke to a number of industry experts across financial institutions, corporations and family groups. Most people felt that the opportunity was immense and the next two decades would be transformational. Indeed.

According to one estimate, Saudi Arabia should be a USD3 trillion economy by 2050. Our view extends as far as USD1.3 trillion in 2025. By all measures, it is a conservative number. Saudi Arabia has the potential to do a lot better than that. Even if the world goes through cataclysmic years like 2008-09, and the current sovereign debt crisis in Europe, Saudi Arabia should comfortably log 4 percent growth annually just on the strength of its oil revenues and domestic investments. And if it does that, USD1.3 trillion is easily surpassed. For a country that was ranked fifth in the world for "continuously improving its provision of services to help businesses in the country boost the economic performance", nothing less is expected.

As the Knowledge Partner to the Euromoney conference The Euromoney Saudi Arabia Conference 2013, we present this special report on Saudi Arabia, its strengths and challenges it is likely to face *en route* to the trillion dollar economies' club. For that, we drew on our years of experience working with clients in Saudi Arabia. We enjoyed the process and hope you will also find it interesting. I welcome your comments on what you think. Please write directly to me at hemendra.aran@aranca.com.

Hemendra Aran
CEO, Aranca



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[This report is produced for The Euromoney Saudi Arabia Conference 2013. Aranca is the Knowledge Partner for the Conference.]

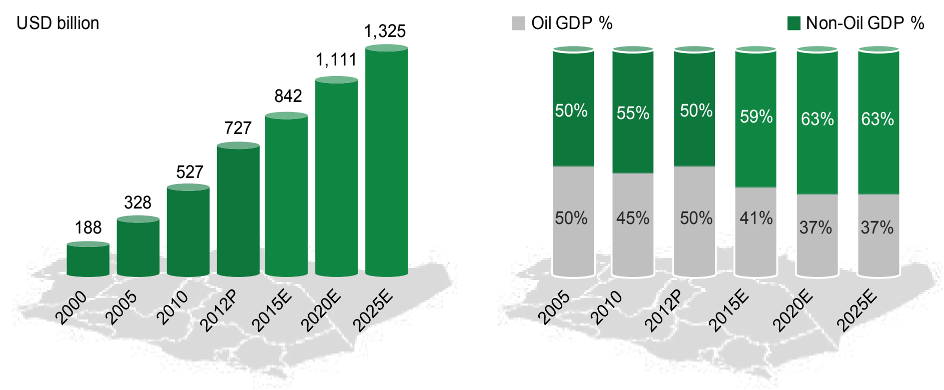
EXECUTIVE SUMMARY

SAUDI ARABIA: JOINING THE TRILLION DOLLAR CLUB

The economy of the Kingdom of Saudi Arabia is on the move. Steadily, it is inching its way to the trillion dollar economy club. While there have been other periods in the past when the economy was flush with oil money, the past decade has been different. The Saudi government is making a concerted effort to invest in the non-oil sector, especially in areas such as infrastructure, in developing its young human capital and in establishing a diversified industrial base, to make the economy's growth more sustainable.

Aranca estimates that Saudi Arabia would enter the league of trillion dollar economies by 2018, and reach USD1.3 trillion by 2025.

Share of non-Oil GDP to increase



Source: Central Department of Statistics and Information (CDSI), Aranca analysis

Aranca estimates that Saudi Arabia would enter the league of trillion dollar economies by 2018, and reach USD1.3 trillion by 2025. That is a CAGR of 3.8%, in constant prices, over 2012-2025, higher than the average growth over the last three decades, i.e. from 1980-2012. A significant share of this growth is expected to come from an increasingly vibrant non-oil sector, expanding at a CAGR of 4.3%, in constant prices, between 2012 and 2025. In comparison, oil GDP would grow by a CAGR of 1.6%. In other words, continued large scale private and public capital investments in the non-oil sector and a strong domestic consumption story would drive the Kingdom's economic growth momentum.

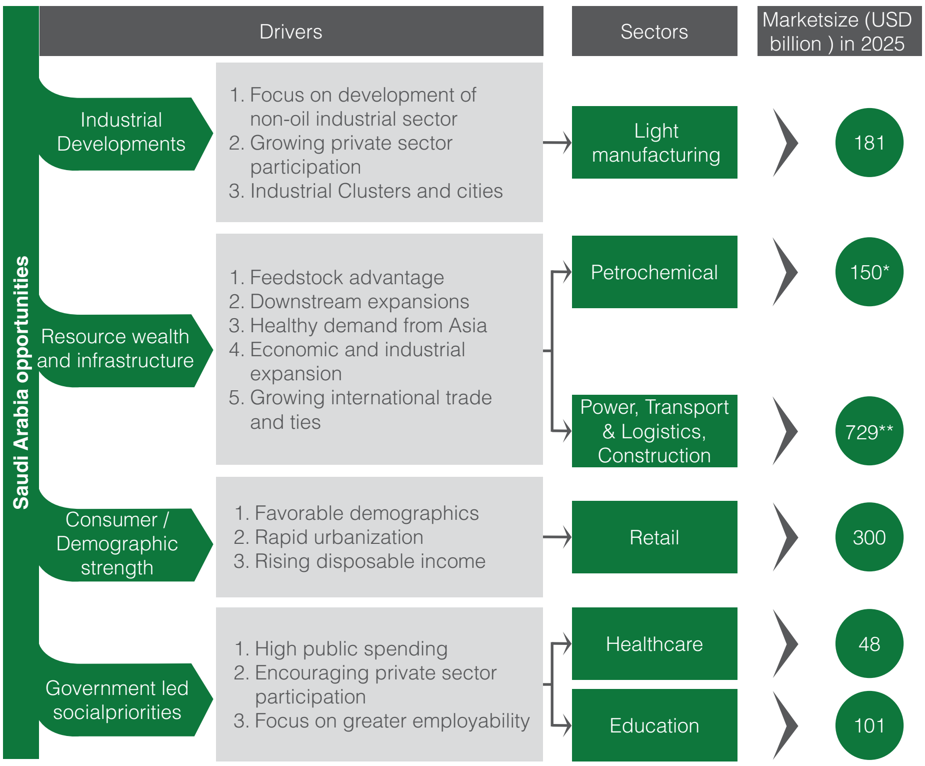
As global and domestic sentiments improve and risk perceptions wane, a large share of the investments is expected to flow into the private sector in Saudi Arabia. These investments drive the Kingdom's energy-intensive industries such as petrochemicals, power, cement, and metals, capitalizing on the abundant availability of raw materials and low-priced feedstock. In addition to creating business opportunities, project financing and foreign direct investment could also create significant employment opportunities for the nationals.

Public spending, too, would continue to grow and remain largely focused around education, healthcare and low-income housing. The investments on education and workforce training would ensure a better skilled workforce and help the Kingdom tackle its stubbornly high unemployment rate (of around 10%) and reap rich demographic dividends. Unlike in other emerging economies, such as China, and in the developed economies like the US that feel threatened by the prospect of aging and higher dependency ratios, Saudi Arabia is in the enviable club of economies with a young population base; around 57% of its population is currently under 30 years of age. Over the next ten to fifteen years, it is this demographic bracket that will do more–work, earn, save, and consume. The consequent rise in spending - per capita income continues to grow and is expected to reach USD35,487 in 2025 from an estimated USD25,263 in 2012 - would lead to a strong domestic consumption market.

Opportunities abound

The economic expansion of Saudi Arabia through 2025 amid structural shifts in the Kingdom's economy in terms of more open and investor-friendly policies, growth-oriented regulations and sops for capital flows, throws open attractive investment opportunities across a range of sectors. Amongst the several, we identified eight sectors that hold large opportunities. While manufacturing, petrochemicals, non-energy infrastructure, and power will be driven by the intrinsic resource wealth of the Kingdom as well as higher investments, consumer-centric sectors such as retail are also expected to grow with rising incomes. Furthermore, healthcare and education are expected to be direct beneficiaries of the increased focus on strengthening the social infrastructure in the economy.

Opportunities in Saudi Arabia



Source: Aranca analysis

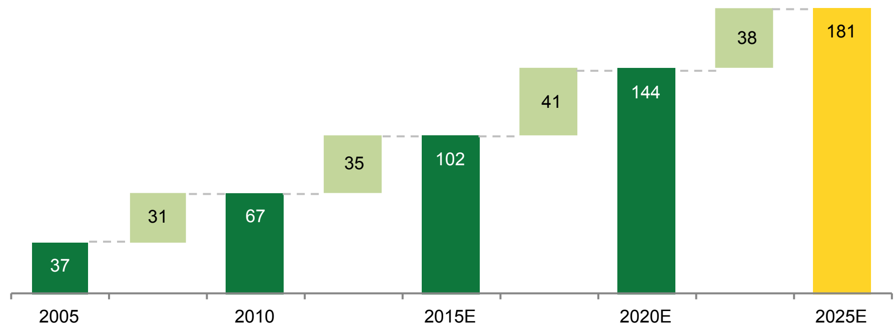
** Size of investments in petrochemical sector, **Size of Infrastructure project pipeline*

While manufacturing, petrochemicals, non-energy infrastructure, and power will be driven by the intrinsic resource wealth of the Kingdom as well as higher investments, consumer-centric sectors such as retail are also expected to grow with rising incomes.

The Kingdom's manufacturing sector is slated to emerge as a potential growth pocket in non-oil diversification as it is core to the government's agenda through 2025. The government continues to offer active support to the manufacturing sector through soft loans, establishment of industrial cities, industrial subsidies, favorable tariffs, and investment in physical infrastructure. In light of the government's strong support, we expect the manufacturing sector in the Kingdom to reach USD181 billion by 2025. Within the non-oil manufacturing sector, we see opportunities in the manufacturing of light metals and automotive parts.

Saudi Arabia's drive to develop its manufacturing base has led to sizable investments in infrastructure building activities, both new and replacements, covering construction, power,

Growth in the Kingdom's manufacturing sector (USD billion)



Source: SAMA, Aranca analysis

transport, logistics, and tourism. The country's budget allocation to the infrastructure sector increased at a CAGR of 19.2% over 2008-2012 to USD15.3 billion. Saudi Arabia's pipeline of infrastructure projects is expected to reach USD729 billion by 2025 up from USD302.8 billion in 2012. Within infrastructure, construction and transport sectors appear particularly attractive for investments. The government is on the forefront of these initiatives as reflected in its share in gross fixed capital formation (GFCF), which increased to 40.5% in 2011 from 31.6% in 2008. Within the construction sector, housing is expected to emerge as one of the strongest sectors, as it benefits from the government's plans to invest in affordable housing. Also, the transport sector is expected to see investments of over USD100 billion over the next ten years, according to Saudi Arabian General Investment Authority (SAGIA).

Saudi Arabia's pipeline of infrastructure projects is expected to reach USD729 billion by 2025 up from USD302.8 billion in 2012. Within infrastructure, construction and transport sectors appear particularly attractive for investments.

In our view, while government spending will continue to be the major driver, private sector participation in the sector will provide added impetus. The government is encouraging active private sector participation in major infrastructure projects through Public Private Partnership (PPP) and Build-Operate-Transfer (BOT) models, especially in power and water sectors.

The Kingdom's proximity to the fast growing Asian economies, notably China and India, afford it a significant cost advantage to develop the petrochemical sector. The Saudi petrochemical sector benefits hugely from the availability of natural gas feedstock at USD0.75/mmbtu through a long-term agreement with Saudi Aramco. The demand outlook for petrochemicals is positive over the long term, backed by expectations of strong economic growth and levels of plastic consumption across emerging economies. Hence, despite achieving significant scale, the sector continues to offer opportunities, especially in value-added derivatives and downstream plastics. For example, global demand for polyvinyl chloride (PVC), a key downstream ethylene product manufactured by Saudi Arabia, is expected to grow at a healthy 4.9% during 2012-2020 to 49.5 million tons. The Asia-Pacific region alone is expected to account for more than 65% of global PVC demand in 2020.

The Kingdom's non-oil driven economic expansion also opens up opportunities in the power sector. Continued expansionary policies, large investments in social and physical infrastructure, and a growing population are expected to provide impetus to the Saudi power sector. Subsidized power tariffs, growing demand for HVAC, rapid industrialization and investments in large physical infrastructure are expected to increase power consumption in Saudi Arabia through the next two decades. With the strong demand outlook for power, the government has realized that it has to reduce reliance on fossil fuels for power generation and has embarked on an ambitious renewable energy program. Saudi Arabia plans to increase its solar energy capacity to 41GW by 2032 at an estimated investment of about USD109 billion.

Besides industrial sectors, services sectors such as retail and healthcare also offer attractive investment opportunities. The Kingdom's young demographic profile, rising disposable income, and growing urbanization is likely to spur consumer spending, especially in the organized retail sector. We estimate the Kingdom's retail market to expand at a CAGR of 8.0% during 2012–25 to reach USD300 billion by 2025. Also, with a growing working class population and rising mobile commerce, new avenues such as online retail are likely to emerge as interesting opportunities. On the other hand, the healthcare industry is expected to continue to be driven by the rise in lifestyle related illnesses such as obesity, diabetes, and cardiovascular problems. The Kingdom's five-year development plan (with total expenditure of USD73 billion) envisages building 121 new hospitals and upgrading 66. Additionally, the government is actively encouraging private sector investment in the sector.

Development of human capital and improving the quality of education have become top priorities for Saudi Arabia, particularly as non-oil sectors gain greater importance in the economy. With the current shortage of skilled manpower across various industry verticals and over-reliance on expatriate talent, Saudi Arabia's education sector has emerged as one of the most lucrative markets. We expect the KSA education market size to almost double to USD101 billion by 2025.

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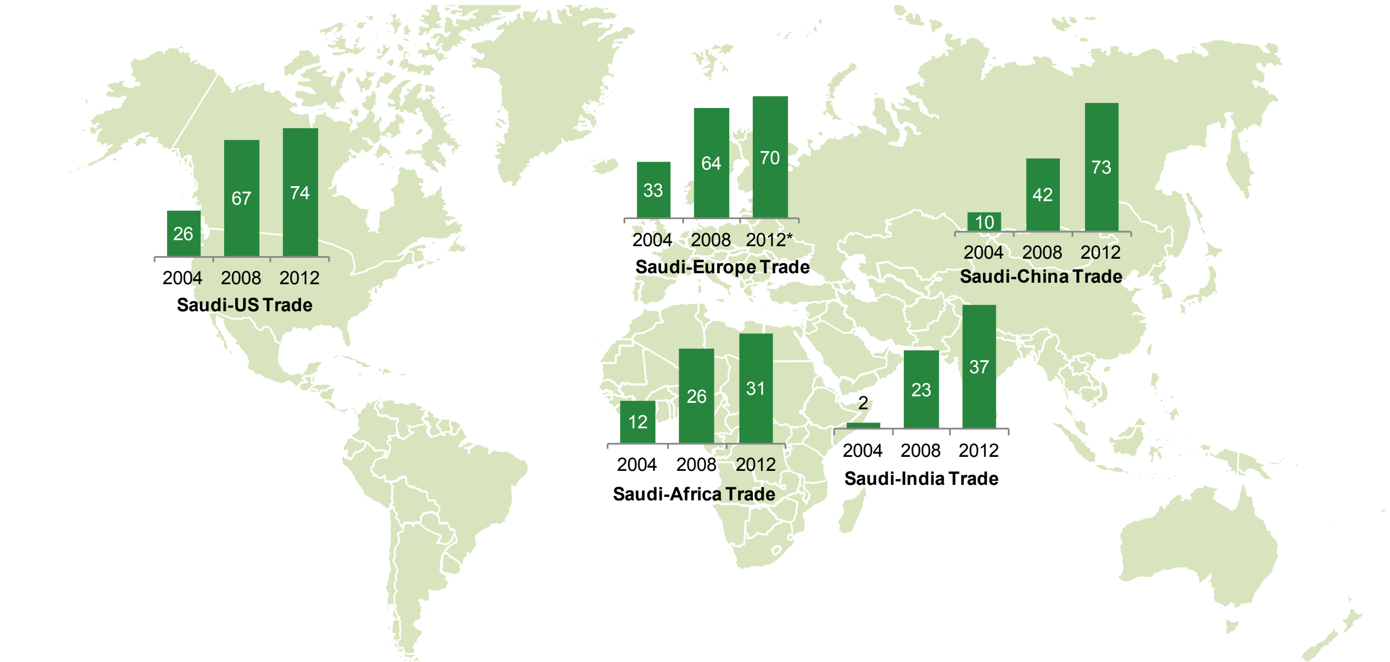
Looking outward

A robust domestic economy is also enabling Saudi Arabia to expand its sphere of influence beyond its borders. Saudi Arabia's investments in the GCC market have increased in recent years as these economies diversify away from oil. For instance, it has plans to invest in massive infrastructure projects in Qatar as the latter prepares to host the FIFA World Cup in 2022. On the other hand, the Kingdom stands to benefit from increasing integration as well as the regional growth stories of neighboring Abu Dhabi, Qatar and Kuwait as these countries invest heavily in infrastructure development.

Turkey is especially attractive given the two countries have seen significant increase in trade and investments in recent years. From just over USD1.3 billion in 2000, trade between

The Kingdom's growing trade (USD billion)



Source: US Department of Commerce, Eurostat, Bloomberg, Aranca analysis
** till November 2012*

the two nations crossed USD8.1 billion in 2012. The two countries plan to increase bilateral trade to over USD10 billion in the near future. Energy continues to dominate the trade relationship with hydrocarbons accounting for nearly 80% of Saudi exports to Turkey. Further, given Turkey's reliance on imports to meet its energy needs, there is significant room for Saudi investments in the refining, petrochemical, and energy development projects.

Africa is another large trading market for Saudi Arabia. So far, Africa has been a strategic partner for Saudi Arabia in its food security initiatives. Saudi investors are believed to have planned or concluded investments in about 800,000 hectares of land in Africa. Agriculture investments have been particularly high in Sudan. Saudi Star Agricultural Development has committed investments to the tune of USD2.5 billion by 2020 in Ethiopia alone. Looking beyond the agriculture and food security perspectives, the potential for deepening this relationship is much broader, given Africa's richness in mineral resources and huge investment needs for infrastructure development. Saudi Arabia's relationship with Africa can be one of the most defining ones in the 21st century if the Kingdom, along the lines of China, is able to capture the opportunities by taking a long-term strategic view on the continent. This would then also serve the long-term interests of Saudi companies looking to expand businesses in growing markets.

Saudi Arabia's relationship with Africa can be one of the most defining ones in the 21st century if the Kingdom, along the lines of China, is able to capture the opportunities by taking a long-term strategic view on the continent.

Since the last few years, Asia has been Saudi Arabia's largest trading partner and accounts for nearly 60% of the country's total foreign trade. It was over USD500 billion in 2012. Already, China and India, two of the region's largest markets have established themselves as the leading economic partners of Saudi Arabia. According to the Energy Information Administration (EIA), China, Japan, South Korea, and India, together accounted for nearly 37% of total Saudi production capacity in 2012, with imports of over 3.3 million barrels of oil per day. Second, emerging Asia also presents significant opportunities across sectors, including oil, petrochemicals, and banking & financial services, especially Islamic finance given that it is home to the three most populous Islamic countries in the world.

Financial sector diversification critical to growth plans

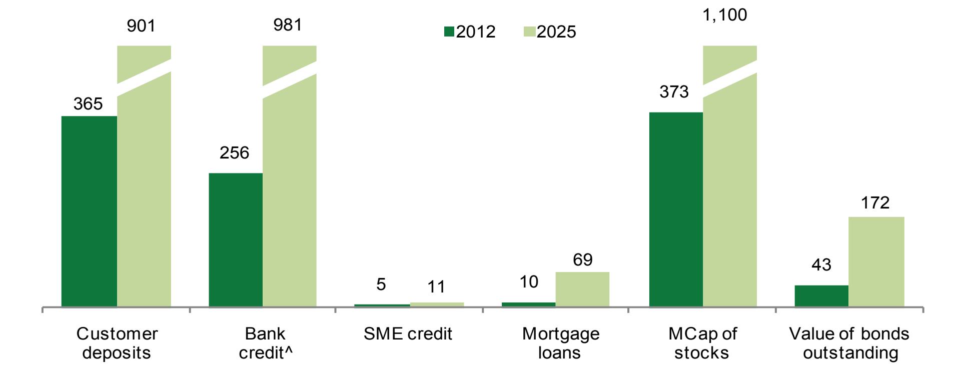
While the growth opportunity in Saudi Arabia is immense, it is equally important to understand the source of funds and the stability of the financial sector in Saudi Arabia. Adequate measures taken by Saudi Arabia before the financial tsunami hit the world in 2008 – when it used its petrodollar surplus to pare public debt and shore up its net foreign asset position – have helped the Kingdom's financial system to remain stable even as the aftershocks continue. As a result, the Saudi financial system is operating from a position of relative strength. As the economy grows, the funding has to come from the banking sector and capital markets. However, the financing mix, currently dominated by bank credit, is expected to become more diverse by 2025.

A well-regulated and capitalized banking sector will continue to channel local liquidity through deposit mobilization and credit expansion. Higher banking penetration and income levels are expected to help deposits expand at a CAGR of 7% to USD901 billion by 2025. The government's focus on developing the SME and housing finance segments through initiatives and regulatory reforms will provide the impetus for banks to increase SME loans and mortgage financing. Between 2012 and 2025, the SME and mortgage markets would require funding worth USD5.5 billion and USD58 billion, respectively. Total bank credit to the private segment is expected to expand to USD981 billion by 2025 from USD256 billion in 2012. Yet, banks are facing stricter compliance norms, the need to match asset-liability tenures, and lending limits to large corporate entities. Hence, a greater proportion of long-term funds are expected to be sourced from capital markets. The need for raising long-term funds is likely to drive further development of capital markets.

Equity is currently the preferred alternative for raising long-term capital and equity capital markets are expected to strengthen further. Of the total securities offered to the public in Saudi Arabia between 2007 and 2011, 74% were equity comprising IPOs and Rights Issues (excluding private placements, which may be debt or equity). We expect market breadth to improve as a larger number of companies try to access capital markets as a funding source for long-term capital. This would include both large family-owned businesses as well as SMEs looking for growth capital. Going forward, Saudi Arabia would not only have to broaden and deepen its capital markets but also promote investor participation. The imminent opening up of Tadawul to foreign institutional investors will be a step change in our opinion, as it will likely lead to higher trading volumes, development of more diverse products, and a decline in the influence of retail investors.

We expect the most dynamic growth to take place in the Kingdom's debt capital markets. In the past 18 months, there has been acceleration in sukuk issuances kick-started by the success of the USD4 billion government-backed sukuk for its aviation agency in January 2012. That said, the rise in sukuk issuances is also a factor of the relative unattractiveness of equity valuations in the past two years. Facilitating trading and liquidity in the secondary market, setting-up local credit rating agencies, and opening up the primary and secondary debt capital markets to foreign institutional investors will help Saudi Arabia tap global funds waiting to invest in Islamic products.

Financial sector development (USD billion)



Source: SAMA, Tadawul, CMA, "Small and Medium Enterprises" Symposium 2010, Opening Speech - SAMA Governor, Aranca analysis; ^Private sector

Facilitating trading and liquidity in the secondary market, setting-up local credit rating agencies, and opening up the primary and secondary debt capital markets to foreign institutional investors will help Saudi Arabia tap global funds waiting to invest in Islamic products.

Besides the established capital markets, prospects for the private equity (PE) and venture capital (VC) market are also bright. The Saudi PE industry is expected to become the most important market for PE firms in the region. Deal activity is also expected to increase as interest in Saudi Arabia is picking up. Similarly, the market for venture capital funds is another potential growth area though the industry is still at a nascent stage. On the demand side, a focus on entrepreneurship in the domestic market will call for a greater role of VC financing. On the supply side, the increase in number of sophisticated investors looking to diversify their holdings will provide liquidity for PE/VC funds.

The expansion of private investable wealth is expected to support the growth of the asset management industry. Apart from alternative funds such as PE/VC, mutual funds and wealth management services are expected to benefit from the steady rise in private wealth in the Kingdom.

Conclusion

From a purely oil-driven economy to one of the most vibrant markets in the Middle East, Saudi Arabia has come a long way. Already, Saudi Arabia's importance has increased significantly in the last decade, more so as a provider of capital to troubled Western financial institutions and governments. The Kingdom is the only OPEC member and the only Arab nation in the G20. The Kingdom also is the eighth most influential member, based on voting power, on the executive board of International Monetary Fund (IMF).

Endowed with one of the best demographic profiles and increasing consumer wealth, Saudi Arabia is on the cusp of becoming a trillion dollar economy within this decade. Growth is expected to be broad-based as economic diversification gathers momentum.

2025, the world would see a Saudi Arabia that is not only an economic powerhouse but also a voice whose influence will far outreach its regional shores.

The coming decade will witness billions of dollars being pumped into the infrastructure sector to meet the increasing demand for housing, utilities, and other tertiary services for the Kingdom's growing population. At the same time, the Kingdom's resource richness will also see it evolve as one of the leading industrial manufacturing hubs in the region. Saudi Arabia recognizes this and is making several strategic, regulatory, and policy level changes so as not fritter away these advantages.

Over the next few years, Saudi Arabia is likely to play an increasingly important role in promoting regional integration as well as economic and political stability. And by 2025, the world would see a Saudi Arabia that is not only an economic powerhouse but also a voice whose influence will far outreach its regional shores.

01.

SAUDI ARABIA RISING: A 1.3 TRILLION DOLLAR ECONOMY BY 2025

- The Kingdom will enter the league of trillion dollar economies by 2018, GDP to hit USD 1.3 trillion by 2025
- Sustained demand at home driven by young consumerism-driven population base, rising spending power (per capita income to reach USD35,487 in 2025 from an estimated USD25,263 in 2012), increasing employment opportunities for Saudi nationals as investments multiply and business confidence improves, and better skilled workforce as focus on education increases
- Structural composition of economy to shift, non-oil exports to nearly treble between 2011 and 2025, and account for ~24% of total exports by 2025
- Chemicals, plastics, machinery, transport equipment, minerals and fertilizers likely to emerge as fastest growing non-oil segments
- While China and India will likely remain the Kingdom's larger trade partners, an enhanced non-oil exports basket could help strengthen trade linkages with Turkey, Egypt. Indonesia and African countries.

KSA GDP to exceed USD1.3 trillion by 2025

An impressive compound annual growth rate (CAGR) of 5.7% between 1990 and 2012, the emergence of non-oil sectors as a force to reckon with, regulatory reforms, and a concerted effort from the government to invest in sustainable growth have placed The Kingdom of Saudi Arabia in an enviable position today. The Kingdom has come a long way from the oil-driven economy of the 1970s and 80s, following a series of strategic decisions that have now placed Saudi Arabia at an advantage to other nations in the GCC region. Having emerged stronger from the global economic crisis, the Kingdom is preparing for the future with a concerted focus on building on its strengths and addressing challenges to secure the future of its people.

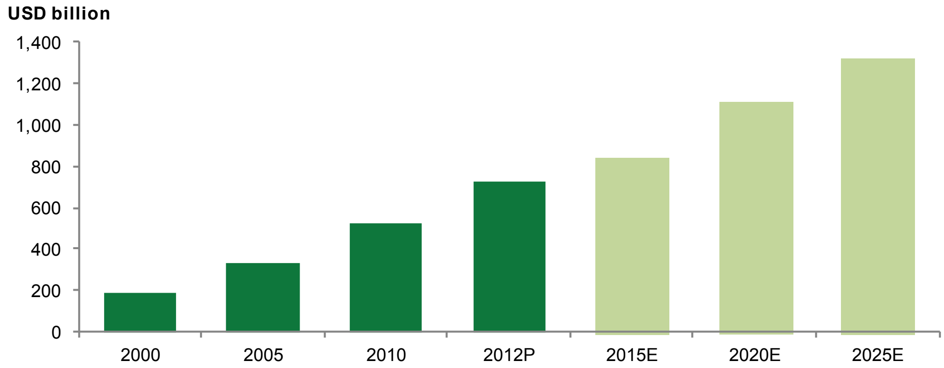
So what lies ahead for the Kingdom? Analysts anticipate the growth of the past decade to sustain itself. The Kingdom's economy is estimated to expand at a CAGR of 3.8% over 2012-2025, marginally higher than the 3.3% observed during 1980-2012. If expectations are realized, the Kingdom will enter the league of trillion dollar economies by 2018, and reach USD1.3[1] trillion by 2025, nearly twice the USD727[2] billion GDP estimated in 2012.
The surge in hydrocarbon-related exports and the resultant liquidity driven investments has fueled strong growth across sectors of the non-oil economy. This liquidity has boosted domestic consumption as well as business and consumer confidence – a trend that is set to continue. A sentiment echoed by Amrith Mukkamala, Head – Asset Management, MEFIC

1 *GDP in current prices*
2 *Revised GDP data as per the preliminary estimate by CDSI, Saudi Arabia*

Capital who says "We expect 4-5% growth in GDP in current prices over the next decade driven in bulk by non-hydrocarbon GDP. Non-hydrocarbon GDP would likely expand by around 7-8%, while hydrocarbon GDP would roughly grow in the range of 2-3%."

Domestic consumption is emerging as a key growth driver as the government steps up capital investments on social and economic infrastructure, extends the social security net, and as wages rise.

GDP to nearly double between now and 2025



Source: Central Department of Statistics and Information (CDSI), Aranca analysis

A significant share of this growth will likely be driven by a rapidly expanding non-oil economy, as it benefits from large and growing private capital investments and strong consumption. Growth will also be supported by the government's continued efforts to diversify the economy away from oil as well as the spillover effect of its stimulus program, a view that resonates with CEOs in the Kingdom. As Paddy Padmanathan, CEO, ACWA Power reiterates, "Saudi Arabia can sustain a fairly high growth rate. Growth of the last ten years has come clearly from (increased inflows due to) higher oil prices but also from reinvesting those funds in development of the non-oil sector and infrastructure."

"*High growth rate is sustainable as it is being driven by policy enhancements. Market dynamics are changing and the government is taking steps across spectrums to ensure that high growth rates are sustainable*

Musaab Al-Muhaidib,
CEO, Al-Muhaidib Technical Supplies

Domestic consumption is emerging as a key growth driver as the government steps up capital investments on social and economic infrastructure, extends the social security net, and as wages rise. Domestic consumption is likely to keep growing strongly as the Kingdom's population expands to 37.4 million by 2025 from 28.8 million at present. Key factors that are likely to help the Kingdom sustain demand at home include: 1) a relatively young and consumerism-driven population base (57.0% below the age of 30); 2) rising spending power as per capita income continues to grow (expected to reach USD35,487 in 2025 from an estimated USD25,263 in 2012); 3) increasing employment opportunities for Saudi nationals as investments multiply and business confidence improves; and 4) a better skilled workforce as focus on education increases.

Economy witnessing a significant shift in structural composition

The government is focused on economic diversification…

Saudi Arabia is progressing well on its quest to achieving the long-term strategic goal of transforming its oil-based economy into a developed and structurally diversified one. While in the 1980s and 1990s the Kingdom saw dramatic fluctuations in Oil GDP, as external shocks triggered extreme volatility and oil prices collapsed, the Kingdom's economy has remained resilient during the ongoing global economic crisis.

The Saudi government is piloting the economic diversification process by liberalizing key sectors, such as financial services, petrochemicals and telecom, and by extending subsidies and incentives to speed up industrialization. Simultaneously, the government under its rolling five-year development plans continued to apportion large budgetary allocations toward social and economic infrastructure development. Private investments in the industrial cities of Jubail and Yanbu, established in the 1980s to promote petrochemicals, fertilizer, steel and refined oil products, also have considerably expanded the Kingdom's economic base in heavy industries. Encouraging private enterprise and welcoming foreign investments have offered the Kingdom access to capital and technology. While these initiatives ensured flow of capital into productive sectors of the economy, they also fostered a competitive environment and helped improve the quality of domestic output.

The Saudi government is piloting the economic diversification process by liberalizing key sectors, such as financial services, petrochemicals and telecom, and by extending subsidies and incentives to speed up industrialization.

…And the economy is now less dependent on oil…

Hectic business activity in the non-oil economy over the last 20 years has transformed the Kingdom's economic composition. During 1990-2012, the non-oil GDP, in constant prices, expanded at 7.0% CAGR, significantly higher than the oil GDP's 2.5% in the same period. Consequently, the non-oil economy's contribution to GDP, at current prices, remained around 50% a year on average in 2000-2012, even as oil prices rose. Stronger non-oil GDP lends stability to the economy when oil prices turn volatile. In 2009, when the country's oil GDP, in constant prices, contracted 8.0% year-on-year (Y-o-Y), as prices crashed and production dipped, the non-oil GDP expanded by a robust 5.3% Y-o-Y. Since then, non-oil GDP has expanded at a stronger 8.2% a year through to 2012. Going forward, the Kingdom plans to keep walking the diversification and reforms path by opening up its capital market to foreign investors, and expects the inflow of new capital to cause business and trade activities to surge. While the direct benefit will be stronger growth across non-oil sectors, the Kingdom also could gain from greater competition resulting in innovation and increased efficiency. Faysal Badran, CIO – Head of Asset Management, NCB Capital points out, "The government's diversification initiatives are broad-based right from investments in infrastructure to human capital development so that the reliance on oil sector reduces, and also the Kingdom is able to provide employment opportunities to its young and growing population."

"Saudi Arabia can sustain a fairly high growth rate. Growth of the last ten years has come clearly from (increased inflows due to) higher oil prices but also from reinvesting those funds in development of the non-oil sector and infrastructure.

Paddy Padmanathan,
CEO, ACWA Power

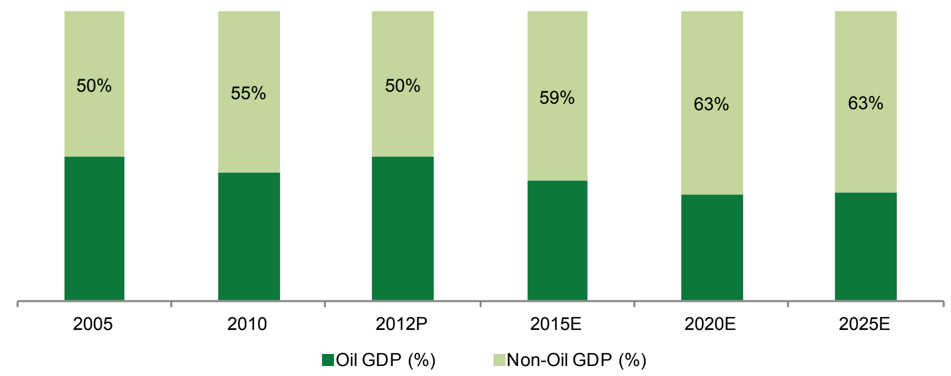
Even as most countries are struggling to keep their economies afloat, Saudi Arabia is experiencing strong growth across key sectors, including construction, financial services, manufacturing, retail trade and tourism. We expect the Saudi economy to strengthen in coming years, as public and private sector investments increase and domestic consumption remains buoyant. Consequently, we expect the Kingdom's non-oil sector to expand at a CAGR of 4.3%, in constant prices, between 2012 and 2025, higher than the expected growth in Oil GDP. Assuming moderate movement in oil prices and production levels over our forecast horizon, we expect the Oil GDP to register a CAGR of 1.6% in 2012-2025, in constant prices. Consequently, the share of non-oil GDP to total GDP, at current prices, will, in our view, reach 61.9% in 2025 from an estimated 49.6% in 2012.

Stronger non-oil export basket to boost external balances

Increased industrial activity, especially across export-oriented heavy and light industries, could enhance Saudi Arabia's export potential, going forward. Capacity additions in the chemicals, plastics, metals and electrical machinery, equipment & tools industries have led to non-oil exports growing 11-fold between 1990 and 2011. As a result, the share of non-oil exports in total exports grew to 12.8% in 2011 from 9.3% in 1990.

Non-oil exports to nearly treble between 2011 and 2025, and account for ~24% of total exports by 2025

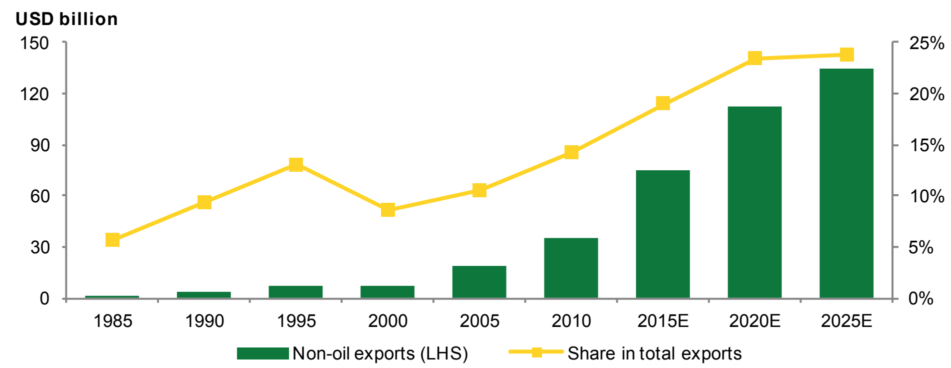
Share of non-Oil GDP to increase



Source: CDSI, Aranca analysis

On an expanded base, we expect non-oil exports to nearly treble between 2011 and 2025, and account for ~24% of total exports by 2025. Chemicals, plastics, machinery, transport equipment, minerals and fertilizers are likely to emerge the fastest growing non-oil segments. While China and India will likely remain the Kingdom's larger trade partners, an enhanced non-oil exports basket could help strengthen trade linkages with Vietnam, Turkey, Egypt and Indonesia.

Non-oil exports surging



Source: CDSI, Aranca Analysis

Investments key to the Kingdom's trillion-dollar dream

Investment momentum in the economy remains strong

Capital investment in non-oil sectors is essential if the Kingdom has to maintain a balanced and sustainable economic growth momentum. With oil being the single largest source of the country's export earnings, all of which accrue to the State, the Saudi government plays a central role in driving investments in the economy. As part of the economic reforms process, the government announced a series of fiscal incentives aimed at creating a pro-business environment and encouraging private capital investments. Foreign direct investment (FDI) also picked up significantly, since the country's entry into the World Trade Organization (WTO) in 2005, and is today a major source of private investment. Consequently, the Kingdom, barring a few exceptional years during the oil booms and busts of 1980s and 1990s, has consistently received huge investments. Gross fixed capital formation (GFCF), a measure of investment in fixed assets, grew four-fold between 1980 and 2011, reaching USD125.6 billion in 2011, propelled largely by the private sector. Private sector investment expanded nearly seven-fold over the same period to USD52.2 billion in 2011, representing 41.5% of total GFCF in that year; government sector investment stood at ~37%. Going forward, we expect private sector investments, including FDI, to play a bigger role in helping the Kingdom achieve its strategic objective of becoming a stable, balanced and sustainable modern economy. As Amrith Mukkamala, Head – Asset Management, MEFIC Capital rightly puts it, "Capital availability and reform initiatives are currently in place for the economy to take its next leap of moving away from a hydrocarbon GDP growth to a non-hydrocarbon GDP growth. This will mean more investments today to reap the benefits later."

Role of private investment expected to remain dominant…

The private sector will have to continue playing a key role in Saudi Arabia sustaining the investment momentum. In 2011, private sector investment grew 15% to USD52.2 billion, but the favorable momentum trend can be gauged from investment remaining strong at ~USD45.0 billion in 2009 and 2010, similar to 2008, even as the global economy threatened to fall off the cliff. What is encouraging is that a significant share of private investment is coming from the domestic private sector. Of the total private sector investment of USD52.2 billion in 2011, the domestic sector accounted for USD35.9 billion, while FDI inflows contracted by ~44% to USD16.3[3] billion. The relatively improved project financing market at home and abroad helped Saudi private enterprises to resume large projects that were either stalled or had faced delays.

The private sector will step up its capital investment cycle, tapping growth opportunities within the domestic market. FDI, too, could surge.

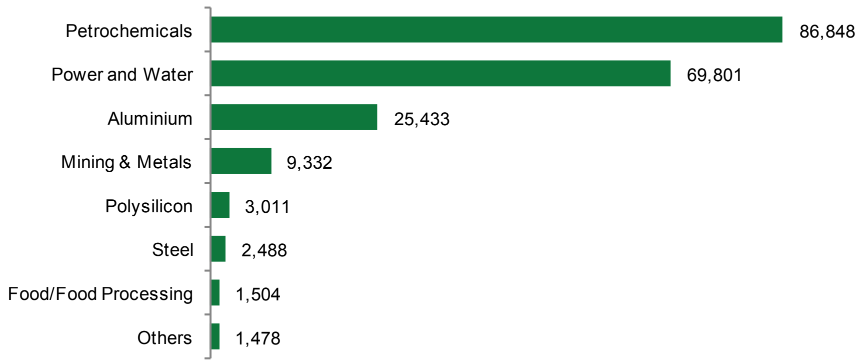
With the global economy slowly showing signs of springing back to life and the domestic economy maintaining its growth momentum, we expect private sector investment to pick up in the years ahead. The private sector will step up its capital investment cycle, tapping growth opportunities within the domestic market, in our view. FDI, too, could surge. Preliminary estimates from the United Nations Conference on Trade and Development (UNCTAD) show that FDI in Saudi Arabia rose nearly 15% to USD18.8 billion in 2012.

"The Saudi economy is structurally well-positioned to sustain the growth momentum. Favorable demographic profile, continued growth in the hydrocarbon sector, increasing diversification initiatives alongside the technocratic policies are likely to feed higher investments which should drive growth in the coming decade.

Faysal Badran,
CIO – Head of Asset Management, NCB Capital

We expect a significant share of the growing investments to continue to flow into the Kingdom's heavy and light industrial sectors. Energy-intensive industries, such as petrochemicals, power, water, cement, and metals, are likely to capitalize on the abundant availability of raw materials and low-priced feedstock, including power and water. Most recent data from Zawya Projects Monitor indicate that USD198.2 billion worth of ongoing industrial projects in Saudi Arabia are expected to be completed over 2013-2017. The largest projects being: Sadara Chemical Company (USD20 billion), Saudi Kayan (USD12.5 billion), and Ras Al Zour Aluminum Complex (USD10.8 billion).

Value of industrials projects in Saudi Arabia (ongoing*) in USD million



*Source: Zawya Projects Monitor; * As of 07 April 2013*

3 *Per Global Investments Trend Monitor, January 2013, UNCTAD*

…driven by ongoing economic and policy reforms…

The pace of private sector investment will accelerate in the coming years, with the project financing market improving significantly, led by financial sector reforms at home and a gradual waning of the global risk perception. However, the continuation of structural and regulatory reforms will be imperative to maintaining investor and business confidence in the region. Reforms include strengthening of public-private partnerships, modernizing regulatory and legislative frameworks across key sectors, and competitive and stable fiscal policies. The government plans to initiate reforms in the housing finance and capital markets in 2013.

The accelerated pace of reforms has led to the Kingdom rising in the ranking on competitive index and ease of doing business globally. Saudi Arabia ranks 18th on the Global Competitiveness Index[4], and is the second most competitive country in the GCC. The country stood 22nd among 185 economies on ease of doing business; it was ranked 67th in 2005. The continually improving business environment has enabled KSA to emerge as the most favored nation for foreign investments in the Arab World. In 1980-2011, the Kingdom received FDI of about USD186.8 billion, more than double the USD85.4 billion received by UAE over the same period.

…and elevated level of public spending

Investment in human capital is also critical to reap the rich demographic dividends on offer. Saudi Arabia has one of the best demographic profiles in the GCC.

Economic growth will also depend on increased public spending in the near to medium term. The Saudi government had announced a USD400 billion stimulus package in 2009 that will run through 2014, for developing and upgrading infrastructure as well as creating jobs across the manufacturing, tourism and services sectors. Large budget surpluses since 2006, with 2009 being the exception, have translated into strong public spending. With oil prices estimated to remain above USD100 a barrel over our forecast horizon, the potential for Saudi Arabia to increase public spending remains significant.

While public spending continues to be centered on healthcare infrastructure and low-income housing, the focus on education has also increased over the years. To augment its human capital to facilitate a balanced and sustainable growth, the government allocated half of the total budgeted outlay of USD385.2 billion under the Ninth Development Plan (2010-14) to education and workforce training. We believe the Kingdom will have to continue spending heavily on upgrading the Saudi education system. Lack of quality education has been a key reason behind the Kingdom's stubbornly high unemployment rate of around 10%.

"With the firepower accumulated during the last years thanks to high oil prices, policy makers have the ability to engineer prosperous economic conditions and strengthen the economy of the country.

Kais Mbarek,
Head of Principal Investment, SWICORP

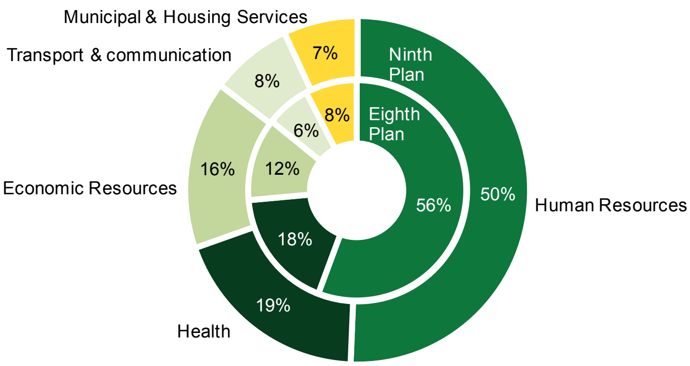
Investment in human capital is also critical to reap the rich demographic dividends on offer. Saudi Arabia has one of the best demographic profiles in the GCC; its population is growing at over 2.0%, almost double the current world average, with about 57% under the age of 30. Hence, superior educational infrastructure and systems focused on technical and vocational training is of prime importance if the Kingdom wishes to realize its development goals.

Saudi Arabia's influence in the global arena is steadily rising

Saudi Arabia's importance has increased significantly in the last decade, more so as a provider of capital to troubled Western financial institutions and governments. The Kingdom is the only OPEC member and the only Arab nation in the G20. The G-20 nations collectively account for nearly 90% of global GDP, 80% of international trade and two-third of the world's population. The Kingdom also is the eighth most influential member, based on voting power, on the executive board of International Monetary Fund (IMF).

4 *Per World Economic Forum's Global Competitiveness Report, 2012-2013*

Public spending focus continues on building human capabilities



Source: SAMA, Aranca analysis

Being a part of these influential groups enhances Saudi Arabia's ability to leverage growth opportunities and have a better say in global policy making. Additionally, Saudi Arabia is likely to play an increasingly important role in promoting regional integration as well as economic and political stability. As the GCC and broader MENA are more interdependent and share a similar economic profile, it is in Saudi Arabia's interest to ensure economic and political stability in regional markets.

Being a part of influential groups like G20 and the IMF Executive Board enhances Saudi Arabia's ability to leverage growth opportunities and have a better say in global policy making.

02.

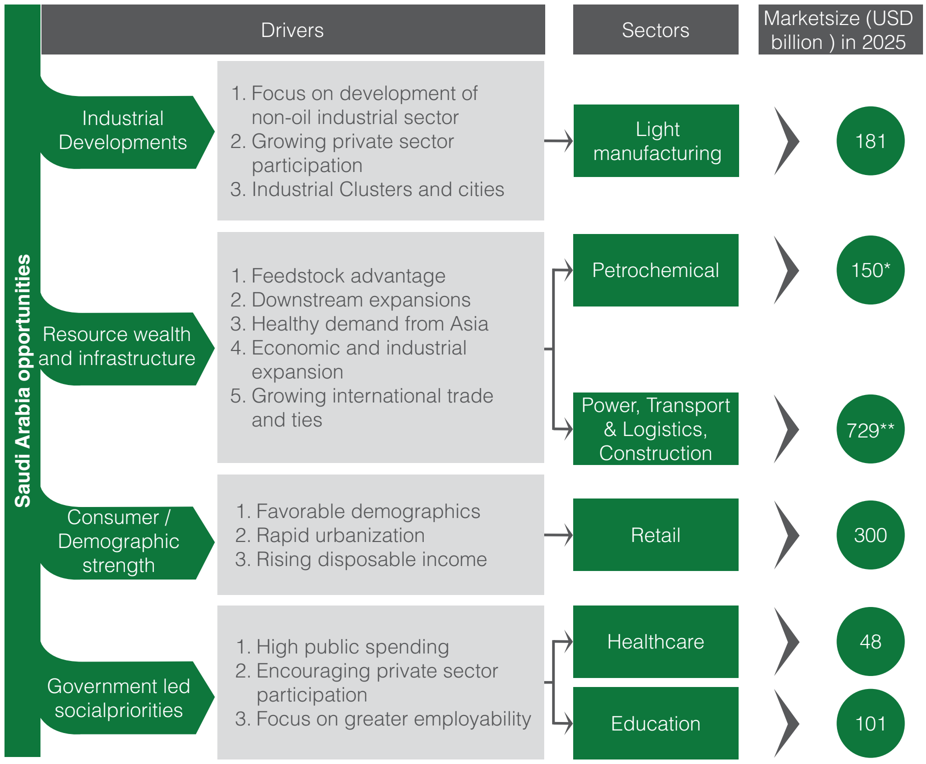
SAUDI ARABIA: A LAND OF OPPORTUNITIES

- Manufacturing to reach over USD180 billion by 2025; opportunities emerging in the manufacturing of light metals and automotive parts
- Diversification in Petrochemicals enabling Saudi firms to move into downstream products, making KSA a key petrochemical hub globally
- Infrastructure pipeline to reach USD729 billion by 2025 as the Kingdom builds physical infrastructure to meet the needs of economic expansion and a growing population
- Construction and transportation sectors hold strong potential; transportation sector set to transform with investments worth USD100 billion over the next 10 years
- Saudi Arabia plans to increase its solar energy capacity to 41 GW by 2032 at an estimated investment of about USD109 billion
- Consumer retail forecast to expand nearly 2.7x to USD300 billion, Healthcare expenditure estimated to grow to USD48 billion and Education sector expected to double to USD101 billion by 2025

As the Kingdom gears up for a sustained period of growth in the decade ahead, investors are likely to be further buoyed by the positive outlook and confidence of business leaders and experts on the region. Kais Mbarek, Head of Principal Investment, Swicorp sums up the reason the Kingdom is of keen interest to investors, "KSA offers a unique combination of high growth, solid financial position and scale. Unlike the rest of the GCC, Saudi has a much deeper and diversified market, driven by a population of just under 30 million."

With a multitude of sectors now in focus, which ones present the best opportunities for investment in the years ahead? Education and healthcare are well placed owing to the government's priorities for development of social infrastructure through increased budget allocation, as well as encouragement to private sector spending. Retail too is likely to emerge as a winner with a favorable demographic, urbanization and a rise in personal disposable income setting the stage for bigger things to come. The petrochemicals sector will see relationships with China and India strengthen. A focus on decreased dependence on the hydrocarbon sector through increased industrial activity will also likely provide a much-needed boost to the manufacturing sector. Infrastructure, including construction, especially affordable housing, power and transport & logistics too are recurrent themes in the growth story.

Opportunities in Saudi Arabia



Source: Aranca analysis

** Size of investments in petrochemical sector, **Size of Infrastructure project pipeline*

The government's National Industrial Clusters Development Program in the automotive, home appliances, minerals & metals, plastics & packaging and solar energy sectors is an initiative that is playing a key role in developing Saudi Arabia as an industrial hub in the region.

Government determined to create a growth enabling environment

To tap growth opportunities, the Saudi government is increasingly playing an active role in enabling growth across the Kingdom. Although only a few centers, namely Jubail and Yanbu, were developed as industrial hubs in the past, government policy seems to have evolved with increasingly more investments being made in developing economic cities and industrial clusters to achieve broad-based growth and create more jobs for its citizens. The government's role has been widely acknowledged. Ali Jaffery, Assistant Vice President, Riyad Capital believes, "Government spending is the key driver of economy, and government has shown a commitment to deliver on housing, infrastructure, power and mega projects like Maaden and Sadara. All these factors bode well for the overall growth."

The government's National Industrial Clusters Development Program in the automotive, home appliances, minerals & metals, plastics & packaging and solar energy sectors is one such initiative that is playing a key role in developing Saudi Arabia as an industrial hub in the region. The growth in mining activities is being harnessed through investments in key anchor projects such as the aluminum flat rolling mill and steel flat rolling mill in the mineral and metals cluster in Jubail. Furthermore, the automotive cluster is being touted as an upcoming hub that could capture a large portion of the fast growing regional automobile market, currently valued at over USD75 billion.

The promotion of industrial clusters notwithstanding, Saudi Arabia's biggest initiative has been the launch of six integrated economic cities. The government expects these cities to unleash a second phase of industrialization and promote balanced regional development with investments in non-hydrocarbon sectors. The economic cities will focus on developing core sectors, including manufacturing and services. The Saudi government estimates the six economic cities will contribute over USD150 billion to the Kingdom's economy by 2020, house nearly 5 million people and provide job opportunities to 1.3 million.

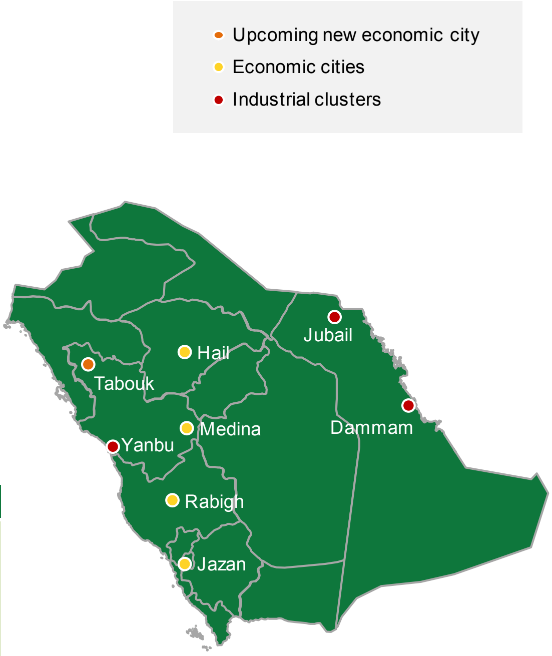
Key Industrial clusters and investments in Saudi Arabia

Key Industrial clusters snapshot

- Key industrial clusters include:
  - Minerals and Metals, Automotive, plastics and packing and solar
- Total investment of USD28.12 billion in petrochemical cluster
- USD10.8 billion aluminum production complex in mineral cluster
- Isuzu Motors and Saudi Industrial Property Authority (Modon) are developing USD 100 million factory in automotive cluster
- A total investment of USD144 billion in major industrial cities at Jubail covering 187 square kilometer

Economic cities snapshot

- More than USD100 billion of investments
- Jobs created: 1.58 million
- Population relocated: 2.60 million
- Land size: 429 million square meters



Source: Aranca analysis, SAGIA

Manufacturing sector – pivotal for growth of non-oil economy

The Saudi manufacturing sector has grown steadily in the last decade, largely due to the government's focus on industrial development, especially non-oil manufacturing.

Fueled by robust hydrocarbon export revenues for decades, the Kingdom is now redoubling its efforts to develop non-oil sectors to hedge against oil price volatility as well as create employment opportunities for its youth. Musaab Al-Muhaidib, CEO, Al-Muhaidib Technical Supplies feels there is a clear focus on the manufacturing sector, "There is a lot of push in the industrial and manufacturing sectors. With SAGIA, there is fresh impetus especially for economic cities to ensure that they promote broad based growth."

"Capital intensive and energy industries are aggressively looking at Saudi Arabia for future expansions. This can be attributed due to the higher risk appetite of Saudi Arabian investors and a longer term focus.

Amrith Mukkamala,
Head- Asset Management, MEFIC Capital

Sector grew steadily in the last decade, led by government action

The Saudi manufacturing sector has grown steadily in the last decade, largely due to the government's focus on industrial development, especially non-oil manufacturing. Consequently, the country's manufacturing sector output in nominal terms increased at a CAGR of 8.8% and 7.3% during the seventh (2000-05) and eighth five-year plan (2005-09), respectively, compared to 5.9% during the fifth plan. The sector's share in the country's GDP grew to 11.7% in 2012 from 9.7% in 2000. Furthermore, while Saudi Arabia's non-oil merchandise exports expanded at a CAGR of 14.1% over 2008-11 to USD47.5 billion, the share of non-oil merchandise exports in total exports increased to 13.1% in 2011 from approximately 10.3% in 2008.

…driven by government initiatives

The steady growth in the Kingdom's manufacturing sector is largely attributable to government's concerted efforts to develop the non-oil manufacturing sector that helped lay a promising foundation for the development of Saudi Arabia's manufacturing sector.

The Saudi government not only directly established industrial plants and estates in basic industries, such as petrochemicals, steel and construction, but also offered a conducive environment that encouraged higher participation from the private sector. Direct and indirect support offered includes soft loans, establishment of industrial cities, industrial subsidies, favorable tariffs, and investment in physical infrastructure.

Government played a crucial role in encouraging industrial growth in Saudi Arabia

- **Direct Support**
  - Financial assistance (soft loans)
  - Subsidies (utilities, fuel, etc.)
  - Physical infrastructure development
- **Regulatory Reforms & Liberalization**
  - Institutional and investment policy reforms
  - **WTO** accession
  - Supreme Economic Council and **SAGIA** formed
- **Industrial Cities**
  - Jubail/ Yanbu established
  - Worldscale infrastructure facilities
  - Logistics support

- **Private Sector Investment**
  - Private sector investment in to non-oil fixed assets in KSA surged to USD45 billion in 2009
  - Non-oil private sector investment totaled nearly USD500 billion during 1990-2009

Source: Aranca analysis

Strong government support through various initiatives, such as Vision 2020, National Industrial Strategy and Industrial Clusters policy, are likely to be facilitators of expansion in Manufacturing.

The way forward: manufacturing to reach over USD180 billion by 2025

In spite of expanding steadily in the last decade, the Kingdom's manufacturing sector holds significant room for growth, given the government's commitment to reduce its dependence on oil. In our view, following are the key enablers that could help the Kingdom realize it true potential in manufacturing:

Government support key to achieving manufacturing scale

In our view, strong government support through various initiatives, such as Vision 2020, National Industrial Strategy and Industrial Clusters policy, are likely to be the facilitators of expansion in this sector.

Government's industrialization objectives are clearly laid out:

- Increase industry sector's contribution to the GDP to 20%
- Raise industrial value added threefold
- Raise industrial exports share from 18% to 35%
- Increase technology based exports from 30% to 60%
- Raise Saudi industrial labor force from 15% to 30%
- Upgrade the Kingdom's status to rank at least among the best performing 30 industrial countries by 2020 by improving its annual ranking by two places

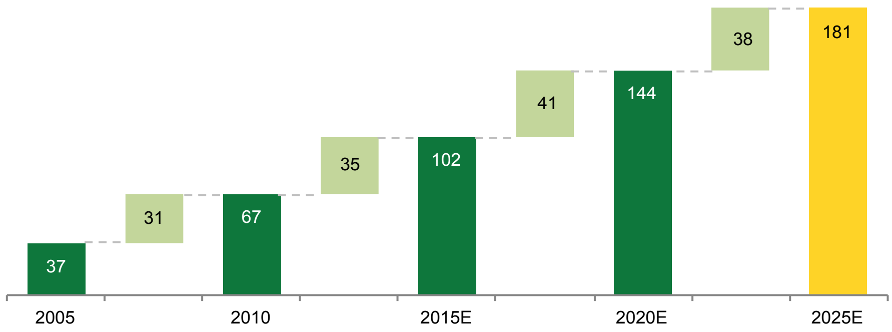
Kingdom's business friendly environment…

As mentioned earlier, government reforms helped Saudi Arabia rank 22nd out of 185 countries in the 2013 World Bank's Ease of Doing Business Index. The Kingdom also figured among the top 10 economies with the fewest payments and lowest tax compliance time. The improvement in the business and investment climate in Saudi Arabia is evident from FDI flows into Saudi Arabia having surged at a CAGR of 46.6% during 2005–08 to USD38.2 billion in 2008. The global economic slowdown and concerns emanating from the events that defined the Arab Spring notwithstanding, Saudi Arabia remains the largest recipient of FDI in the Arab world since 2007.

…is complemented by greater private sector participation

The Saudi government offered a favorable environment for the private sector, due to which investments into non-oil fixed assets, as measured by gross fixed capital formation, more than doubled to USD52.8 billion in 2011 from USD21.9 billion in 1996. The private sector contributed 45.7% of the country's total investments in 2011.

Growth in the Kingdom's manufacturing sector (USD billion)



Source: SAMA, Aranca analysis

Government reforms helped Saudi Arabia rank 22nd out of 185 countries in the 2013 World Bank's Ease of Doing Business Index

With strong government support and rising private sector participation, we expect the manufacturing sector to reach USD181 billion by 2025. Within the non-oil manufacturing sector, we see opportunities in the manufacturing of light metals and automotive parts.

Potential opportunities within non-oil manufacturing

Sector	Objective	Illustrative Opportunities
	Metals and Mining	
Aluminum	Maximize the value of resources by creating & growing new competitive industries	■ Foundry for automotive and industrial products ■ Foil mill for food and consumer goods packaging ■ Aluminum & alloyed rod for wire & cable ■ Alloyed billets for extrusion products
Steel	Produce quality products & build capabilities for growing and creating new conversion industries	■ Auto and appliances sheet ■ Specialty alloy steels & Stainless Steels ■ Small seamless pipe plant ■ Tooling manufacturing ■ Specialty forging manufacturing ■ Stainless tubing and pipe
Copper and Zinc	Integrate resources with smelters to serve the growth in conversion industry & construction	■ Copper rod for the wire & cable industry ■ Plate & sheet for the power industries ■ Copper tubing & pipe for appliance, ■ Automotive and construction industries
Automotive		
Automotive parts manufacturing	Capture potential USD80 billion of regional auto market	■ Vehicle Assembly ■ Auto glass ■ Interior and exterior parts ■ Engines and transmission assembly

Source: Aranca analysis

Petrochemical sector: value-added downstream products show the way

Diversification helps KSA evolve as a key petrochemical hub globally

In an attempt to diversify its economy away from oil and create employment opportunities, the Saudi government promoted the use of associated gas (which is rich in ethane) to develop its petrochemical sector. After establishing government-led SABIC in 1983, the upstream petrochemical segment was opened to private investors in 1995. That resulted in the formation of the first wholly owned private company (Saudi Chevron Phillips Company) in 1999. Since then, the sector has witnessed exponential growth, with aggressive investments supported by access to natural gas feedstock at USD0.75/mmbtu. The Saudi petrochemical sector's capacity increased to over 84million tons per annum (mtpa) in 2012 from 3.7 mtpa in 1985, as per different industry sources such as BMI, oil and gas journal and Saudi companies. This allowed the Kingdom to up its share in the global petrochemical sector to 7-8% in 2010 from near zero in the 1980s.

The demand outlook for petrochemicals is positive over the long term, backed by expectations of strong economic growth and increasing consumption

The Saudi petrochemical sector benefits hugely from the availability of natural gas feedstock at USD0.75/mmbtu through a long-term agreement with Saudi Aramco. That enables pure-ethane feed Saudi crackers to generate significantly higher cash margins than their global peers. However, consumption of natural gas gradually outpaced supply in the Kingdom, thereby forcing Saudi firms to plan new capacities using a mix of feedstock (such as ethane, propane, butane and naphtha). Though this diminished the cost advantage, usage of heavier feedstock expanded the sector's product mix, thereby enabling Saudi firms to move into downstream products.

Rising demand from Asian markets (mainly China) fueled growth in the Saudi petrochemical sector. China is a key export market for the sector where the demand for basic petrochemicals and key plastics increased at a CAGR of 10% to over 100 mtpa in 2000-10, according to the Chemicals Industry Report released by GlobalData. Petrochemical demand in China is expected to record a high single digit CAGR in the next decade.

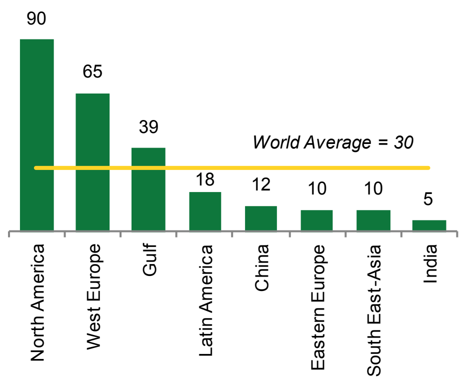
Kingdom's share in the global petrochemical sector to double in the next decade

The demand outlook for petrochemicals is positive over the long term, backed by expectations of strong economic growth and levels of plastic consumption across emerging economies that are well below those in developed economies. Saudi firms are also gearing up to meet the rising demand through investments. According to Business Monitor International's (BMI) Saudi Arabia Petrochemical report-Q4-2012, the Saudi petrochemicals sector's total production capacity is expected to reach 100 mtpa by 2016 from about 75 mtpa in 2010. Two key projects in the pipeline are – PetroRabigh's USD7 billion, phase 2 expansion to add 2.4 mtpa of petrochemical products in 2015 and Saudi Aramco's USD19 billion, 65%:25% joint venture with Dow Chemicals, Sadara, to add 8.1 mtpa in 2016. As a result, Saudi Arabia's share in the global petrochemical sector is expected to increase to more than 15% in the next decade from 7-8% at present.

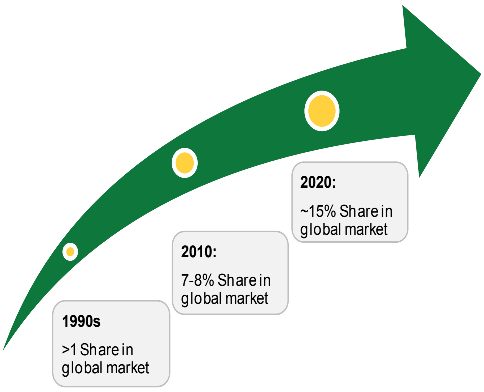
Value added derivatives and plastic - a key growth area

Despite achieving significant scale, the sector offers more opportunities, especially in value-added derivatives and downstream plastics. Global demand for Polyvinyl chloride (PVC), a key downstream ethylene product manufactured by Saudi Arabia, is expected to grow at a healthy 4.9% during 2012-2020 to 49.5 million tons. The Asia-Pacific region will account for more than 65% of global PVC demand in 2020. The Kingdom is striving to increase its focus on manufacturing value-added downstream petrochemicals, plastics and derivatives (beyond basic olefins, polyolefins and methanol), given the higher demand for these products in countries such as China and India.

Per capita plastic consumption in Kg.



KSA emerging as a key petrochemical producer

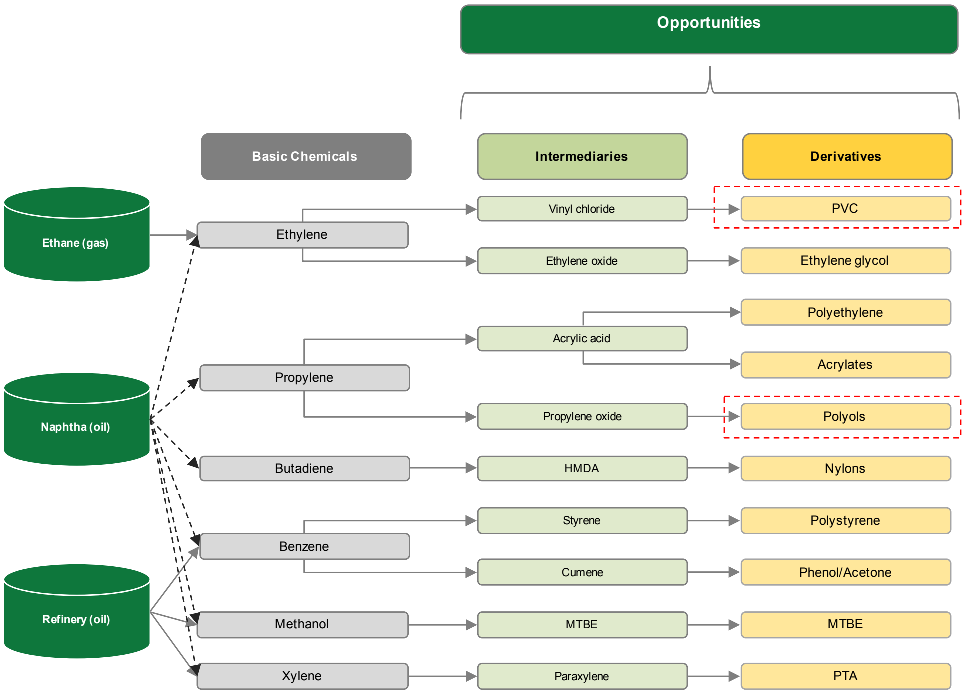


Source: Industry source

Increased focus on value-added products will help the Kingdom diversify its economy, generate more employment opportunities, and lend stability to earnings from petrochemical projects. The share of artificial resins and plastic materials in the Kingdom's total exports increased to 4.0% in 2011 from 2.7% of the total in 2007.

The Kingdom is striving to increase its focus on manufacturing value-added downstream petrochemicals, plastics and derivatives (beyond basic olefins, polyolefins and methanol), given the higher demand for these products in countries such as China and India.

Petrochemical value chain—opportunities in downstream value-added products and derivatives



Source: Aranca analysis

Downstream expansion to help better monetize hydrocarbon reserves

Saudi Arabia's downstream focus across the petrochemical value chain, aimed at monetizing its hydrocarbon reserves, could lead to an increase in the production of complex products. Petrochemical projects valued in excess of USD110 billion and focused on value-added derivatives and downstream plastics are underway. These projects by SABIC, Sipchem, Sahara and Tasnee will add about 3 mtpa of downstream capacity during 2013-2016. The planned start up of Saudi Aramco's Sadara project will add more than 3 mtpa of diversified products to the sector's downstream product portfolio.

Infrastructure – all about building capacity beyond oil

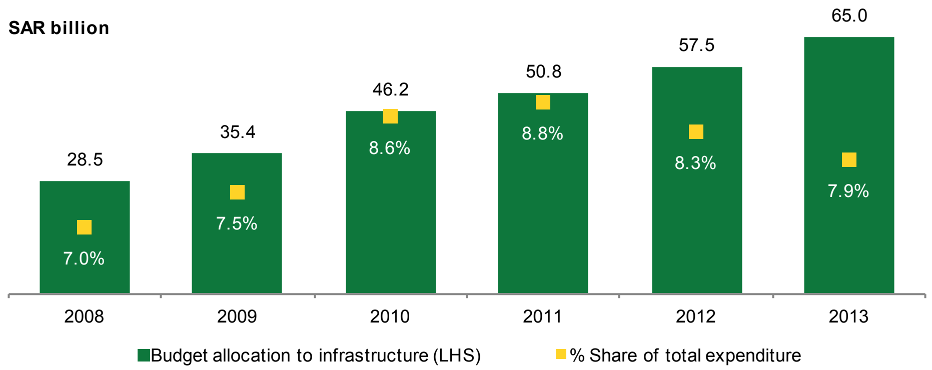
Saudi Arabia's drive to develop its manufacturing base has led to sizable investments in infrastructure building activities, new and replacement, that cover construction, power, transport, logistics and tourism. The Kingdom has, therefore, become a magnet for civil construction and engineering players.

Public spending spurs strong growth in last five years

Saudi Arabia's infrastructure sector has witnessed strong growth in the last five years, supported by the government's investments in developing roads, railways, ports and airports, telecom, electricity and water-supply networks, hospitals, schools and universities. The country's budget allocation to the infrastructure sector increased at a CAGR of 19.2% over 2008-2012 to SAR57.5 billion. Besides increased budgetary allocation, government investment in the Kingdom increased to SAR173.4 billion in 2011 from SAR58.7 billion in 2006. Moreover, the government's share in gross fixed capital formation (GFCF) increased to 40.5% in 2011 from 31.6% in 2008.

Saudi Arabia's pipeline of infrastructure projects is expected to reach USD729 billion by 2025, with government spending and private sector participation set to rise

Saudi Arabia budget allocation to infrastructure

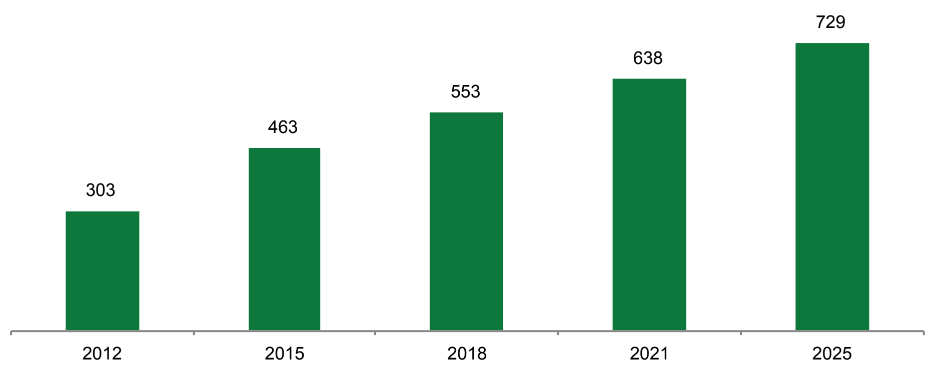


Source: Ministry of finance, Saudi Arabia

The way forward: Infrastructure pipeline to reach USD729 billion by 2025

Saudi Arabia's pipeline of infrastructure projects is expected to reach USD729 billion by 2025 from USD302.8 billion in 2012. The Kingdom will be building physical infrastructure to meet the needs of economic expansion, growing population, and increasing global integration. In our view, while government spending will continue to be the major driver, private sector participation in the sector will provide added impetus.

Saudi Arabia infrastructure pipeline (USD billion)



Source: Zawya Projects, Aranca analysis

Public sector spending will continue to dominate…

The Saudi government has embarked on a USD624 billion investment program entailing infrastructure and industrial projects through to 2020. The thrust is on establishing the Kingdom as a global industrial force and a hub for regional transport and logistics. Under the Ninth Five-Year Development Plan (2010–14), the Saudi Council of Ministers allocated USD385.1 billion (SAR1.4 trillion) for key projects, 67% higher than the provision made in the previous plan.

…with private sector participation increasing steadily

In order to support the massive expansion in economic and industrial activities over the next decade, the government is actively focusing on channelizing budget surpluses in developing physical infrastructure. Given the quantum of the Kingdom's infrastructure requirement over the next decade, the government will need active private sector participation. This will open up many opportunities for private sector players across the various sub-segments of the Infrastructure space.

Given the quantum of the Kingdom's infrastructure requirement over the next decade, the government will need active private sector participation.

Construction and transportation sectors hold strong potential

The Saudi construction sector is the largest in the GCC, given that its order backlog of USD673.0 billion comprises 38.6% of the region's total backlog. The sector contributing 7.4% to Saudi Arabia's GDP has experienced rapid growth in recent years. Within the construction sector, housing is expected to emerge as one of the strongest sectors, as it benefits from the government's plans to invest in affordable housing. The construction sector in Saudi Arabia is poised for strong growth in the next 10-15 years, supported by the government's expenditure plans.

Transportation sector set to transform with investments worth USD100 billion over the next 10 years

Transport and logistics, in our view, offer an attractive investment opportunity within the infrastructure segment as the Kingdom looks to complement its economic expansion through 2025. Saudi Arabian General Investment Authority (SAGIA) expects investment of USD100 billion in the transport sector over the next 10 years.

Key drivers include:

- Country's strategic location makes it a potential global transport and logistics hub
- Road transport is the popular mode of transport due to low rail density, low cost of fuel etc.
- Development of the planned Economic Cities will require transport infrastructure
- Low cost of fuel provides an advantage in energy intensive logistics activities
- Strong domestic growth, supported by massive capital spending and rising personal wealth
- Massive investments being made in the rail, road, marine and aviation sectors

"Infrastructure projects including back-end support such as transportation, logistics are growing significantly and mega-projects are going to sustain higher growth.

Musaab Al-Muhaidib,
CEO, Al-Muhaidib Technical Supplies

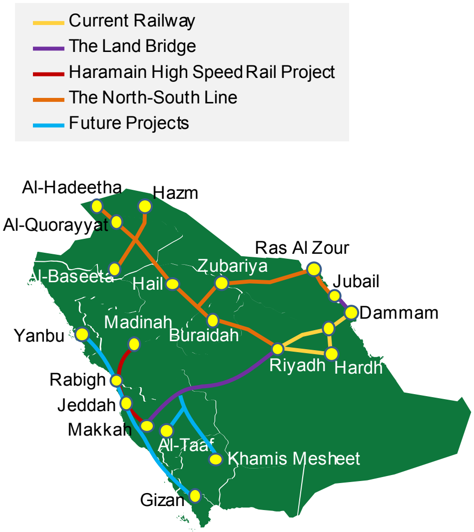
Saudi Arabia is expanding its rail infrastructure, with more than USD81.6 billion of projects being executed or in the pipeline. Major projects now being planned and executed include the Saudi Land Bridge project, the Haramain High Speed Rail Project, and the North–South Railway. Moreover, Light Rail Transit Systems within cities such as Riyadh, Jeddah and

Transport and logistics offer an attractive investment opportunity within the infrastructure segment as the Kingdom looks to complement its economic expansion

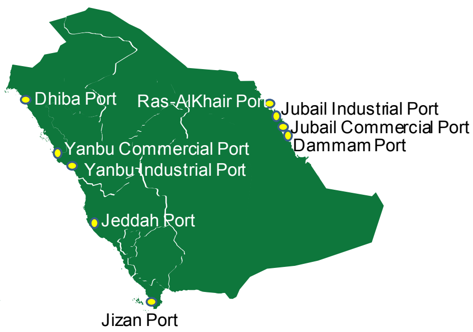
Medina are also being planned and developed. To support this flurry of transport contracts and to ease layers of red tape, the government established a Public Transport Commission in October 2012. SAGIA is also continuing to invest in building new road connections and expanding existing ones. According to Zawya Projects, the project pipeline for road infrastructure in Saudi Arabia currently totals ~USD4.0 billion.

Container traffic is largely dependent on trade and Saudi Arabia's value of goods exported is forecasted to increase from SAR1.5 trillion in 2012 to SAR2.3 trillion by 2025. Leveraging on the anticipated rise in exports two new ports are being set up, in addition to the existing nine. These are being established in conjunction with the economic cities of King Abdullah Economic City (KAEC) and Jizan Economic City (JEC).

Saudi Arabia rail network



Key ports in the Kingdom



Source: Saudi Railways Organization, Ports Authority, Saudi Arabia

Investments in the Saudi aviation sector also appear to be surging, with plans worth SAR200 billion likely to be executed over the next five years. Projects include the development and expansion of Riyadh airport and the setting up of the country's first private airport in the Prince Abdulaziz bin Musaed economic city. Furthermore, Madinah's Prince Mohammad Bin Abdulaziz International Airport is undergoing major rehabilitation, expansion and development works. Constantly growing religious tourism is expected to provide further impetus to the Saudi aviation sector.

Power sector – direct beneficiary of industrial and economic expansion

Electricity generation: matching step with the economy

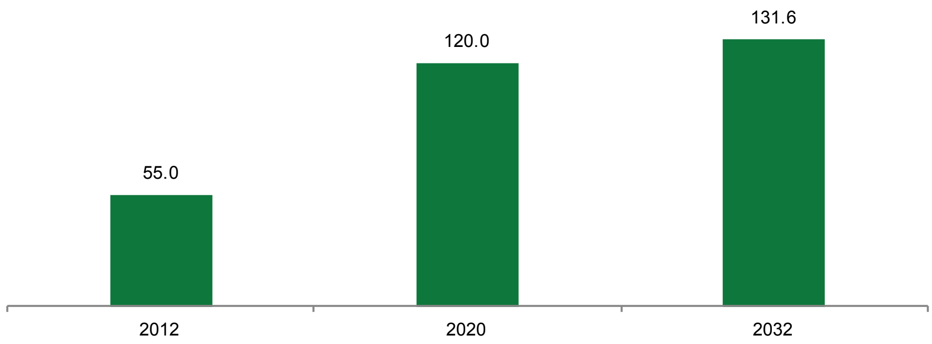
Saudi Arabia, with annual electricity production of 217billion kilowatt hours (kWh) in 2009, accounted for 52.2% of all power produced in GCC in that year. The household, services and agricultural sectors consumed 82% of the total electricity generated. A steadily growing population, changing lifestyles and rising per capita income, abundant crude oil resources and robust government finances have been the key demand and supply drivers for the Kingdom's power industry.

The Saudi power sector offers an attractive investment opportunity, as its significance grows along with the Kingdom's non-oil led economic expansion initiative through 2025. Continued expansionary policies, large investments in social and physical infrastructure, and a growing population are expected to provide impetus to the Saudi power sector, going forward.

Saudi Arabia electricity generation (TWh)

Source: BP Statistical Review of World Energy, 2012

Expected expansion in power generation capacity in Gigawatt



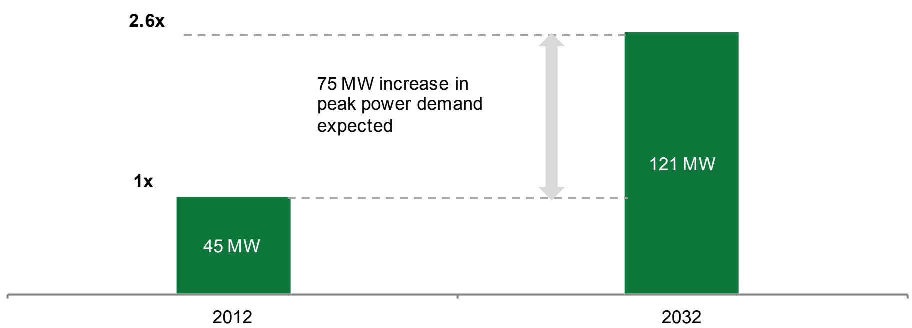
Source: EIA and Ecoseed.org

Subsidized power tariffs, growing demand for HVAC, rapid industrialization and investments in large physical infrastructure are expected to increase power consumption in Saudi Arabia through the next two decades.

Peak power demand to more than double in 20 years

Subsidized power tariffs, growing demand for HVAC, rapid industrialization and investments in large physical infrastructure are expected to increase power consumption in Saudi Arabia through the next two decades. This is expected to boost peak power demand in the Kingdom to 121 GW by 2032 from 45 GW in 2012. Expectations of high growth in demand have prompted Saudi officials to work on plans to raise generation capacity to 120 GW by 2020 from 45 GW in 2012.

Saudi Arabia peak power demand estimate



Source: King Abdullah City for Atomic and Renewable Energy

Unprecedented push for renewable power aimed at reducing dependence on oil

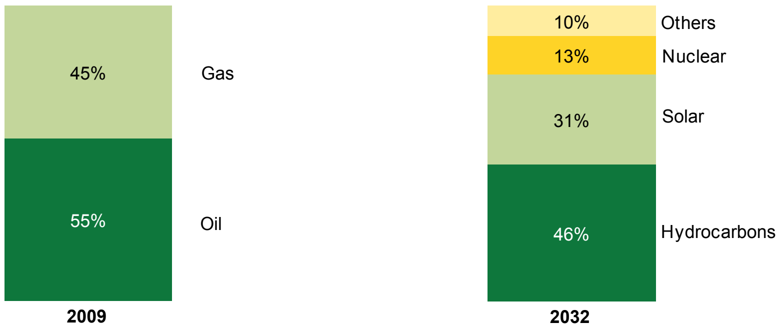
Saudi Arabia consumes a staggering one-fourth of its production, primarily for generating power. Alarmed by the growing domestic oil consumption, some forecasters have voiced fears of the country becoming a net oil importer by 2030. The government has realized that it has to reduce reliance on fossil fuel for power generation and has embarked on an ambitious renewable energy program.

Solar, Nuclear energy the new sunshine sectors; contractors to gain

Saudi Arabia plans to increase its solar energy capacity to 41 GW by 2032 at an estimated investment of about USD109 billion. Plans include generation of 60% of solar power from solar thermal plants (that utilize mirrors to focus sunlight on heating fluids, which, in turn, drive turbines), while the balance is expected from photo-voltaic panels. Competitive bidding rounds from 2013 onwards are expected to create business opportunities for solar plant contractors and panel manufactures.

Solar energy capacity to increase to 41 GW by 2032 at an estimated investment of about USD109 billion

Expected shift in the Kingdom's generation mix



Source: World Nuclear Association and Ecoseed.org

Undeterred by the reduced global appetite for nuclear power plant after the Fukushima incident in Japan, Saudi Arabia has set the bar higher for itself. The government plans to build 16 nuclear power plants with a total capacity of 21 GW by 2032 at an estimated investment of around USD100 billion. Such large investments are creating opportunities for companies involved in the construction of nuclear power plants, manufacturing and supply of nuclear fuel elements and plant maintenance. The Kingdom has signed nuclear cooperation agreements with countries such as China, France, Argentina and South Korea. Other countries are eagerly exploring opportunities created by Saudi Arabia's nuclear rush.

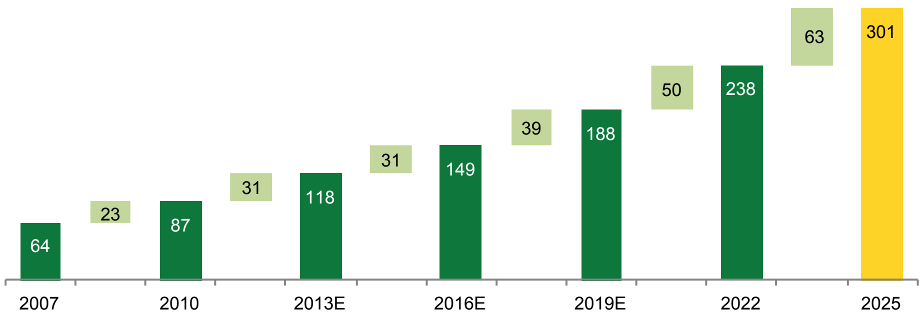
Consumer retail sector

The inherent strength of the Saudi economy has created opportunities in the services sector, with retail and healthcare offering an attractive investment opportunity through 2025. These sectors have registered double-digit growth in the last five years. The Kingdom's consumer retail market is estimated to have expanded at a CAGR of 11.0% during 2007–12 to reach USD108.6 billion in 2012. Factors such as growth in disposable income and the under-penetrated nature of the market have contributed to the overall growth of the sector.

Consumer retail to expand nearly 2.7x to USD300 billion by 2025

Despite registering double-digit growth, we estimate the Kingdom's retail market to expand at a CAGR of 8.0% during 2012–25 to reach USD301.0 billion by 2025. In our view, a combination of the following triggers makes Saudi Arabia an attractive destination for retailers:

Retail sales in Saudi Arabia to grow nearly 2.7x to USD301 billion



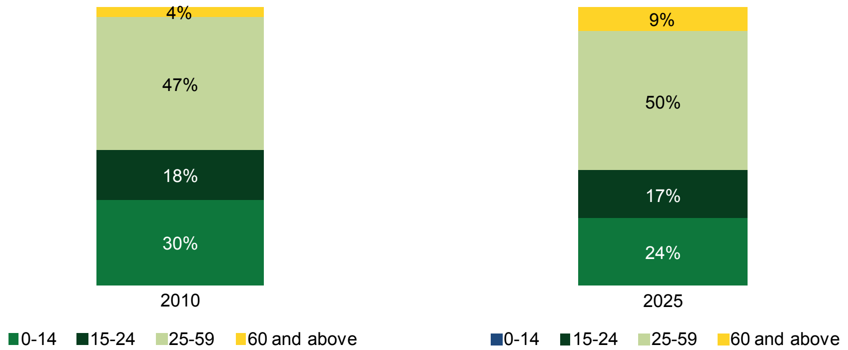
Source: EIU, Aranca analysis

Demographic dividend – steadily expanding young population base attracts retailers

The Kingdom's attractive demographic profile offers a compelling value proposition for retailers. Currently, Saudi Arabia's population is among the youngest in the world, with 57.0% below the age of 30 compared to UAE (49.6%), Kuwait (54.4%), Bahrain (49.5%), and Qatar (44.8%). In terms of the ratio of population below the age of 30, Saudi Arabia also compares well with other emerging countries such as China (43.2%), Brazil (50.9%), Russia (37.1%), and Malaysia (56.2%). This demographic advantage is likely to drive growth in the retail sector as consumer spending rises, led by rising disposable incomes and changing lifestyles. We estimate Saudi Arabia's population to increase by about a third from current levels to reach 37.4 million by 2025. Growing urbanization adds to the attractiveness of the retail sector. Saudi Arabia's urbanization rate of over 82% (76.6% in 1990), lower than most of its GCC counterparts, is estimated to reach 91% by 2015. Rapid urbanization and gradually increasing demand for organized retailing are likely to accelerate growth in the retail sector.

Rapid urbanization and gradually increasing demand for organized retailing are likely to accelerate growth in the retail sector.

Expected shift in the Kingdom's demographic structure



Source: World Bank

Rising disposable income, low penetration to drive consumer spending

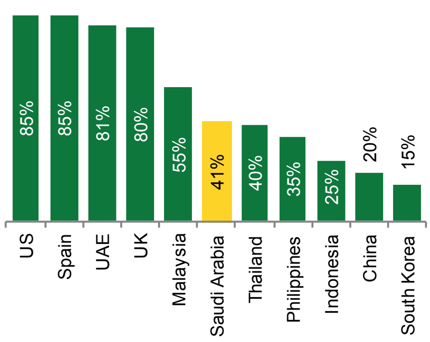
The spending power of Saudi consumers is well-supported by sustained high oil prices. Saudi Arabia's per capita GDP expanded at a CAGR of 8.7% in 2006–12 and is estimated to reach USD35,487 by 2025, implying a CAGR of 6.7% in 2013–2025. This makes the Saudi consumer partially insensitive to prices. Our analysis on sector attractiveness shows that the estimated real GDP per capita growth (2013–2025) for Saudi Arabia and BRIC nations is higher than that of most other developed nations. Despite the growth in per capita income levels, Saudi Arabia's organized retail sector remains highly under penetrated at 41.0% compared to UAE (81.0%), Malaysia (55.0%), the US (85.0%) and UK (80.0%).

Rising disposable incomes, low organized retail penetration and realignment of the consumption pattern toward Western-style consumerism could boost consumer spending over the next decade.

Low consumer leverage to further aid consumption

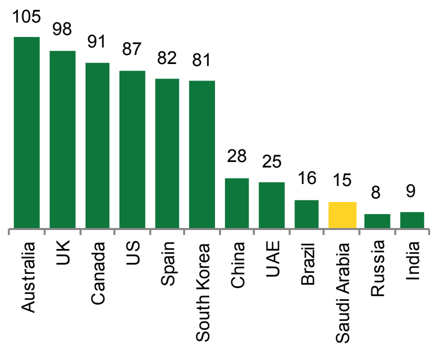
Consumer leverage in Saudi Arabia is low, accounting for a mere 15% of the Kingdom's GDP. The expected rise in income levels is likely to realign consumption patterns toward secondary comfort and luxury goods.

Penetration of organized retail in Saudi Arabia



Source: SAVOLA presentation

Household leverage in Saudi Arabia (% of GDP)



Source: SAMA, Aranca analysis

Consumer leverage in Saudi Arabia is low, accounting for a mere 15% of the Kingdom's GDP, rise in income levels is likely to realign consumption patterns toward secondary comfort and luxury goods

Opportunity in non-food consumer discretionary products

The Kingdom's rapidly expanding young population base, rising income levels and rapidly growing female consumer base offer significant room for growth in discretionary spending. Besides, entertainment options in Saudi Arabia are limited, due to cultural reasons and extreme climatic conditions, prompting Saudi consumers to spend more on leisure and discretionary shopping activities.

Online retailing in nascent stage, but holds great potential

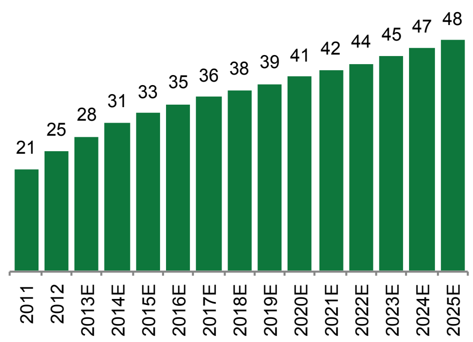
E-commerce and online retailing in Saudi Arabia are currently in a nascent stage, largely due to the low credit card usage rate. However, the following factors are likely to drive the online retailing market in Saudi Arabia.

- Growing working class population means paucity of time to shop at stores and malls
- Young entrepreneurs are increasingly venturing into the retail online business. For instance, the El Ilhaam e-portal could become the next popular portal selling luxury retail brands
- Strong potential in mobile commerce, especially once the 3.5G and 4G network expands and data-transmission speeds improve

Healthcare sector – healthcare expenditure to reach ~USD48 billion by 2025

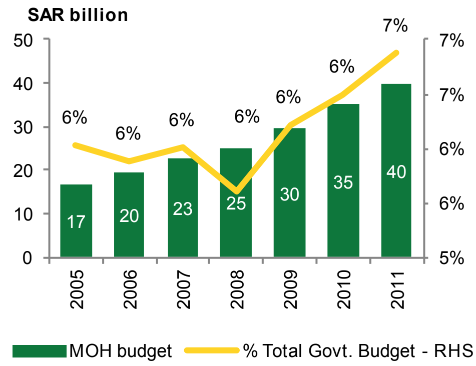
With healthcare spending pegged at an estimated USD25.1 billion in 2012, the Saudi Arabian healthcare sector is one of the largest in the Middle East. Growth in the sector has been fueled by the steadily increasing population, rising income levels, insurance reforms (mandatory health insurance for expatriates) and other government policies. The government's budgetary allocation to healthcare has expanded at a CAGR of 15.4% to USD10.6 billion in 2011 from USD4.5 billion in 2005.

Healthcare industry to hit USD48.3 billion by 2025



Source: WHO, EIU, Aranca analysis

KSA's budget allocation to healthcare



Source: Health Statistical Year Book 2011

Healthcare sector: Vital signs point to rising investment opportunities

Saudi Arabia, the largest healthcare market in the GCC region, is expected to almost double to USD48.3 billion by 2025 from USD25.1 billion in 2012. Government's focus on privatization will play a crucial role in helping Saudi Arabia realize its true potential in the healthcare sector. Key demand drivers include:

The government's focus on privatization will play a crucial role in helping Saudi Arabia realize its true potential in the healthcare sector

Changing lifestyle leading to higher incidences of diseases

The Kingdom is witnessing a socio-economic transformation that is leading to a change in lifestyle. Increasing income levels has resulted in a sedentary lifestyle and poor dietary patterns. The healthcare industry is expected to continue to be driven by the rise in lifestyle related diseases such as obesity, diabetes and cardiovascular problems. Obesity has become a major issue in Saudi Arabia, with 63.1% of males and 65.9% of females above the age of 15 being obese. This is broadly in line with the developed economies and much higher than that in the BRIC nations. Moreover, International Diabetes Federation reported that GCC countries figure among the top 12 globally with high incidence of diabetes. Prevalence of diabetes in Saudi Arabia increased to 19.4% in 2012 from 16.2% in 2011. Diabetes accounts for 6% of the Kingdom's mortality, much higher than that in major developed and developing nations. With NCDs emerging as the leading cause of death in Saudi Arabia, the demand for advanced healthcare services is expected to grow manifold.

Rising private sector participation, healthcare reforms widen the playing field

Over the years, healthcare spending in the Kingdom has largely been funded by the government. However, with healthcare needs rapidly rising, the government has realized the importance of the private sector in helping bridge the gap in healthcare investment and providing services. Accordingly, it is increasingly focusing on creating more public-private health partnerships.

Besides privatization, Saudi Arabia also entered into the WTO that facilitated patent and exclusivity for innovative drugs launched in the domestic market for around 20 years. The country has enacted laws such as the Trademarks Regulations (August 2002), Copyright Regulations (August 2003), Patents Regulations (July 2004) and the Rules for the Protection of Trade Secrets (including protection for undisclosed pharmaceutical data; 2005) in the past.

Additionally, the focus on health insurance has increased. The opening up of the health insurance industry to private players could also aid the healthcare industry. Health insurance accounted for 52.5% of the entire premium collected in the insurance industry in

2011, with SAR9.7 billion in underwritten premiums. Therefore, any parallel growth in health insurance is also expected to boost access to advanced drugs.

High dependence on imports provides investment opportunities

While there were around 30 domestic drug makers in Saudi Arabia in 2009, almost 80% of all the drugs consumed were imported. Saudi Arabia is highly reliant on imported products for its drugs and surgical equipment needs. The manufacture of pharmaceuticals and surgical equipment is limited and these allied sectors offer room for private investment. Of the 200 registered foreign players in the Kingdom, only a few have a manufacturing base. Due to legal requirements, foreign players usually do business through joint ventures with local firms. The Kingdom's huge dependence on imports for its healthcare needs provides huge investment opportunities for domestic and international players.

The manufacture of pharmaceuticals and surgical equipment is limited and these allied sectors offer room for private investment

Investment opportunities abound: Clutch of areas identified by the Government

Secondary Care: Services offered by specialty centers, specifically in cardiology and diabetes, are on the increase. This will help address the shortages of beds in public hospitals and the limited availability of specialists.

Tertiary care: As public hospitals struggle to manage the deluge of patients, leading to long waiting hours and shortages of beds, the quality of care has deteriorated. That is creating opportunities for multidisciplinary hospitals and specialized centers of excellence that include complex disciplines such as oncology and organ transplants.

Ambulatory care and testing centers: The demand for outpatient facilities involving ambulatory care, ambulatory surgical capacity and diagnostic imaging centers are growing as hospitals are finding themselves unable to meet the growing demand for medical testing procedures.

Health insurance: Enactment of the Cooperative Insurance Act has made insurance mandatory. All employers have to provide private health insurance, initially to non-Saudis, but eventually to cover all employees. Insurance companies stand to gain significantly.

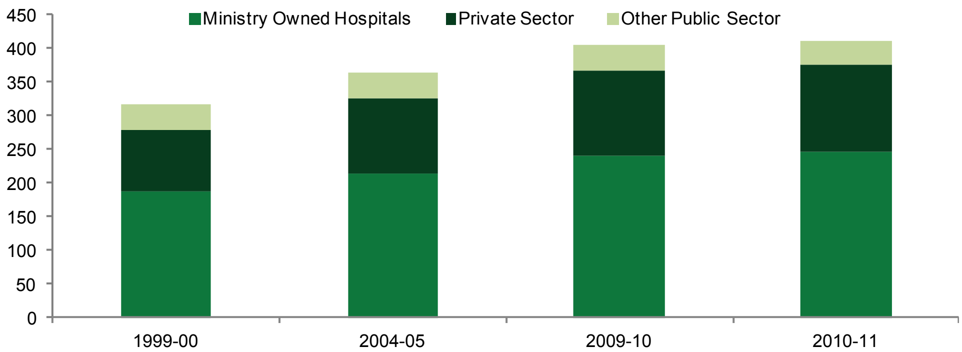
E-Health: The healthcare sector adding more number of service providers, coupled with the rising sophistication of care, is creating an increasing need for maintaining a national electronic records database. This is generating opportunities for health systems integrators and potentially tele-medicine specialists.

Healthcare infrastructure by way of new hospitals, clinics present a strong investment opportunity

Saudi Arabia has been experiencing a surge in inpatient and outpatient visits. The ratio of inpatient admission to total population increased to 12% in 2010 from 10.4% in 1999. Furthermore, in 2005–10, total admissions rose at a CAGR of 7.1% to 3.3 million, (private hospitals saw inpatient admissions rise at a CAGR of 11.1%). Outpatient visits in Saudi hospitals were pegged at nearly five times the population to 130 million in 2010. The average number of visits per person increased to 4.8 in 2010 from 4.5 in 2005. With patient handling capacity failing to keeping pace with rising demand, the congestion in the system grew.

The Kingdom's five-year development plan (with total expenditure of USD73 billion) envisages building 121 new hospitals and upgrading 66. The government, in 2011, had also announced the need to raise hospital bed capacity by 41,000 over the next four years to address the rising demand from a growing population. The private sector is also pitching in with its own investment plans, thereby complementing government efforts to build a robust healthcare infrastructure and real estate.

Saudi Arabia number of hospitals



Source: MOH annual report 2010, IMF

Saudi Arabia hospital bed capacity addition targets

Type	2009 beds	MOH target beds (2014)	Incremental beds	Incremental hospitals	Investment (USD billion)
MOH	33,277	56,379	23,102	154	6.2
OPS	10,822	20,296	9,474	3	2.5
Private sector	11,833	20,860	9,027	290	2.4
Total	55,932	97,535	41,603	447	11.1

Source: SAMA 48th annual report, EIU

The Kingdom's five-year development plan (with total expenditure of USD73 billion) envisages building 121 new hospitals and upgrading 66

Education sector–total spending to reach USD101 billion

Development of human capital has become a top priority for Saudi Arabia as the Kingdom pushes toward developing its manufacturing base. Thus, improving the quality of education provided to the Kingdom's youth has become a top priority for the government. Paddy Padmanathan, CEO, ACWA Power believes the right skill set and right mix has been recognized and that while universities are being created, education is geared toward sciences, vocational training and industry participation is being encouraged.

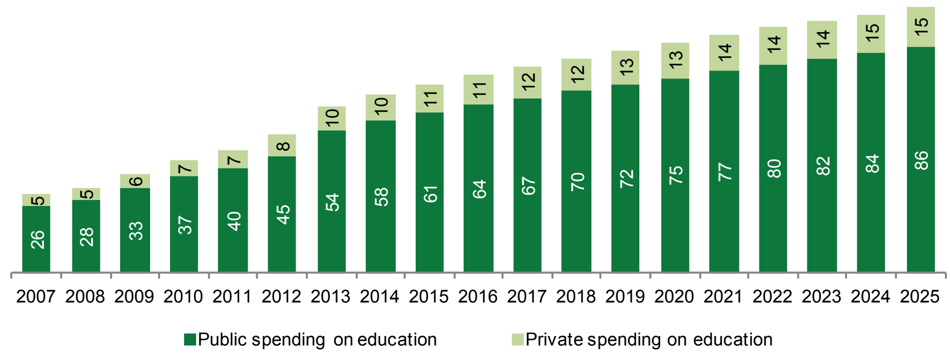
Saudi Arabia's budgeted spend on education increased at a CAGR of 11.8% in 2007-12

The education sector has emerged as a priority area for the Saudi government, with budgetary allocation more than doubling since 2005. The Kingdom spent USD45.0 billion on the sector in 2012, up from USD25.8 billion in 2007; education and training accounted for more than 24% of Saudi Arabia's budget expenditure in 2012. The Saudi government has introduced new education programs, research and development initiatives, and built many schools and universities to enhance the country's education system. Government spending on education accounts for majority of the total spending on education in the Kingdom.

The way forward: Total spend on education to double by 2025

Saudi Arabia's education sector (both public and private) is expected to double to USD101 billion by 2025 from USD53 billion in 2012. Rising unemployment among Saudi nationals, rapidly increasing demand for skilled personnel across various industry verticals, improving infrastructure and increasing government support have turned the Kingdom's education sector into a lucrative market in the GCC. The Kingdom offers the largest education base in the GCC region. Furthermore, increasing private sector participation, mainly due to the support provided by the government, is expected to augment the government's efforts.

Saudi Arabia's budget allocation to education



Source: SAMA, Aranca analysis

Increasing investment by government in education

The Saudi government has made massive investments to improve the functioning and enhance the reach and quality of the education sector. The government plans to invest SAR81.5 billion in the Kingdom's education sector. This includes the setting up of:

Saudi Arabia's education sector (both public and private) is expected to double to USD101 billion by 2025 from USD53 billion in 2012

- 18 university cities and academy complexes for male and female students in Jazan, Hail, Jouf, Tabuk, Najran, Northern Borders, Baha, Shaqra, Majmaah, Taibah, Qassim, Taif and Kharj
- King Abdullah bin Abdulaziz City for Female Students at Imam Muhammad bin Saud Islamic University, Female Students City at King Saud University and Female Students City at Umm Al-Qura University,
- 161 infrastructure and support projects
- 167 colleges for male students
- 161 colleges for female students
- 11,000 housing units for faculty members
- 100 housing units for students accommodating 50,000 students
- 3,800-bed 12 university hospitals in Jazan, Jouf, Hail, Baha, Taif, Taibah, Tabuk and Northern Borders, Najran, Rabigh, Kharj and Qassim

In the Ninth Five-Year Development Plan (2010–14), the Kingdom appropriated USD195.0 billion (50.6% of total allocation) to the development of human resources. Under the plan, Saudi Arabia aims to:

- Boost the capacity of primary, intermediate and secondary schools to 5.3 million students and that of universities to 1.7 million students
- Construct 50 industrial training institutes, 25 technology colleges and 28 technical institutes
- Build 15 universities technological innovation centers, 10 research centers and a minimum of 8 technology incubators at KACST and other universities
- Expand post-graduate programs
- Earmark funding of USD240 million for scientific and technological research each year.

Moreover, its FY13 budgetary allocation of USD54.4 billion is 21% higher that than in the previous year.

Rise in private sector participation

According to the Parthenon Group, private sector education currently accounts for 2% of all education enrollment, and the government wants the private sector to achieve a 30% share of total enrollments. Private sector participation is expected to raise the bar on quality, international experience the standards of education in the country. Private sector participation will also involve training of teachers and upgrading teaching standards. Increased private sector participation could make Saudi more attractive to PE players.

Opportunities in the Kingdom's e-learning market

Rising number of internet users and rapid technological advancements are making, e-learning a key method of education in the Kingdom. Internet users in Saudi Arabia are estimated to have increased at a CAGR of 41.6% in 2000–12 to reach 13 million by 2012. E-learning is also being driven by expensive higher education making several universities adopt e-learning. Furthermore, the National Center for E-Learning and Distance Education has taken several educational projects to promote e-learning. Saudi Arabia planned to invest about USD13 billion in information technology during 2012–14.

Private sector education currently accounts for 2% of all education enrolment, the government has set a target for the private sector to achieve a 30% share of total enrolments

Lack of adequate skill-sets drives demand for education and training

A rapid increase in demand for skilled personnel across various industry verticals is expected to trigger strong growth in the Saudi Education sector. The current Saudi education system is often unable to impart the right skills required for a modern workplace forcing employers to hire foreign nationals with matching skill sets. The disconnect between education and workplace requirements is largely due to factors such as insufficient classroom infrastructure, untrained teachers, and irrelevant curricula.

03.

MOVING BEYOND THE KINGDOM

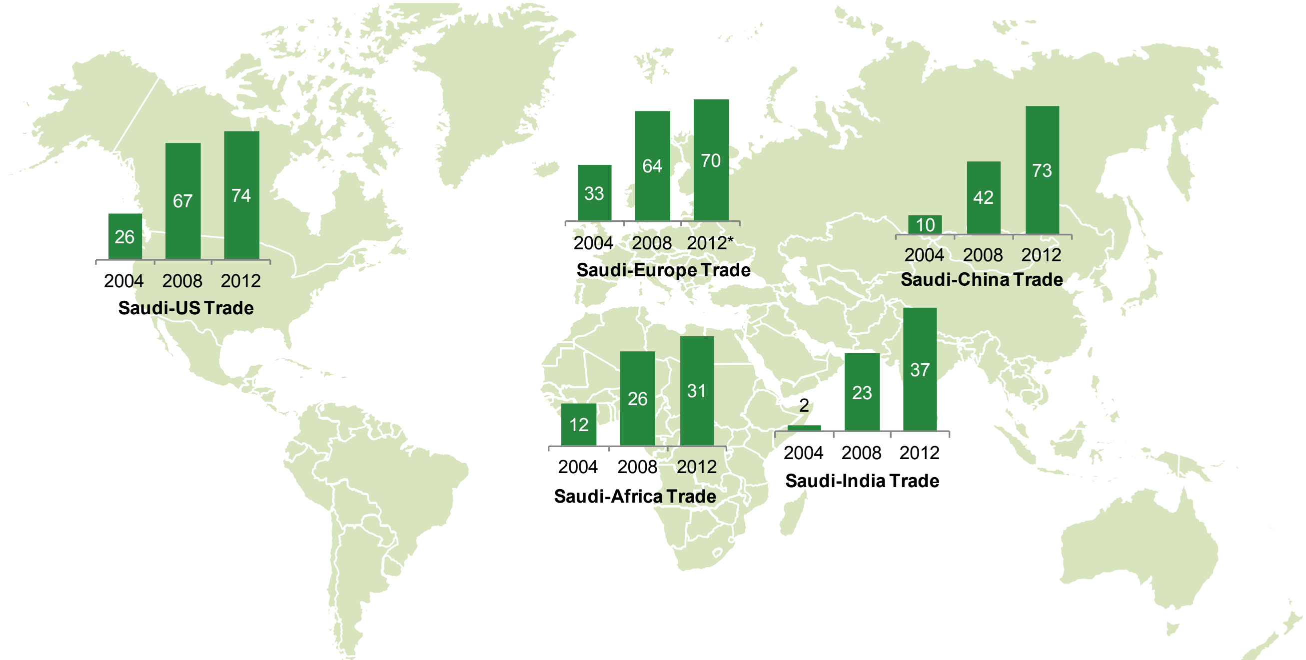
- Saudi Arabia's investments in the GCC market have increased in recent years, with the UAE, Qatar and Bahrain emerging as favorite destinations.
- Two-way trade with Turkey has increased significantly in recent years, from just over USD1.3 billion in 2000, to USD8.1 billion in 2012.
- Africa has been a strategic partner for Saudi Arabia in food security initiatives. Saudi investors are believed to have planned or concluded investments in about 800,000 hectares of land in Africa.
- Asia has been Saudi Arabia's largest trading partner since the past few years and accounted for nearly 60% of the country's total foreign trade of over USD500 billion in 2012. The Kingdom capitalizes on growth opportunities coming from the largest and third largest markets China and India.
- Western markets are being tapped for technology in the form of R&D collaborations, partnerships and investments

Saudi Arabia's growing trade and investment links with other markets (advanced and emerging), along with continued economic liberalization and private sector expansion, are likely to see it emerge as one of the world's leading economic powers in the next decade. While the country continues to pursue economic and foreign policies that spread and increase its interests abroad, both strategically and otherwise, the private sector is increasingly emerging as a complementary force in achieving these objectives. Endowed by structural growth drivers, such as a positive demographic profile and rising consumer wealth, the Saudi private sector appears well positioned to leverage on growth opportunities abroad.

Tapping regional growth opportunities

Positioned at the center of the Arabian Peninsula amid the two busiest energy transit routes, the Red Sea and the Arabian Gulf, Saudi Arabia's importance to global commerce and trade has increased manifold in the past decade. However, being the largest economy in the region notwithstanding, Saudi Arabia's trade with neighboring GCC markets has remained low. Intra-region trade, while increasing nearly five-fold from around USD8.7 billion in 2001 to over USD44.1 billion in 2011, remains significantly low as a proportion of total trade of these countries put together (4% of USD1.2 trillion of total trade in 2011). The reason for low intra-regional trade is largely due to these countries having a very similar trade profile, i.e., hydrocarbon exports and imports of food and manufactured products.

The Kingdom's growing trade (USD billion)

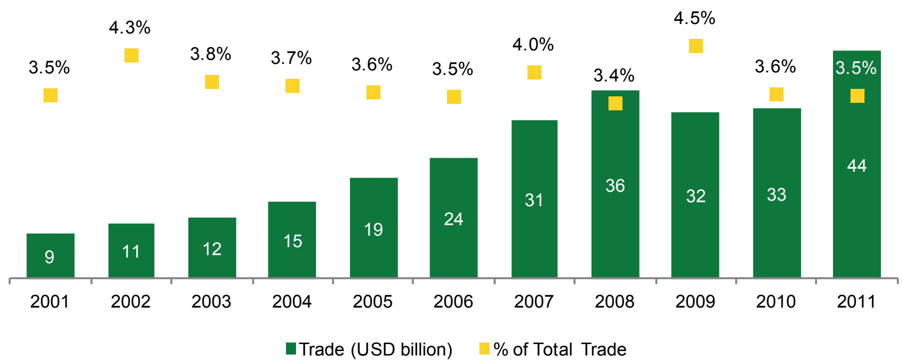


Source: US Department of Commerce, Eurostat, Bloomberg, Aranca analysis
** till November 2012*

Nonetheless, economic diversification and the growing importance of transit trade through re-exports are beginning to enhance regional trade and investment.

The potential of greater regional cooperation in and integration of trade and investments is high. There are talks of integrating the regional stock markets while the establishment of the Gulf Monetary Council in March 2010 marked an important development in the GCC Monetary Union project. Furthermore, the proposed rail network and the common aviation policy that are being discussed are key examples that would benefit regional businesses. Concerted efforts are also being made to develop the region as a leading international trading hub. Governments, along with the private sector, are investing heavily in ports and cargo transport infrastructure, with Saudi Arabia having invested over USD10 billion in this area.

Intra-region trade in the Gulf Cooperation Council (GCC) – USD billion



Source: UNCTAD, Aranca analysis

The Kingdom is also keen on taking advantage of the regional growth story, as economies, including Abu Dhabi, Kuwait and Qatar, invest heavily in developing domestic infrastructure and diversifying their economies away from oil. Saudi Arabia's investments in the GCC market have increased in recent years, with the UAE, Qatar and Bahrain emerging as favorite destinations. Private sector companies from Saudi Arabia are actively pursuing massive infrastructure projects in Qatar, as that country prepares to host the 2022 Football World Cup. Recently, in Doha, a trade delegation of more than 50 Saudi businessmen expressed keen interest in participating in the USD130 billion infrastructure projects planned over the next decade.

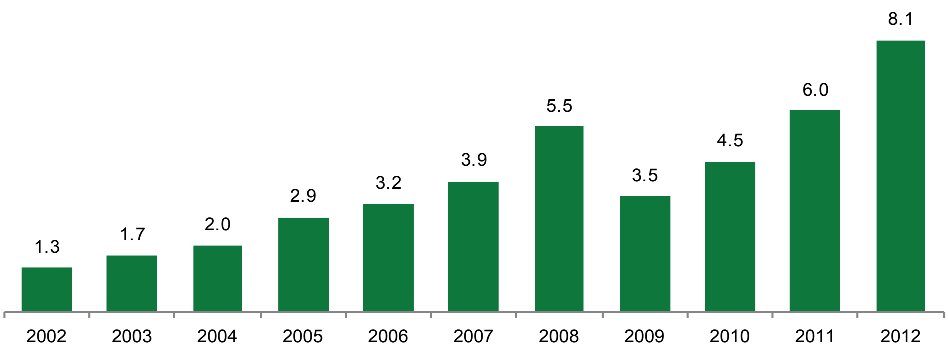
Increasing opportunities in Turkey's energy and industrial sectors

Apart from its immediate neighbors, Turkey has emerged as one of the most preferred destinations for Saudi companies, both from an investment and an export market perspective. The cultural, historical and religious linkages notwithstanding, the two countries are similar to each other in many aspects. They are among the fastest growing economies in the world with similar demographic characteristics where the majority of the population falls in the working age group (15-64 years). In addition, Saudi Arabia and Turkey are the only members of the coveted G20 group of nations from the Middle East and are also full members of the World Trade Organization (WTO). Furthermore, given their increasing economic might and strategic location, both countries are likely to emerge as important players in the global economic and political order in the coming decade.

Both Saudi Arabia and Turkey have a thriving external sector with two-way trade increasing significantly in recent years. From just over USD1.3 billion in 2000, trade between the two nations peaked at over USD5.5 billion in 2008, before falling to USD3.5 billion in 2009 during the financial crisis. Trade increased again to around USD4.5 billion in 2010 and to over USD6 billion in 2011 and USD8.1 billion in 2012. The two countries plan to increase bilateral trade to over USD10 billion in the near future. However, while trade between the two countries has grown, it continues to be dominated by energy; oil exports account for as much as 80% of Saudi Arabia's total exports to Turkey, while nearly 90% of imports comprise manufacturing goods. Given Turkey's reliance on imports to meet its energy needs, there is significant room for Saudi investments in the refining, petrochemical and energy development projects. Petkim, the Turkish subsidiary of Azerbaijan's refining giant SOCAR, currently meets only 15% of Turkey's demand for petrochemicals. With the country looking to invest significantly to increase its refining capacity, the opportunity for Saudi petrochemical giants, including SABIC and SAFCO, is immense.

Trade with Turkey continues to be dominated by energy; oil exports account for as much as 80% of Saudi Arabia's total exports to Turkey, while nearly 90% of imports comprise manufacturing goods

Increasing trade between Saudi Arabia & Turkey – USD billion



Source: Turkstat, Aranca analysis

Opportunities exist in the increasingly growing industrial space as well, with the strategic location of both countries giving them the competitive edge over others. Turkey provides the gateway to the markets in Europe, Central Asia and Africa, which can be a boon for Saudi companies looking to tap into these markets. Turkey is also promoting foreign investments in the power sector as the country plans to nearly double the installed capacity from around 53,000 MW to over 100,000 MW by 2023. ACWA, a Saudi-based energy company, in partnership with Turkey's Eser Holding, is planning to invest USD1 billion to construct an 800 MW natural gas combined cycle power plant in Turkey. The economic partnership between the two countries is also resulting in diversification of trade from energy to other sectors. Since 2004, many Saudi companies operating in the agriculture/ food, automotive, banking, construction, textiles and tourism spaces have made investments of over USD1.5 billion in Turkey. Around 250 Saudi companies operate in the Turkish market, including Saudi Oger Limited, Saudi Cable Company, SWICORP, and Astra Polymers. Furthermore, the Abdul Latif Jameel (ALJ) Group, in its endeavor to make Turkey its second-largest market, plans to invest nearly USD1 billion in Turkey's construction, tourism, energy, and real estate sectors.

Saudi investments in Africa driven by food security concerns

Much like the surge of the East Asian Tiger economies in the early 1990s, Africa's rise in the past decade has taken the world by surprise. The continent's economic pulse quickened as real GDP growth averaged 5.2% during 2003-12, reaching USD1.9 trillion in nominal terms at the end of 2012, roughly the size of India. While rising commodity prices played a key role in increasing Africa's economic might – it is home to 12% of the world's energy resources – growth was broad based with higher activity in key sectors including wholesale and retail, transportation, telecommunications, and manufacturing. The continent's increasing importance has brought it closer to other emerging markets, especially in Asia and the Middle East, with countries from these regions building broad-based trade and investment partnerships and forging closer ties. With close geographical proximity, the importance of Africa to Saudi Arabia has increased manifold not least due to the cultural and historical linkages, but also as a source for agricultural imports, an investment hotspot as well as a key export destination.

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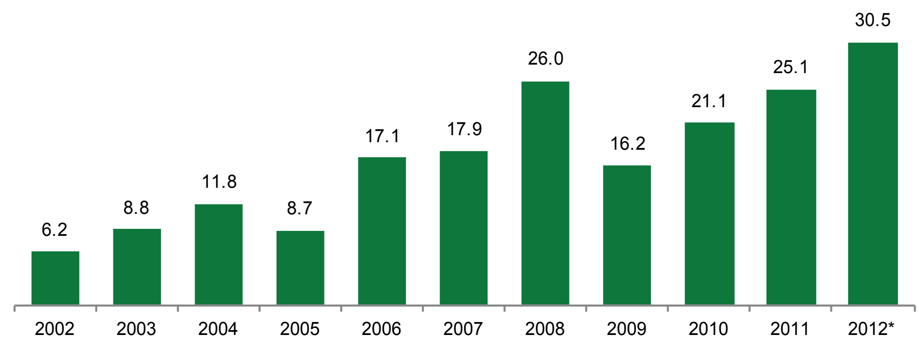
Growing trade between Saudi Arabia & Africa – USD billion



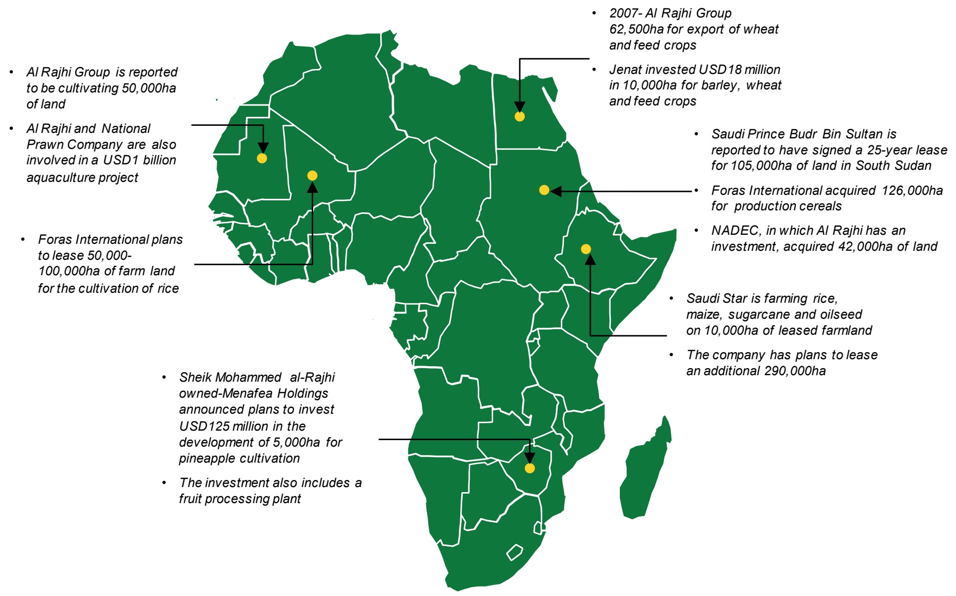
*Source: Bloomberg, Aranca analysis; *Data till October 2012*

Saudi investments in Africa have largely been driven from a food security viewpoint. The Kingdom is among the most water scarce countries globally and relies heavily on food imports to meet the growing consumption requirement of its domestic population. With Saudi Arabia's food sector growing at an annual rate of 18.5% and food & agricultural products comprising 15% of the overall imports, consumption is exceeding local food production, a factor that will drive imports further. In order to reduce its reliance on imports, especially given that higher agricultural commodity prices have stoked inflationary pressure in the past, the Saudi government, under its King Abdullah Initiative for Saudi Agricultural Investment Abroad, has made overseas investment in agriculture a top priority. Saudi Arabia has identified over a dozen countries and established a USD800 million company to finance private sector firms (to the extent of 60% of the total investment cost) that are willing to invest in farms abroad.

Africa has been a strategic partner for Saudi Arabia in its food security initiatives. Saudi investors are believed to have planned or concluded investments in about 800,000 hectares of land in Africa. Agriculture investments have been particularly high in Sudan. Foras International Company, in what is estimated to be one of the largest deals, acquired nearly

126,000 hectares of land for production of cereals. The Kingdom's National Agricultural Development Company (NADEC) acquired 42,000 hectares of land in the Nile province. In addition, the Hail Agricultural Development Company (HADCO), a Saudi agribusiness firm, has leased over 10,000 hectares north of Khartoum. Furthermore, Saudi Star Agricultural Development has committed investments to the tune of USD2.5 billion by 2020 in Ethiopia alone.

Saudi investments in Africa's agriculture and food sectors



Source: Standard Bank, Aranca analysis

Potential for deepening the relationship is much broader, given Africa's richness in mineral resources and huge investment needs for infrastructure development

So far, the trade and investment relationship between Africa and Saudi Arabia has been agriculture and food security centric. However, the potential for deepening the relationship is much broader, given Africa's richness in mineral resources and huge investment needs for infrastructure development. The continent has also become an increasingly attractive hub for foreign investment due to the economic, political and social reforms that have improved business environment significantly and made it conducive for foreign investments. In fact, studies suggest that Africa presents an investment opportunity worth over USD1 trillion across sectors such as agriculture, consumer goods, infrastructure, mining and tourism. Countries such as Nigeria, Democratic Republic of Congo, Namibia, Tanzania and Zambia have large swathes of mineral resources that have been largely unexploited due to the lack of adequate capital as well as technical know-how. Similarly, infrastructure presents a significant growth opportunity with the continent requiring nearly USD80 billion annually to meet its infrastructure needs, according to the World Bank Africa Country Infrastructure Diagnostic study. Furthermore, Saudi telecom companies can benefit immensely from expanding their businesses in Africa as it presents a market of over 1 billion people where mobile phone penetration at over 80% is comparable to that of Asian markets, and demand for data services is increasing. As a step to capture this growing investment opportunity, in 2012, South Africa and Saudi Arabia announced the creation of a joint holding company that seeks to invest at least USD2.4 billion in various business opportunities in both the countries.

Saudi Arabia's relationship with Africa can be one of the most defining ones in the 21st century if the Kingdom, along the lines of China, is able to capture the opportunities by taking a long-term strategic view on the continent. This would not only diversify the trade and investment relationship from the agriculture and food sectors but also serve the long-term interests of Saudi companies looking to expand businesses in growing markets.

China in Africa

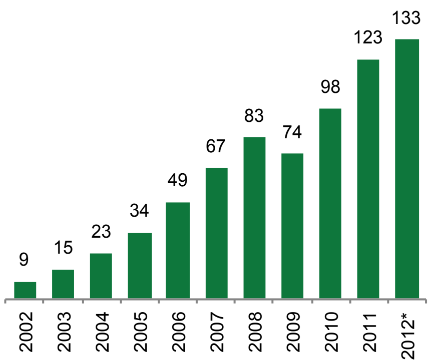
The Sino-African trade relationship, initiated by China to secure its energy needs, has evolved into a strategic partnership over the years. While China has been importing a significant amount of its oil requirements from Africa, it has also played an important role in infrastructure development in Africa. China is the world's largest oil consumer and currently procures about one-third of its oil imports from Africa. According to the International Energy Agency (IEA), China will become the largest net importer of oil in the world, by 2020. Africa, with about 12% of the world's energy reserves, will be one of the key suppliers to China.

The Sino-African trade, though, is not just one-way traffic. While China imports oil and other mineral resources from Africa, it has also found the continent to be an attractive market for its industrial machinery, communications equipment and consumer goods. China is also playing an active role in the development of infrastructure in Africa. China has granted resource backed development loans to several oil rich countries in Africa such as Angola. The country has also established special trade and economic cooperation zones in Ethiopia, Nigeria, and Zambia.

These efforts have culminated in a strong Sino-African trade relationship over the years. China replaced the US as Africa's largest trading partner in 2009. Bilateral trade between the two touched USD198 billion in 2012, according to the Financial Times. Also, the Heritage Foundation estimates that nearly 14% of China's foreign investments between 2005 and 2010 were routed to Sub-Saharan Africa. Chinese President Xi Jinping, recently reaffirmed China's pledge to USD20 billion loans to African countries over the next three years. The Chinese president also signed an agreement to build a major port and industrial zone in Tanzania at an estimated cost of up to USD10 billion.

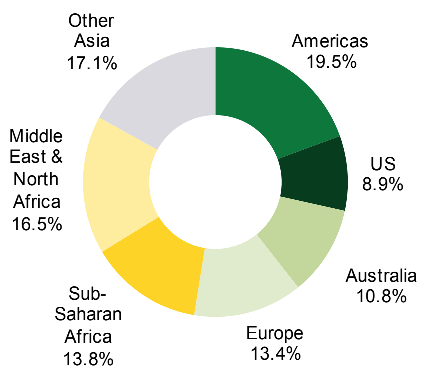
China will become the largest net importer of oil in the world, by 2020. Africa, with about 12% of the world's energy reserves, will be one of the key suppliers to China.

China-Africa trade (USD billion)



*Source: Bloomberg, Aranca; *Data till October 2012*

China foreign investments between 2005-10



Source: Heritage Foundation, The Economist

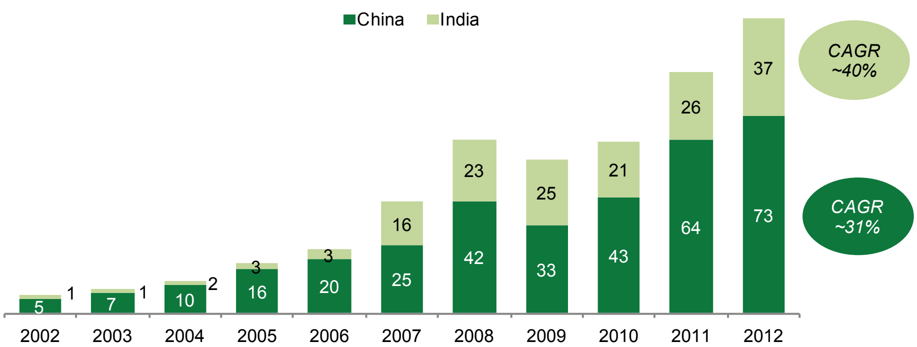
Attractive opportunities in Emerging Asia

The winds of change are most visible in Asia, more than anywhere else as the Indian Ocean becomes an increasingly important global trade nexus. For Saudi Arabia, opportunities in Asia come from two broad perspectives. Firstly, the Kingdom capitalizes on growth opportunities coming from the largest and third largest markets China and India, respectively. Already, these two countries have established themselves as the leading economic partners of Saudi Arabia. Asia has been Saudi Arabia's largest trading partner since the past few years and accounts for nearly 60% of the country's total foreign trade of over USD500 billion in 2012. According to the Energy Information Administration (EIA), the Far East Asia region accounted for nearly 54% of Saudi crude oil exports and exports of refined products and natural gas liquids. In fact, China, Japan, South Korea and India, with imports of over 3.3 million barrels of oil per day, together accounted for nearly 37% of total Saudi production capacity in 2012. Second, emerging Asia also presents significant opportunities across sectors, including hydrocarbons, petrochemicals, and banking

& financial services, especially Islamic finance, given that it is home to the three most populous Islamic countries in the world.

Saudi Arabia's economic partnership with China has exceeded all expectations, with the Middle Kingdom displacing the US as the largest crude importer from Saudi Arabia. Indeed, the symbiotic relationship has benefited both the countries, not only in the form of bilateral trade, but also in cross-border investments in the energy sector. According to IMF, trade between the two countries rose 58 times in the last two decades to USD74 billion in 2012, breaching the target trade value of USD60 billion by 2015 four years earlier; China has dethroned the US as Saudi Arabia's largest trading partner. Increasing cooperation in the trade and investment space through energy is also feeding into growing direct interest by Saudi firms in the Asian markets. This is especially true for the Saudi and Chinese companies that have intensified their efforts in the energy and petrochemicals space. Saudi Aramco has invested in two refineries in China: one as a joint-venture with Sinopec, China's biggest oil producer, and ExxonMobil, a US-based oil giant; and another fully owned in Qingdao province. Then there is a petrochemicals joint venture between SABIC and Sinopec in Tianjin in northern China to manufacture 3.2 million tons a year of ethylene derivatives. On the other hand, the Saudi manufacturing sector, too, seems to be benefiting from China's experience with Chinalco, China's state-owned aluminum manufacturing company, planning to set up a production facility in the Jizan Economic City.

Saudi Arabia's increasing trade with China & India (USD billion)



Source: Bloomberg, Aranca analysis

Trade between Saudi Arabia and China rose 58 times in the last two decades to USD74 billion in 2012, breaching the 2015 target trade value of USD60 billion four years early

Another large Asian economy that Saudi Arabia has set its eyes on is India. As the largest supplier of crude oil (nearly a fifth of total oil supplies) and fourth largest trading partner to India, Saudi Arabia has the unique advantage of tapping the country's huge growth potential. Total trade between the two has increased significantly, reaching over USD37 billion in 2012. Furthermore, India, which is set to become the world's fourth-largest energy consumer, is dependent on oil for roughly 33% of its energy needs, 65% of which it imports. The two countries are exploring options to set up a joint fund of about USD750 million that could be used for infrastructure development as well as joint exploration and production of hydrocarbons. SABIC is exploring the possibility of forming a joint-venture to expand its operations and is in the process of investing USD100 million in India.

Additionally, there exists a significant growth opportunity in the banking & financial services space, especially Islamic banking and finance. Islamic finance has emerged as one of the most rapidly expanding sectors in emerging Asia, with both Hong Kong and Singapore vying to be the centers of Islamic finance in Asia. Saudi banks and financial institutions, with their expertise in the Islamic finance domain, could gain significantly from the increasing demand for such services from the large Muslim population in the emerging Asian countries. India, with a total Muslim population of over 177 million, appears to be one of the most attractive markets that can be tapped in the Islamic banking and finance space. In addition, with India seeking over USD1 trillion in infrastructure investments in the next five years through private sector and foreign investors, the opportunity for Saudi businesses to tap this opportunity is immense.

Scouting the Western markets for technology

Even as it scours the markets for growth opportunities, Saudi Arabia is investing heavily in technology through joint ventures

While Saudi companies are increasingly venturing into other emerging markets of Asia and Africa to tap the growth opportunities, they also continue to foray into the developed Western markets largely in the lookout for technology. For example, in 2011, SABIC joined the Inpro JV, consisting of Daimler, Siemens, ThyssenKrupp, and Volkswagen which would develop technology for the manufacturing and production processes related to lightweight materials. SABIC also entered into an agreement with an Italian acrylics company Montefibre, which provides it with technology needed to develop a carbon fiber plant in Saudi Arabia. These projects highlight Saudi Arabia's commitment to lowering production costs and developing the domestic automotive parts market. Furthermore, through its corporate venture capital arm SABIC Ventures B.V., SABIC has jointly invested USD13 million in FibeRio, the developer and manufacturer of nano-fiber production systems. This deal increases SABIC's market reach as well as offers an opportunity to move further down the value chain with innovative fibers.

Examples abound in other sectors. Saudi telecom company Mobily and global major IBM plan to collaborate on future innovation with the help of IBM Research. In another instance, The National Industrialization Company of Saudi Arabia (TASNEE) has invested AUD4 million in Australian clean energy company Dyesol Limited to form a partnership and explore additional investment opportunities focusing on R&D collaboration and production.

Saudi Arabia's trade policies have been driven not just by its desire to provide food security and employment opportunities to its growing population, but at the same time, allowing its vibrant private sector to tap opportunities in other parts of the world. As a result, we believe that the country's growing trade and investment links with other advanced and emerging markets is likely to see the Kingdom emerge as a leading economic power in coming years.

04.

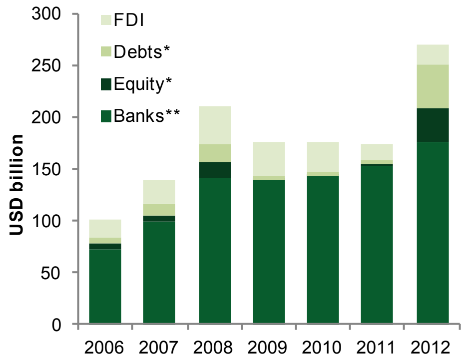
FINANCIAL SECTOR DIVERSIFICATION CRITICAL TO KSA'S GROWTH PLANS

- Bank credit to the private sector likely to expand to USD981 billion by 2025, nearly 74% of GDP in that year, stemming from corporate lending, mortgage financing and SME lending
- SME financing segment presents a huge opportunity with current loans accounting for just 2% of the banking sector's loan book portfolio
- Mortgage financing market to expand to USD68 billion, taking its size as a proportion of GDP from less than 2% in 2012 to 5% in 2025
- Basel III norms might mean that banks find financing long-term infrastructure projects either unviable or unattractive, making capital markets an urgent need to bridge the funding gap
- Market breadth to improve in terms of number of companies listed, market capitalization-to-GDP ratio to improve from current 50% against global average of 70%
- Corporate entities starting to explore sukuk issuance as means of funding; global demand for shariah-compliant bonds to exceed USD900 billion by 2017 from USD300 billion in 2012
- Opening up the primary and secondary debt capital markets to foreign institutional investors to help Saudi Arabia tap global funds waiting to invest in Islamic products

Adequate measures taken by Saudi Arabia before the financial tsunami hit the world in 2008 have helped the Kingdom's financial system to remain stable even as the aftershocks continue. Before 2007-08, the Kingdom used its petrodollar surplus to pare public debt and shore up its net foreign asset position. As a result, the Saudi financial system is operating from a position of relative strength. Musaab Al-Muhaidib, CEO, Al-Muhaidib Technical Supplies points out that the Saudi capital markets and the banking system are very sophisticated by regional standards. However, another view suggests that while significant steps have been made, there is room for further change, "Capital markets needs to be more developed – the recent initiatives of allowing foreign investor to participate in the domestic market is positive that can improve market breadth and depth."

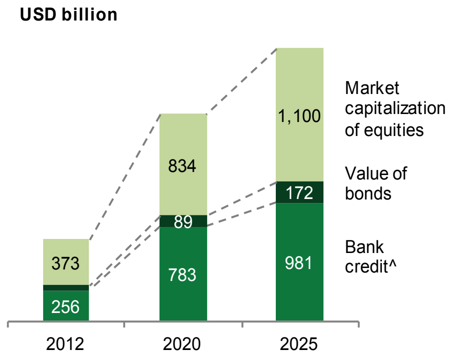
Historically, Saudi Arabian businesses have relied on bank credit and equity capital for their funding needs, but, corporate bonds are slowly gaining in popularity now. In the next decade, we expect the Saudi financial sector to expand significantly, as it caters to the capital needs of businesses and consumption needs of households in a growing economy. Banks will continue to play a significant role in deposit mobilization, increase lending to SMEs and households, as well as serve existing corporate customers. The need for raising long-term funds is likely to drive the development of capital markets, which, in turn, could help diversify the financing mix that is currently dominated by bank credit by 2025.

Companies rely on bank funds and equity



Source: Bloomberg, Aranca; *Data till October 2012

Financial assets are expected to expand



Source: Heritage Foundation, The Economist

Stable, well-capitalized banking sector aiding deposit mobilization and lending

Saudi banks have been major enablers of economic expansion in the Kingdom, a fact that is reflected in bank credit to the private sector having expanded at a CAGR of 14% to USD256 billion in 2012 from that in 2002. In GDP terms, the resultant increase from 28% to 35% over the 10 years under review highlights the Saudi banking sector's potential to expand credit further[5]; the BRICS and G-20 average of 80% and 95%, respectively. The corporate sector, especially large companies, has traditionally accounted for the highest share of credit (an average of 72% in 2007-2012)[6], a trend that banks are now striving to change by increasing their lending to SMEs and households. Deeper financial intermediation through corporate lending, mortgage financing and SME lending will likely see bank credit to the private sector expand to USD981 billion by 2025, nearly 74% of GDP in that year. We expect funding for the loan expansion to come from greater deposit mobilization and capital markets.

The corporate sector, especially large companies, has traditionally accounted for the highest share of credit; banks are now striving to change that by increasing their lending to SMEs and households.

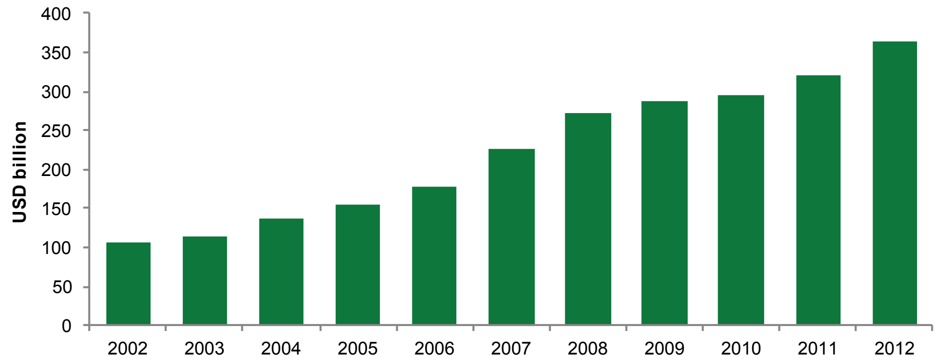
In emerging economies, such as Saudi Arabia, banks play a significant role in channeling private local liquidity toward productive sectors of the economy. Hence, it is unsurprising that commercial bank deposits in the Kingdom have increased at a CAGR of 13% between 2002 and 2012. That growth notwithstanding, deposits represent 50% of Saudi Arabia's GDP compared to the global average of 77% (excluding UK and Hong Kong, which are outliers at deposits-to-GDP ratios of 420%+)[7], signaling significant room for growth. We expect higher banking penetration and income levels to help deposits expand at a CAGR of 7% to USD901 billion by 2025, resulting in a deposit-to-GDP ratio of 68%. Over the same period, private credit-to-deposit ratio could expand to 108% from the current 73%, in our view.

"SAMA had been criticized for not being as "innovative" as some of the other central banks, however their stewardship protected the Saudi banking system and today our banks are some of the strongest and most liquid institutions in the world.

Ali Jaffery,
Assistant Vice President, Riyad Capital

5 WEO October 2012 Dataset
6 SAMA, Aranca analysis
7 IMF FAS (2011)

Deposits have grown at 13% since 2002



Source: SAMA

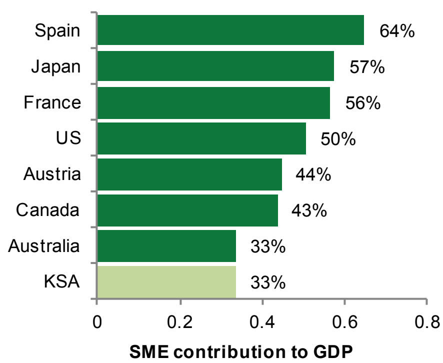
Unlike banks in some advanced economies, which have been forced to de-lever their balance sheets from an over-leveraged position, Saudi banks have strong capital adequacy and liquidity ratios, thanks to SAMA. The introduction of Basel II and Pillar 2 requirements by SAMA has ensured the sector's compliance standards are not compromised in the quest for growth. SAMA has also been proactive in introducing Basel III requirements in the Kingdom, and the IMF has applauded the regulator for introducing risk-based approaches to supervision. Swift measures initiated by the central bank that resulted in the banking sector adopting prudent loan loss provisioning and high capital adequacy standards helped Saudi Arabia emerge largely unscathed from the financial crisis. Hence, we believe banks are well-placed to fund the growing needs of the corporate (large and SME) and consumer (personal and household) sectors.

Saudi Arabia's SME financing segment presents a huge opportunity; lending by banks to SMEs estimated to nearly double by 2025

Greater credit to SME sector is the need of the hour

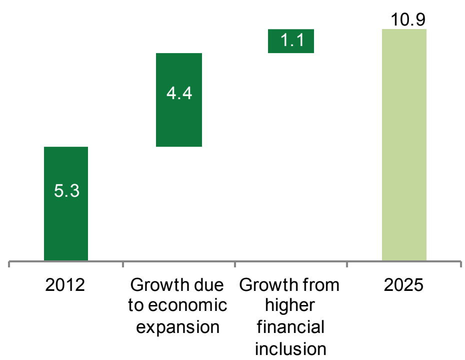
The SME sector is an important contributor to the Saudi economy, accounting for 90% of all businesses and 60% of employment, but only 33% of total GDP[8], which is below international standards. Difficulty in accessing finance at various stages of development, limited management skills, and inefficient market linkages are major hurdles that are preventing the SME sector[9] from increasing its contribution to the Saudi economy. To address this issue, the government is focusing on developing the sector by encouraging banks to offer more credit to SMEs and by providing support services. Ali Jaffery, Assistant Vice President, Riyad Capital says the Saudi government is making a huge effort to diversify the economy and is taking substantial steps to encourage SME's and infrastructure growth.

SME contribution to GDP is low in KSA



Source: "Small and Medium Enterprises" Symposium 2010, Opening Speech - SAMA Governor

A USD 5.5 billion opportunity by 2025



Source: Aranca analysis, "Micro-, small and medium-sized enterprises in emerging markets: how banks can grasp a USD350 billion opportunity" McKinsey

8 *"Small and Medium Enterprises" Symposium 2010, Opening Speech - SAMA Governor*
9 *"Leveraging Growth Finance for Sustainable Development", Khalid Al-Yahya and Jennifer Airey,*

Saudi Arabia's SME financing segment presents a huge opportunity, in our view. To realize their potential, though, SMEs will have to overcome major hurdles that include paucity of specialized financing avenues, such as venture capital, reluctance of banks to disburse loans to SMEs due to a lack of information, absence of or poor quality financial reporting, and a weak regulatory environment. Loans to SMEs currently account for a mere 2%, or USD5.3 billion, of the banking sector's total 2012 loan book portfolio[10]. Although the Kafala program that provides loan guarantees of up to 80% is encouraging banks to improve credit to SMEs, Saudi banks will also have to make a concerted effort to get out of their comfort zone and look beyond large corporate customers. We expect lending by banks to SMEs to increase to USD10.9 billion by 2025, as the economy expands and penetration rates

The government has allocated about USD5 billion to SCSB and intends to make additional funds available to SIDF to support bank credit to SMEs through the Kafala program

Public and private initiatives that support SMEs in Saudi Arabia

Support organizations	
Global Competitiveness Forum	■ Founded in 2006 by Saudi Arabian General Investment Authority (SAGIA) ■ Annual meeting held in Riyadh attended by select intellectuals interested in competitiveness, businesses and political leaders ■ Raise awareness and enthusiasm about competitiveness challenges
Saudi Entrepreneurship Development Institute	■ Set up by Sobhi Batterjee, President and CEO of the Saudi German Hospital Group in 2002 ■ Facilitates young Saudi nationals with potential to develop business skills ■ Encourages development in keeping with Saudi traditions and entrepreneurship ■ Technical support by the United Nations Industrial Development Organization (UNIDO)
The Saudi Fast Growth 100	■ A national program to promote entrepreneurship by recognizing fast growing Saudi companies ■ Ranks the fastest-growing emerging companies in the Kingdom in a list created by SAGIA's National Competitiveness Center, Al-Watan newspaper, and AllWorld Network ■ Strategic partners include National Commercial Bank, Sukoon International, and Siraj Capital
Incubators, VC & PE	
Women's Incubator and Training Center	■ WITC set up by the International Organization for Knowledge Economy and Enterprise Development (IKED) and the Institute of International Education consortium (IEE) ■ Acts as a business incubator supporting women's entrepreneurship by providing support to Saudi Women.
Saudi Industrial Development Fund (SIDF)	■ Run under the Ministry of Finance's supervision and funded by the government and local banks ■ SIDF established a special fund for SMEs with a credit guarantee scheme ■ Supports SMEs through short-term financing and technical, administrative, financial and marketing assistance to customers ■ Total capital of USD53 million
Banks	
National Commercial Bank	■ Among the largest banks in KSA, owned by the Saudi Public Investment Fund ■ Runs a Sharia-compliant financing scheme for SMEs
The Saudi Credit Bank (SCB)	■ Mainly focused on giving social loans to low-income Saudis ■ SCB has created a program for SMEs providing loans up to USD53,000 in specific sectors ■ Total capital is USD256 million
The Centennial Fund	■ Established by a Royal Decree ■ Supports youth projects through guidance, funding and facilitation to funds
Bab Rizk Jameel Center	■ Established by Mohammed Abdulatif Jameel in Jeddah ■ Offers financial support for start-ups, microfinance and loans for vocational training
The Al-Ahli Program for Free Tradesmen	■ The program offers Sharia-compliant loans of up to USD267,000 for three years

Source: Wamda Ltd.

10 *"Importance of an SME Authority for Saudi Arabia", Capitas Group International*

improve. The sector's development will also depend on the establishment of a network of support services, in our view.

The Saudi government is playing a proactive role in helping SMEs grow, with government-funded agencies, such as the Saudi Industrial Development Fund (SIDF) and the Saudi Credit and Saving Bank (SCSB), providing loans and assistance. The government has allocated about USD5 billion to SCSB and intends to make additional funds available to SIDF to support bank credit to SMEs through the Kafala program. We believe training in business management skills and support in establishing better market linkages (supply chain, for example) will also aid in ensuring a high survival rate of SMEs.

Measures in the reforms package such as collateralization and the development of secondary markets, coupled with regulation of mortgage providers, are expected to create greater traction in the mortgage lending space.

International development institutions, such as the World Bank's International Finance Corporation (IFC), are also facilitating SME funding either through advisory services or direct investments. IFC committed USD2.8 million to the Kingdom in fiscal 2012, and its current Saudi portfolio stands at USD129 million[11]. Its recent initiatives include:

- Advisory support to Saudi Hollandi Bank for expanding into small and medium enterprise banking operations
- Organize conferences and meets to discuss SME risk management, corporate governance, and housing finance, among others
- USD20 million investment in the Saudi Orix Leasing Company (SOLC), which focuses on SME and sustainable energy financing
- USD55 million investment in Saudi German Hospitals
- USD50 million investment in Creative Energy Resources Company

Mortgage law a major step towards realizing USD68 billion housing finance potential

The burgeoning demand for housing has brought real estate financing and legislation into focus. In a bid to tackle the housing shortage, Saudi Arabia is implementing long pending reforms to its mortgage laws. Of the set of five laws, the Kingdom issued final regulations for three–Real Estate Financing, Leasing and Financial Companies' supervision–earlier this year. Rules on Foreclosures and Mortgage Registrations are expected soon. Increasing population, expanding labor force, rising per capita incomes and reduction in average family size are expected to drive demand for housing higher. The Financial Times (FT) reports that at least 1.5 million new affordable homes will be required in the next few years.

"*The pace of reforms in the financial sector is likely to accelerate. The mortgage law is in the last leg of approval and is most likely to be enacted this year. This would substantially boost liquidity in the housing finance market, and help increase home ownership in the Kingdom in the long run.*

Faysal Badran,
CIO – Head of Asset Management, NCB Capital

The reforming of mortgage laws will boost home ownership and mortgage financing, in our view. Currently, only about 30%-45% of the Saudi population owns a house, while the figure in G-20 peer countries, such as the US (65%)[12], UK (65%)[13], France (57%)[14] and Germany (46%)[15], is much higher. Lack of financing and non-affordability are preventing most of the Kingdom's population from owning a home.

We believe banks, too, have not aggressively pursued mortgages in the past. SAMA's 100% capital adequacy weight to real estate financing, a lack of collateralization, and legal structures for procedures such as foreclosures have limited the market's attractiveness for

11 *IFC*
12 *US Census Bureau*
13 *Nationwide UK*
14 *"Is Home Ownership Overrated?", WSJ, 3 May 2011*
15 *"Is Home Ownership Overrated?", WSJ, 3 May 2011*

banks. As compared to around 4% of the total loan portfolio in Saudi Arabia, mortgage loans account for a larger share in the Middle-East ranging between 7% and 8%. Measures in the reforms package such as collateralization and the development of secondary markets, coupled with regulation of mortgage providers, are expected to create greater traction in the mortgage lending space. Although the package is yet to be enacted there are signs that banks are more than willing to extend consumer housing loans, with real estate financing having grown by nearly 30% YoY to USD10 billion in 2012[16]. By 2025, we estimate the mortgage financing market will expand to USD68 billion, taking its size as a proportion of GDP from less than 2% in 2012 to 5% in 2025.

Once laws come into effect, the mortgage financing market should expand to USD68 billion boosting home ownership

Capital adequacy norms exacerbating the need to find long-term sources of funds

The implementation of Basel III, in our view, could potentially limit banking finance to infrastructure projects and other forms of long-tenure loans. Although the exact composition of Basel III norms is unclear, there is concern about their impact on banks' lending portfolios. SAMA follows a conservative approach to risk and its risk weights are usually higher than Basel requirements. We expect the central bank to maintain its proactive role in adopting Basel III, but, full implementation is unlikely before 2019. Banks, though, will have to start preparing well in advance by implementing new risk management and stress test measures as well as restructuring their loan portfolios, if needed.

One of the fallouts of complying with Basel III could be banks avoiding funding long-term projects at a time when Saudi Arabia is estimated to require additional USD426 billion worth of investments in infrastructure projects between now and 2025. Under the new norms, banks will have to hold more capital and higher liquidity, while simultaneously reducing risk, which will require, among other things, a greater balancing of assets and liabilities. Banks may, therefore, find financing long-term infrastructure projects either unviable or unattractive. While government-backed loans (export credit agency facilities, for example) will likely be less costly, they are not likely to be an alternative to bank financing. There is, hence, a greater urgency to develop capital markets further to bridge the funding gap.

"Given the long term nature of project finance loans, and the short term nature of Saudi deposits, we think it is imperative that other sources of capital, such as pension funds who are long term investors, complement the funding provided by banks.

Kais Mbarek,
Head of Principal Investment, SWICORP

Equity capital markets make progress

Saudi Arabia's equity market has seen dynamic growth in a relatively short period of time. The setting up of Tadawul in 2001 and the Capital Market Authority in 2003 encouraged companies to raise capital in equity markets that, in turn, enhanced market depth and breadth. Equity is now the preferred alternative for raising long-term capital. Of the total securities offered to the public in Saudi Arabia between 2007 and 2011, 74%[17] was equity (rest debt) comprising IPOs and Rights Issues (excluding private placements, which may be debt or equity).

Going forward, we expect market breadth to improve in terms of number of companies listed, as Saudi Arabia's diversification initiative leads to the creation of more number of corporate entities with long-term capital needs. Market depth, too, is currently under-developed when

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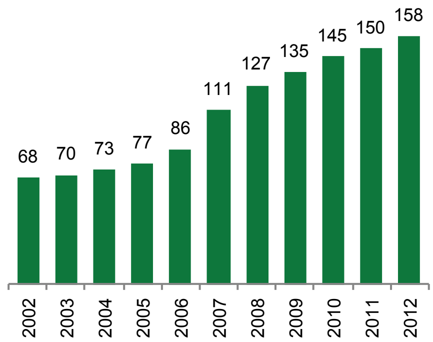
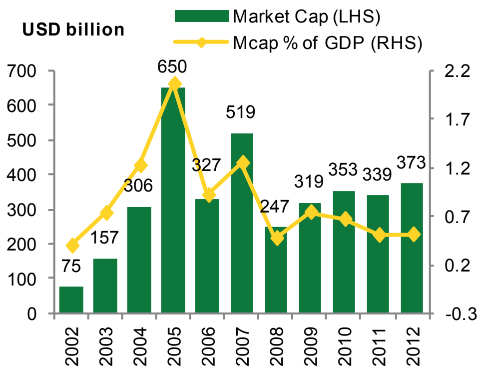
Number of companies listed



Source: Tadawul

Market capitalization of stocks



Source: Tadawul, Aranca analysis

The imminent opening up of Tadawul to foreign institutional investors will be a step change, as it will push trading volumes higher, create the need to develop more diverse products, enhance reporting standards, and reduce the influence of retail investors.

viewed in context of international peers. The average market capitalization-to-GDP ratio of the G-20 countries is 82% compared to 50% for Saudi Arabia and a global average of 70%[18]. To reach that stage Saudi Arabia will not only have to broaden and deepen its capital markets but also promote investor participation.

In this context, the imminent opening up of Tadawul to foreign institutional investors will be a step change, as it will push trading volumes higher, create the need to develop more diverse products, enhance reporting standards, and reduce the influence of retail investors. Kais Mbarek, Head of Principal Investment, Swicorp says the opening of the Saudi market is a question of when, not if. He says some steps have already been taken in that direction and expects more to follow. He says, "Saudi is not short of liquidity, but what matters is better coverage of stocks, and better valuation as well as less speculative activity." Faysal Badran , CIO – Head of Asset Management, NCB Capital says "The reform would not only help attract a larger and wider international pool of money, which are sitting on the sidelines, but also usher in a greater degree of stability to the market, which is traditionally dominated by retail investors." There is no dearth of interest from foreign investors, who can currently invest only through equity swaps and ETFs. MSCI Inc, which in 2012 resumed coverage of Saudi stocks, said it would consider including the TASI in emerging market indices if the market is opened up to foreigners. MSCI's indices are tracked by managers with assets under management of USD7 trillion[19]. The inclusion and weight of a country in MSCI's indices determines global investor interest and fund flows in that country. Some estimates suggest that direct access will bring USD25-30 billion worth of inflows into Saudi Arabia[20]. Consequently, players in the fund management industry are making a beeline for Saudi Arabia. Large international banks, including Credit Suisse, Morgan Stanley, and Russia's VTB Capital, have made Riyadh their equities hub in the region. Others, such as Deutsche Securities and HSBC, have a presence in the country. Most analysts and experts expect the government to open up the market in the next 12 to 18 months. Ali Jaffery, Assistant Vice President, Riyad Capital puts it in perspective, "The reality is that just about anyone, anywhere in the world can already invest in Saudi equity markets via Mutual funds, ETFs or SWAP agreements. Should the markets access be made even easier, any increase in activity will be only incremental. Saudi Market is already so liquid and vibrant, that even a multi-billion dollar investment will only amount to a day's worth of trading."

"

For DCMs to develop (debt issuance) the Kingdom needs to put in place more regulation and the secondary market needs to be developed. We will move to a situation over the next 10 years where we migrate from 100% Bank/ECA funded projects to a substantially DCM funded environment complimented by bank/ECA funding

Paddy Padmanathan,
CEO, ACWA Power

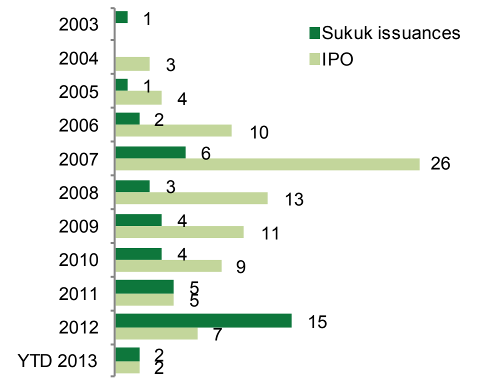
18 *IMF*
19 *Passport's Burbank Says Saudi Arabia Best Emerging Market, Bloomberg, February 2013*
20 *Passport's Burbank Says Saudi Arabia Best Emerging Market, Bloomberg, February 2013*

Next decade will see debt capital markets also playing catch up

There are signs that Saudi Arabia is waking up to the need for developing debt capital markets, especially in project financing and corporate debt. Ali Jaffery, Assistant Vice President, Riyad Capital explains that a big reason why debt markets in Saudi Arabia are underdeveloped is because enough Equity capital exists to finance a lot of projects. He says, "Debt capital markets have lagged (UAE and Qatar) because corporates and government are cash rich. When there is a need for debt capital it has been fulfilled." Historically projects were financed almost entirely through a mix of commercial and export credit agency funding, with a major chunk coming from the former. During the crisis, Export Credit Agencies (ECAs) came to the fore as liquidity dried up and banks were constrained; liquidity has now improved and commercial loans are easier to come by. However, for large corporate entities, an area of concern is banks nearing their lending limits to individual companies. As a result, in the past 18 months, corporate entities have looked to raise funds through sukuk issuances, an activity that was kick-started by the success of the USD4 billion government-backed sukuk for its aviation agency in January 2012. The rise in sukuk issuances since 2011 is also a factor of the relative unattractiveness of equity valuations over the past two years. These issues are finding increasing favor with buyers that are attracted to sukuks as an alternative to low-interest rate SAR denominated bank deposits.

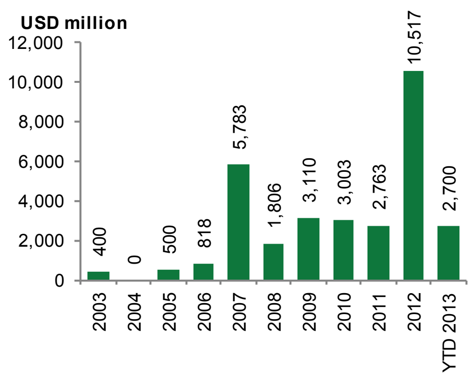
If the last decade was that of the equity markets, the next decade could well be that of debt markets.

Sukuk issuances have outpaced IPOs since 2011



Source: CMA, Zawya

Sukuk worth USD29 billion issued since 2003



Source: CMA, Zawya

While the momentum is encouraging, facilitating trading and liquidity in the secondary market is critical to sustaining primary market issuances, in our view. Local credit rating agencies may prove to be more successful in building credibility for investors. Opening up the primary and secondary debt capital markets to foreign institutional investors will help Saudi Arabia tap global funds waiting to invest in Islamic products. If the last decade was that of the equity markets, the next decade could well be that of debt markets. Faysal Badran , CIO – Head of Asset Management, NCB Capital says, "Islamic finance market in Saudi Arabia is likely to grow at an accelerated pace with Sukuk issuance by local companies being the key drivers." As the world's second largest issuer, Saudi Arabia is well positioned to capture a share of the global demand for Islamic products if the domestic market is allowed to develop further. In its '2011-12 World Islamic Banking Competitiveness Report', Ernst & Young expects global demand for Shariah-compliant bonds to exceed USD900 billion by 2017 from USD300 billion in 2012.

Saudi Arabia – an emerging private equity and venture capital destination

The Saudi Private Equity industry is developing steadily and is expected to become the most important market for PE firms in the region. In the past decade, Egypt accounted for 40% of deals in the Arab world, UAE 27%, and Saudi Arabia 23%[21]. The crisis years followed by the Arab spring have moved the spotlight from Dubai and Manama, which were previously perceived as relatively more investor friendly, to Riyadh and Jeddah. The reason being fund managers who had earlier pursued investment targets outside Saudi Arabia are now finding domestic opportunities attractive.

The relatively new domestic PE industry is attracting big names of the PE world. Amwal AlKhaleej was the first Saudi-based PE firm to set up shop in 2004 and begin operations in 2005. The climate, though, appears to have turned positive with global PE firms being increasingly enamored by the vibrancy of the domestic market. As global firms drop anchor in Saudi Arabia they are likely to require local teams to help them build relationships, better understand the local culture, and navigate the Kingdom's evolving legal landscape. Apart from players such as Amwal, Sedco, and ICT Ventures, global majors, including Standard Chartered (PE unit), Carlyle Group and KKR, are also active in Saudi Arabia's PE space.

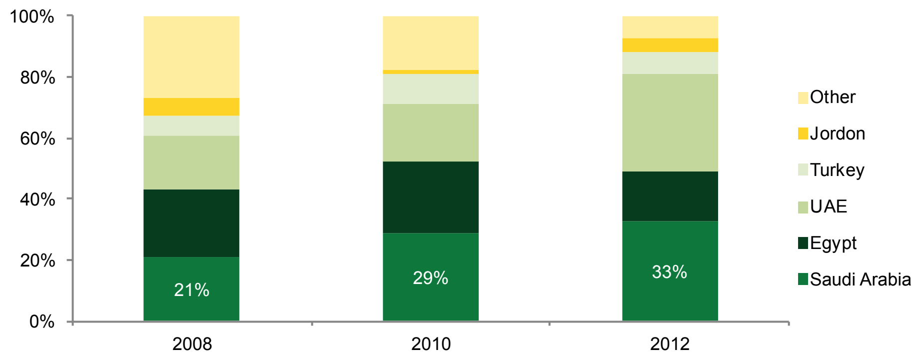
While global PE majors have Saudi Arabia on their investment radar, the limited number of deals done has been primarily in the middle market comprising growth companies looking for non-bank financing. Such companies are either averse to the idea of debt financing or are in the so called "banking blind spot" (not big enough for SME financing and too big for micro financing). Musaab Al-Muhaidib, CEO, Al-Muhaidib Technical Supplies puts it in perspective, "Business owners have cushions as they can always reach out to friends and families for funds. Even banks are eager again to lend money. Also, the value proposition that PE brings are not very clear to many Saudi businesses, therefore, the reluctance on their part to use this as an alternative source of financing."

Since the industry is relatively new, funds are still cash rich and deployments are expected to increase; exits too, will rise, as some of the earliest investments are now coming to the market.

Funds tend to be industry-agnostic and potential targets are identified through networking, and rather than focusing on a particular industry, they target opportunistic deals. Sectors that have seen PE activity include education, healthcare, construction and consumer-centric industries.

We expect deal activity to gather momentum, given the increasing interest in Saudi Arabia as an investment destination. Respondents to Deloitte's MENA Private Equity Confidence Survey 2012 ranked Saudi Arabia highest in terms of expected deal activity. Furthermore, the number of respondents ranking Saudi Arabia highest has increased since 2008. Since the industry is relatively new, funds are still cash rich and deployments are expected to increase, in our view. Exits, too, will rise, as some of the earliest investments are now coming to the market.

Expectations of increased deal activity



Source: MENA Private Equity Confidence Survey 2012, Deloitte

21 "Private equity sizes up Saudi potential", FT.com, August 2010

The increase in PE activity notwithstanding, challenges such as regulatory restrictions on controlling stakes, curbs on investment in certain sectors deemed of national importance, low accounting standards of private companies, a higher capital gains tax on non-GCC funds, unrealistic valuations of target companies and weakness of equity markets as a reliable exit strategy remain. Since family firms may be unwilling to let go of control, PE firms will also need to focus on management capability pre-deal, as they will have little chance of influencing management composition or decisions. Buyouts and hostile takeovers are virtually unheard of. Some of these issues are being addressed through gradual reforms and, hence, prospects for the industry remain bright. Egypt's Citadel Capital expects to see deals worth at least USD20 billion in Saudi Arabia between 2010 and 2015[22]. Paddy Padmanathan, CEO, ACWA Power's is optimistic, "Domestic experience in project financing has improved and this will help in the way deals are structured and the success of transactions"

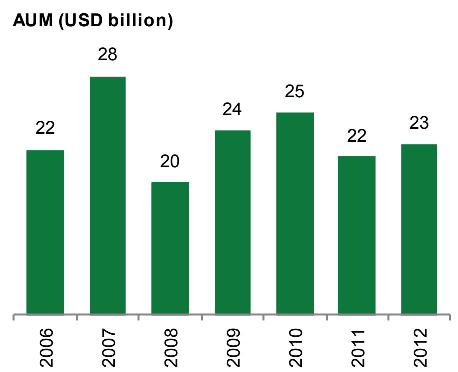
Apart from PE, the market for venture capital funds is another potential growth area, as the Kingdom's wealth increases, sophisticated investors are looking to diversify their portfolios away from real estate and secondary market products by directly investing in the equity of growth companies. Anecdotal evidence suggests that venture capital funding is catering to some of the equity needs of frontier industries such as information and communication technology. On the demand side, the impetus provided by the Saudi government is encouraging entrepreneurship in the domestic market, a move that is likely to shape the future of business in the Kingdom. Ali Jaffery, Assistant Vice President, Riyad Capital mentions an environment that fosters entrepreneurship as being a driver of future growth, "Previous generation made money primarily through "Agency" business model. For the next phase of growth the nation needs a culture of entrepreneurship, and that requires minimizing barriers to entry." We expect VC funding to become increasingly acceptable, as unlike bank financing, VC funding is usually equity based and, hence, more in line with Islamic principles, thereby accounting for a large chunk of the SME sector's financing needs in the coming decade.

The liquid assets of Saudi Arabia's affluent to increase at a CAGR of 14% between 2011 and 2015; the fund management industry has a potentially large opportunity to increase its assets under management

Managing the private wealth treasure trove

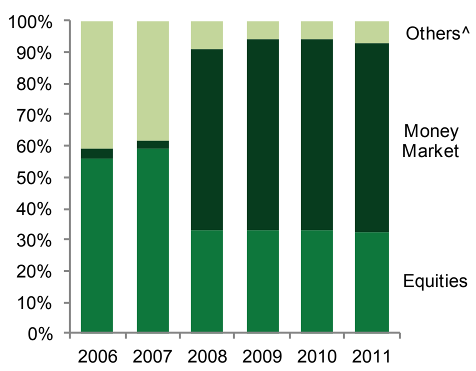
The Kingdom's economic prosperity has translated into greater personal investable wealth, with the Kingdom having 1225 ultra high net worth individuals (UHNIs) with a combined net worth of USD2.3 trillion[23] in 2012. Datamonitor estimates the liquid assets of Saudi Arabia's affluent to increase at a CAGR of 14% between 2011 and 2015. Consequently, the fund management industry, which has grown in the past five years, has a potentially large opportunity to increase its assets under management.

Mutual funds were hit badly by the financial crisis



Source: CMA, Zawya

Money market funds now dominate



Source: CMA; ^ Others includes debt market, balanced, capital protection, fund of funds, real estate and others

22 "Private equity sizes up Saudi potential", FT.com, August 2010
23 "Barclays Wealth Makes Top Saudi Arabia Appointment", Wealth Briefing, 23 January 2012

The mutual fund industry suffered a major setback during the crisis, but is now on the recovery path. After peaking in 2007, AUM grew before declining again in 2011, in line with the fall in the stock market. But 2012 proved to be a better year, with total AUM returning to pre-crisis levels, led by money markets that have been played a dominant role since the crisis broke. Concentration of market capitalization in a few stocks, and the limited availability of debt, especially sovereign that is largely held by pension funds Public Pension Agency and General Office for Social Insurance are likely to challenge the ability of fund managers to diversify their holdings, in our view. As it will be a while before mutual funds recover from the turmoil caused by the stock market plunge, we expect money market funds to remain the flavor for a few more years.

There is considerable interest in Saudi Arabia's financial services industry not only from local banks that are offering a whole range of securities services specialized units but also from global majors.

There is considerable interest in Saudi Arabia's financial services industry not only from local banks that are offering a whole range of securities services specialized units but also from global majors such as HSBC and Morgan Stanley. The number of firms registered to manage funds in the Kingdom has gone up to 69 in 2011[24] from 47 in 2007. Apart from performance, loyalty, brand awareness and relationships are important drivers of success in the market. Private wealth in Saudi Arabia is on the increase and a large proportion of the region's investable wealth will be centered in the Kingdom. With more people seeking professional advice on how to better manage their wealth and diversify their portfolios, the Saudi asset management industry is a market that players in the industry can choose ignore at their own peril.

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05.

CONCLUSION

From a purely oil driven economy earlier to one of the most vibrant markets in the region since the beginning of the 21st century, Saudi Arabia, endowed with one of the best demographic profiles and increasing consumer wealth, is on the cusp of becoming a trillion dollar economy in the next 10 years. In fact, we estimate the Kingdom's economic size will increase to over USD1.3 trillion by 2025, nearly twice its current size as it diversifies its economic base. Growth is likely to be broad based as economic diversification gathers momentum.

The coming decade will witness billions of dollars being pumped into the infrastructure sector to meet the increasing demand for housing, utilities and other tertiary services for the Kingdom's growing population. At the same time, the Kingdom's abundant resources could also see it evolve as one of the leading industrial manufacturing hubs in the region. Furthermore, the government's emphasis on social infrastructure development through higher budgetary allocation and encouragement of private sector participation is likely to see the education and healthcare sectors emerging as key growth drivers. Saudi Arabia is also characterized by a sophisticated banking and financial sector that is operating from a position of strength and is poised to realize its true potential.

While growth avenues abound within the Kingdom, increasing economic integration with the world through trade and investments is also providing opportunities in the most attractive pockets.

While growth avenues abound within the Kingdom, increasing economic integration with the world through trade and investments is also providing opportunities in the most attractive pockets. The Saudi government is taking a long-term strategic view on deepening its partnership with two of the world's fastest growing large economies, China and India. It also is expanding ties with Africa by not just capitalizing on the opportunities it provides in the agriculture and food sectors, admittedly to meet its food security requirements, but also encouraging its private sector to invest in infrastructure and export goods and services in the petrochemicals, telecom and other sectors. The Saudi corporate sector meanwhile continues to gain global experience by leveraging on the technical knowhow of Western companies and using it to its advantage.

As a result, we believe that Saudi Arabia's importance in the global economic and political order will only increase as it emerges from being one of the largest suppliers of energy resources to an economic powerhouse that drives regional integration and promotes economic and political stability.


OIL

06.

SECTOR PROFILES

- Agriculture & Food Sector: Poised for strong growth
- Building & Construction Sector: On track for unprecedented growth
- Cement Sector: Towering strength
- Energy Utilities: A renewables opportunity
- Insurance Sector: Making structural changes for long-term growth
- Media and Publishing Sector: Going electronic
- Real Estate Sector: Building blocks of growth
- Retail Sector: Structural consolidation, a key growth driver
- Telecom Sector: Data/Corporate to take growth to the next level
- Transportation sector: Turning to better connectivity for growth

Agriculture & Food Sector: Poised for strong growth

Saudi Arabia is among the world's most arid countries, with limited agricultural production. As of 2010, agriculture accounted for just 6% of the country's total GDP. The Kingdom heavily relies on imports to meet its food requirements. According to Foodex Saudi, in 2012, food alone accounted for 15% (or USD17.3 billion) of the country's imports totaling USD115.3 billion. Foodex Saudi is the Kingdom's biggest trade fair for the food and drinks industry planned from December 8-11, 2013. However, to secure food supplies for the future, the Kingdom is increasingly investing in agricultural projects within the country and in acquiring land abroad. As per the Saudi Agriculture (32nd international agriculture, water and agro-industry trade show) website, in the beginning of 2013, the government announced its plan to invest USD16 billion in the agricultural sector.

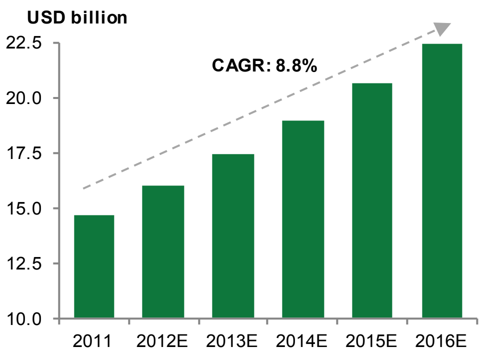
On the consumption side, KSA's food sector has been growing at an annual rate of 5%, as per Business Monitor International (BMI), mainly driven by a large and steadily increasing population base with rising disposable incomes. Overall, Saudi Arabia is the largest food market in the GCC region with a population base of around 28.8 million (as of 2012, IMF) that accounts for about 65% of the total GCC population.

In 2012, food alone accounted for 15% (or USD17.3 billion) of the country's imports totaling USD115.3 billion.

Saudi food market: growth momentum to remain robust!

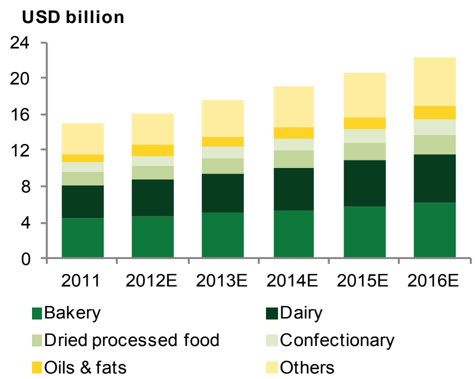
- According to BMI, KSA's food consumption is expected to increase at a CAGR of 9.2% to USD65.54 billion in 2016 from USD42.21 billion, estimated in 2011.
- As per Agriculture and Agri-Food Canada report on Packaged Food Sales in Saudi Arabia, July 2012, KSA's packaged food market is expected to grow at a CAGR of 8.8% to USD22.4 billion in 2016 from USD14.7 billion in 2011.
- KSA's fast food sector is expected to reach a market size of USD 4.5 billion by 2015, mainly driven by the large size of its youthful population that is increasingly adapting to western trends of food consumption.

Market size of KSA packaged food: 2011-2016E



Source: Euromonitor as quoted in Agriculture and Agri-Food Canada report, July 2012

Segment wise growth in packaged food: 2011-2016E



Source: Euromonitor as quoted in Agriculture and Agri-Food Canada report, July 2012

KSA Agriculture and food sector - Advantages

Demographic advantage: KSA is the largest food and beverage market in the GCC region, accounting for 65% of the total GCC population, thereby providing a huge market for the food sector. By 2025, Saudi Arabia's total population is expected to increase to 37.4 million and per capita income to grow 1.4 times to USD35,487 in 2025 from USD25,263 in 2012 (Aranca estimates).

Changing consumption preferences of consumers: Growth potential across the packaged and processed food market remains high due to westernized consumption preferences of young/expatriate population. About 51% of KSA's population (as of 2012) is under the age of 25 years and 30% of the total population comprises expatriates.

This offers significant potential for growth in the fast food and packaged food segments. Increasing ranks of health conscious people with rising incomes offer growth opportunity in organic foods

Tourism to boost food consumption: Expected increase in inflow of tourists is positive for KSA food sector as nearly 7% of a tourist's total expenditure in KSA is on food. As per BMI, number of tourists in KSA is expected to increase at a CAGR of 10.2% to 15.8 million by 2014. During 1Q2012 tourists spent nearly SAR50 million (7% of total SAR7.1 billion spent) on food in KSA

Government's active participation: Government's plan to invest USD16 billion in the agricultural sector was announced at the beginning of 2013. Permits were given to over 200 new agricultural projects in 2011. KSA has invested USD800 million in setting up Saudi Company for Agricultural Investment & Animal Production (SCAIAP) in 2009.

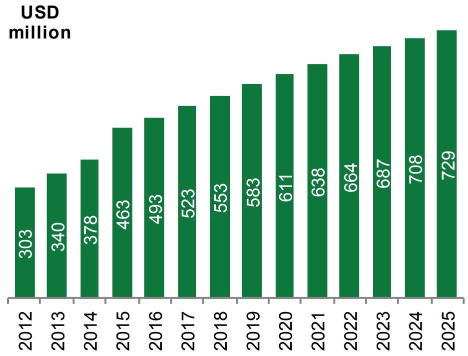
Building & Construction Sector: On track for unprecedented growth

Saudi Arabia's construction market is the largest in the GCC with an order backlog of USD673.0 billion comprising 38.6% of total backlog. The sector contributes 7.4% of the country's GDP. Although, the government has been the principal source of construction expenditure in the country, rising investments by the private sector is also playing a key role in driving the industry. Furthermore, strong demand for real estate and pressing social needs on account of to lack of adequate healthcare services, high domestic unemployment in the county are expected to boost sector growth.

Construction sector growth to remain buoyant supported by strong project pipeline

Saudi's construction sector is expected to maintain its positive growth trajectory supported by the strong construction and infrastructure projects, which is forecasted to increase at a CAGR of 7.0% to USD729 billion over 2012-25.

Infrastructure and construction projects



Source: NCB Capital and Holtec

Budget allocation

For 2010-14 in USD billion	
Human Resources	195.0
Social and Health	73.0
Economic Resources	60.7
Transportation and Communications	29.6
Municipal and Housing Services	26.8
Total	385.1

Source: Ministry of Economy and Planning, KSA

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KSA Advantage

Aggressive public sector expenditure: Rising government expenditure remains a key catalyst for growth in the construction sector. In the Ninth Five-Year Development Plan (2010–14), budgetary allocation of USD385.1 billion was made across key projects. According to Zawya Projects, ~1,054 projects totaling USD673.0 billion are currently under execution in Saudi Arabia. Further, Saudi's focus on diversification from oil to non-oil is expected to stimulate growth in downstream petrochemical projects.

Private sector participation driven by rising bank lending and mortgage law: Increasing private sector participation in the sector supported by higher bank lending is likely to aid in expansion of construction activities. Furthermore, implementation of the much awaited mortgage law is likely to see a spurt in bank lending, which, in turn, could translate into greater demand for residential units. Bank lending to the construction sector expanded at a CAGR of 11.7% during 2007–12 and reached SAR75.4 billion in 2012.

Favorable demographics lift demand for residential and commercial construction: Strong demand in the real estate sector, supported by the growing proportion of young population, rising urbanization and declining household size, is expected to boost demand for residential construction activities in the Kingdom. Further, strong expansion activities of retail companies supported by rise in consumer demand, is expected to result in a rise in demand for commercial real estate.

Growing social infrastructure demand: High growth in tourism industry is likely to boost demand for social infrastructure. Further, pressing social needs like shortage of adequate healthcare facilities, domestic unemployment due to lack of skills would result in increased investments in health and education.

Focus on changing mix for energy: Thrust on energy efficiency to change the generation mix and encourage the development of renewable and nuclear energy is likely to result in investments in new power projects.

Ban on cement assures adequate supply to meet domestic demand: Saudi Arabia produced 53.2 million tonnes of cement in 2012, barely managing to meet its consumption need of 53.3 million tonnes. The continued ban on cement exports from Saudi Arabia ensures availability of cement for domestic construction projects.

Cement Sector: Towering strength

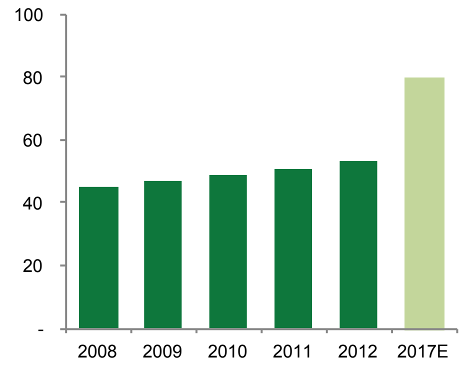
The Saudi Arabian Cement sector has witnessed unprecedented growth during the past few years. Driven by the boom in the construction industry, cement consumption in KSA clocked a cumulative annual growth rate (CAGR) of 14.4% over 2007-11, according to E&Y Cement Market Study. Saudi Arabia also found a place among the top 15 cement consumers in the world in 2012. Keeping pace with consumption, the country's cement production capacity also rose from 38 million tons per annum (MTPA) in 2007 to 53 MTPA in 2012 (Source: E&Y Cement Market Study).

The top three cement players in KSA command over 40% of the market share: Saudi Cement Company (16.4%), Southern Province Cement Company (13.7%) and Yamama Saudi Cement Company (12%). (Source: Yamama Saudi Cement Co).

Industry Capacity to hit 80 MT by 2017

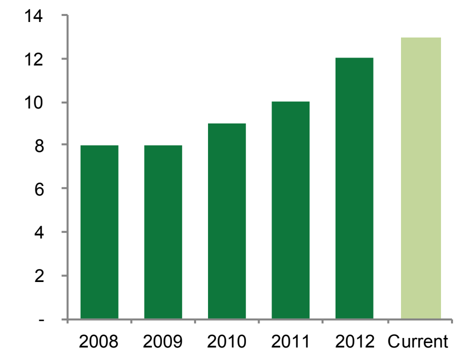
In 2012, the Saudi Arabian cement Industry had a production capacity of 53MTPA and was worth USD3.7 billion – the largest on the Arabian Peninsula. Taking into consideration the country's expansionary policies, large infrastructure investments, rising population, and its positive impact on cement demand, some of the existing and new players have drawn expansion plans to boost capacity by ~27MT, mainly during 2014 and 2015. These expansions are likely to increase Saudi Arabia's total cement production capacity to 80MT by 2017 (Source: Holtec).

Saudi Arabian Cement Sector Capacity (MT)



Source: NCB Capital and Holtec

No of listed cement companies in KSA



Source: Tadawul

Taking into consideration the country's expansionary policies, large infrastructure investments, rising population, and its positive impact on cement demand, some of the existing and new players have drawn expansion plans to boost capacity by ~27MT, mainly during 2014 and 2015.

KSA Advantage

Availability of cheap energy and raw materials: Cement companies in Saudi Arabia benefit from the availability of cheap energy and raw materials, especially natural gas and limestone. Government-owned Saudi Aramco provides natural gas at USD0.75 per mmbtu.

Housing demand: Saudi Arabia faces a severe housing shortage and needs around 275,000 units per year until 2015, due to rapid population growth. Given the population growth rate and government's focus on housing, Saudi cement companies are likely to enjoy sustained demand, going forward. Approval of the mortgage law and declining average household size in KSA are also expected to propel demand for more homes and thereby cement.

Massive infra push will work as a catalyst: Investment in infrastructure projects is likely to act as a catalyst for cement demand. According to Zawya projects, as of December 2012, approximately USD293 billion worth of infrastructure projects were in the planning, design, bid or construction stage in Saudi Arabia.

Continued Government support: In April 2013, King HH Abdullah bin Abdulaziz Al Saud issued a directive to import around 10MT of cement in order to address the immediate shortage. With a long-term view, the then King granted USD800 million for the setting up of three to four cement plants over the next three years so that demand can be met internally.

Attractive location: Cement companies in Saudi Arabia have previously exported cement to nearby countries. Should there be a surplus capacity on the future, these cement companies can easily cater to the regional cement demand from countries like the UAE, Bahrain, Yemen, and others, thereby enjoying better price realizations for their produce.

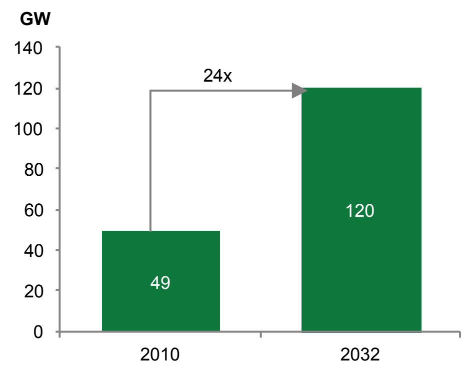
Energy Utilities: A renewables opportunity

In 2011, the Kingdom ranked 13th globally on total primary energy consumption, with a demand of 8.8 quadrillion British thermal unit (Btu). Driven by economic and population growth, primary energy consumption increased at a CAGR of 5.5% between 2000 and 2011. About 60% of the country's energy is derived from petroleum-based resources, with natural gas accounting for most of the remaining energy requirements. Nevertheless, KSA has ambitious plans of generating 50% of its domestic electricity needs from non-fossil fuels by 2032; the King Abdullah City for Atomic and Renewable Energy (K.A.CARE) was established in April 2010 to oversee the country's strategy for alternative sources of energy. At the same time, the KSA government is carrying out reforms to make the country's electricity sector more competitive and efficient.

Installed capacity projected to more than double by 2032; renewables capacity to drive growth

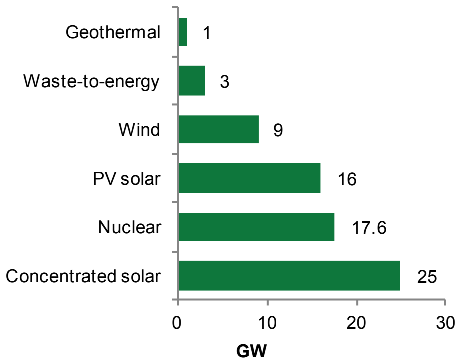
- K.A.CARE estimates installed capacity for electricity generation to more than double to 120 GW by 2032 from 49 GW in 2010 (as estimated by the EIA).
- K.A.CARE envisions expanding the installed capacity for electricity generation from renewable resources, which is currently almost non-existent, to 24 GW by 2020 and 54 GW by 2032.
- KSA would need to invest over SAR500 billion (USD133 billion) in power projects over the next 10 years, as stated by Saudi Water and Electricity Minister Abdullah Al-Hussayen at the Saudi Water & Power Forum & Exhibition (SWPF) 2012.

Saudi installed capacity (2010-32)



Source: U.S. EIA, K.A.CARE

Renewable installed capacity (2032)



Source: K.A.CARE

KSA has ambitious plans of generating 50% of its domestic electricity needs from non-fossil fuels by 2032; policy reforms and privatization are likely to make the sector more competitive and efficient.

KSA Advantage

Rapid growth in energy consumption: Energy consumption in KSA, estimated by K.A.CARE at 3.4 million barrels of oil equivalent (mboe) per day in 2010, is projected to increase 2.4 times to 8.3 mboe per day by 2028. This is supported by growing energy demand from strong economic activity (GDP expanding at a CAGR of 3.8% until 2025) and an expanding population (37.4 million in 2025 compared to 28.8 million in 2012).

Focus on energy sustainability: The Kingdom is focused on diversifying its energy mix with a thrust on renewable and atomic energy. To this end, the government has established K.A.CARE to spearhead its initiatives. Policy reforms and privatization are likely to make the sector more competitive and efficient, while spending on power projects is anticipated at SAR500 billion (USD133 billion). K.A.CARE envisages forming comprehensive partnerships with local and international stakeholders for developing both atomic and renewable capacity, such that 60% of all inputs for nuclear energy developments and 80% of solar-related activities could be sourced locally.

Grid collaboration: Besides participating in GCC's efforts to link power grids of member countries, Saudi Arabia also is evaluating the possibility of a 3 GW link with Egypt. Connections of KSA's power grids with those in Europe are also being considered.

Abundance of energy feedstock: KSA has the highest proven crude oil reserves in the world, estimated by the OPEC at 265 billion barrels as of December 2011. Being a desert region, KSA has abundant supply of sunlight all-round the year and this can be harnessed to produce solar energy.

Minimum external economy and currency risks: Besides having the Saudi riyal pegged to the U.S. dollar, KSA has a large current account surplus (estimated by the IMF to be 26% of the GDP in 2012), as well as over USD660 billion in foreign assets that support the dollar peg (source: EIU, March 2013).

Insurance Sector: Making structural changes for long-term growth

It is a good time to be an insurer in Saudi Arabia. Premiums are rising as awareness about insurance needs is spreading, leading to high insurance penetration rates. The government's focus on promoting insurance services is another strong positive. Given the strong growth potential, a number of domestic and international players have entered the market.

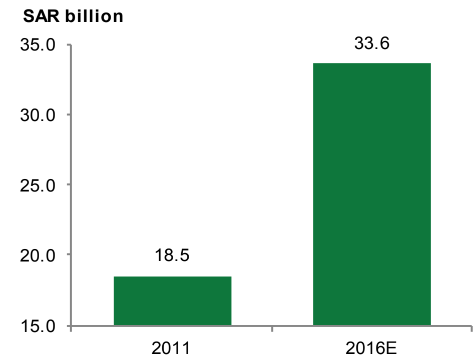
The segment is fragmented with a total of 35 companies, including 32 licensed operators, one licensed reinsurer and two new insurers that are awaiting regulatory approval to start operations. According to Standard & Poor's Ratings Services, around 54% of the total gross written premiums (GWP) in 2012 were accounted for by the top three insurers: The Company for Cooperative Insurance/Tawuniya (27% share), Mediterranean & Gulf Insurance & Reinsurance Co/Medgulf (16%) and Bupa Arabia (11%).

KSA insurance sector – growth driven by Non-life segment

- The Saudi insurance sector has witnessed double-digit growth in recent years, with GWP increasing at a CAGR of 21.2% from SAR8.6 billion in 2007 to SAR18.5 billion in 2011 (as per Saudi Arabian Monetary Authority).
- Market is expected to increase at an annual rate of 13.0% to SAR33.6 billion in 2016, in tandem with the economic growth (according to Timetric). The non-life insurance segment will continue to account for a major share of the market.

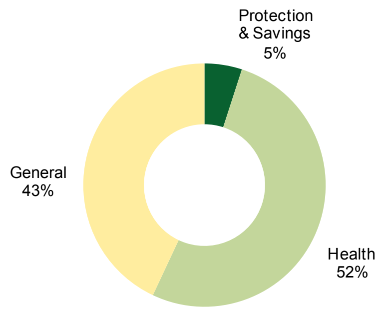
Premiums are rising as awareness about insurance needs is spreading, leading to high insurance penetration rates.

Market size of insurance sector: 2011 – 2016E



Source: Saudi Arabian Monetary Authority, Timetric

Insurance market segmentation, 2011



Source: Saudi Arabian Monetary Authority

KSA Advantage

Mandatory insurance for expatriates: Rising economic prospects, a robust financial sector and increasing government expenditure in infrastructure development have made Saudi Arabia an attractive employment destination for expatriates. With the implementation of compulsory health insurance for all expatriates in the country, demand for health insurance products from the private sector is expected to grow significantly.

Implementation of new Mortgage Law: Property and life insurance products are expected to witness higher demand with the implementation of the 2012 Mortgage Law in Saudi Arabia. The implementation of the law is expected to drive demand for 'home and contents' cover as well as term life insurance that is taken out on mortgage borrowers.

Fast growing and young population: Saudi Arabia is dominant in the GCC region with a population of over 28.8 million in 2012, which is expected to reach 37.4 million by 2025. Further, with over 67% of the population between 15 - 64 years of age (according to World Bank), demand for insurance services (especially non-life) is likely to grow.

Low penetration levels: Low insurance penetration rates (GWP as percentage of GDP of less than 1%)[1] is among the major factors contributing to the high growth potential. Even with a high savings rate of 50.7% in 2011 (as per IMF), the insurance premiums accounted for less than 2%[2] of the gross national savings. Going forward, as the market matures and the range of products and services expand, a greater portion of the savings will be channeled into the financial sector, including insurance.

Regulatory support: The Saudi Arabian Monetary Authority (SAMA) has been a growth enabler for the sector, having introduced a regulatory framework for the sector, encouraging foreign participation, granting new insurance licenses and promoting fair competition.

1 Applying the GWP of SAR18.5 billion on KSA nominal GDP of SAR2,511 billion in 2011, we get GWP as a percentage of nominal GDP at 0.7%.

2 As per IMF, KSA's gross national savings rate stood at 50.7% of nominal GDP (which was at SAR2,511 billion) in 2011. This puts the share of insurance premiums (GWP of SAR18.5 billion) in national savings (SAR1,273 billion) at 1.5%.

Media and Publishing Sector: Going electronic

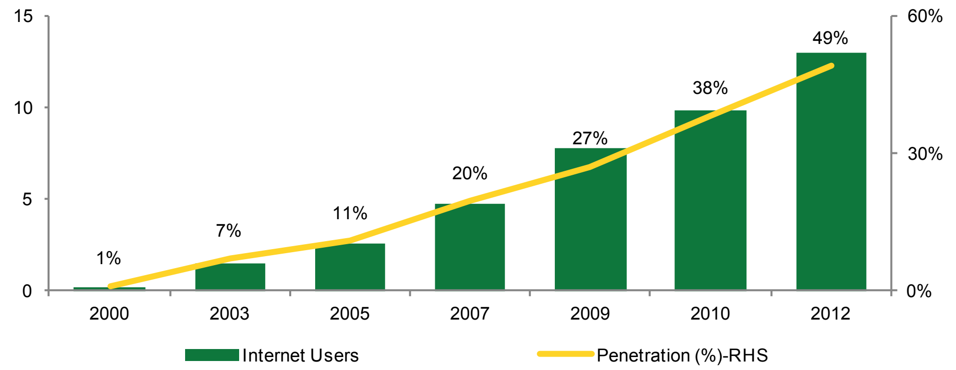
Saudi Arabia's media sector has historically been dominated by the government. Saudi newspapers are still created by royal decree and are subject to censorship. However, the rise of a young, tech-savvy population and increase in the usage of social media means the media and publishing sector is fast moving towards the electronic medium.

KSA dominates the media and publishing sector in the GCC, comprising 87% of all media and publishing revenues in the GCC in 2012. Saudi Research And Marketing Group is the leading player in Saudi Arabia, followed by Saudi Printing & Packaging Co.

Media and Publishing sector to grow at a swift pace backed by electronic media

KSA media sector is expected to witness strong growth, driven by its transformation from traditional to electronic medium. Furthermore, KSA government's focus on driving growth in the education and information technology sectors could also boost demand in the sector.

KSA internet users & penetration



Source: internetworldstats.com

KSA government's focus on driving growth in the education and information technology sectors could also boost demand in the sector.

KSA Advantage

Favorable demographics coupled with increasing per capita income: Rising per capita income due to strong economic growth, along with favorable demographics supported by rising young population, is expected to result in higher demand for the media and publishing sector. Moreover, KSA's focus on diversification towards non-oil could give the services industry a boost.

Increased government focus: Government's thrust to strengthen educational infrastructure in the Kingdom is likely to drive demand for publishing. The publishing sector is also moving toward the electronic medium, with issues like limited capability of Universities' printing houses making the traditional medium ineffective. Further, government's rising investments in IT and education is evident in higher budgetary allocations.

Expansion in advertising expenditure; e-advertising gaining prominence: Advertisement spending in KSA is rising, as consumers become more brand conscious. Saudi Arabia's advertising market stood at SAR1.5 billion in 2012, and accounted for 29% of the total GCC market as reported by Jeddah Chamber of Commerce and Industry (JCCI). Electronic advertising is gaining prominence. JCCI states that e-advertising market rose 14 times during the last five years from SAR11 million in 2008 to SAR150 million in 2012.

Digital-savvy youth driving growth in electronic medium: KSA's youth driven population is increasingly becoming digitally savvy and to meet their requirements internet and mobile have been introduced. Saudi Arabia has a fast-growing internet population that expanded at a CAGR of 41.6% during 2000–12 to reach 13 million by 2012.

Real Estate Sector: Building blocks of growth

Saudi Arabia's real estate sector is one of the most vibrant and resilient in the region. The sector is on the threshold of significant growth and presents one of the most attractive investment opportunities in the region. The residential sub-segment, in particular, offers an attractive investment opportunity. According to government estimates, the country is in need of around 275,000 new housing units a year until 2015 due to accommodate a rapidly growing population. This prompted the Saudi Arabian General Investment Authority to issue licenses to 50 new real estate developers over the last three years. Consequently, the Saudi real estate market, which was until recently concentrated in and around big cities like Riyadh and Jeddah, is beginning to witness growth across all regions. With current population of ~29 million, and the oil-driven economic prosperity, which drives hoards of expatriates into the country, the Kingdom certainly presents prospects for an upcoming real estate boom.

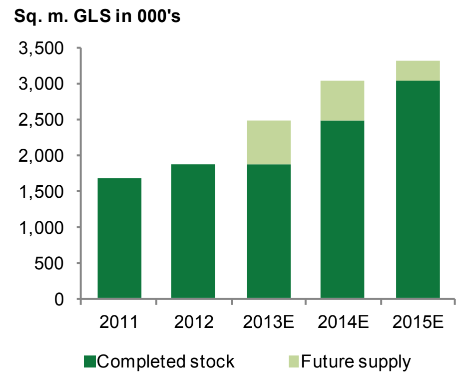
The Saudi real estate market, which was until recently concentrated in and around big cities like Riyadh and Jeddah, is beginning to witness growth across all regions.

Saudi construction sector is expected to grow ~6% annually until 2017:

- The Saudi real estate sector is expected to grow at an accelerated pace of ~20% in 2013, following the strong 9% growth registered in 2012 (according to Saudi news agency 'Mubasher').
- Business Monitor envisages that the annual growth rate of the construction sector in the kingdom is expected to remain stable at ~6% until 2017.
- The commercial segment (combined office space availability at Riyadh and Jeddah) is expected to grow at the fastest pace at 18.8% CAGR over 2012-2015 (according to Jones Lang LaSalle Riyadh and Jeddah Real Estate Overview Q4 2012).
- The retail segment (combined retail space availability at Riyadh and Jeddah) is expected to post a 10.0% CAGR over 2012-2015, according to Jones Lang LaSalle Riyadh and Jeddah Real Estate Overview Q4 2012, whereas the residential growth over the same period is expected to be at 3.4% CAGR (combined residential space availability at Riyadh and Jeddah).

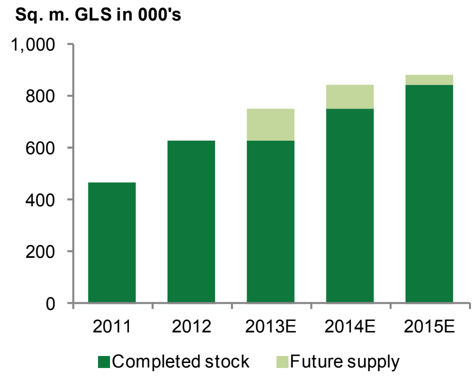
KSA Real Estate sector - Advantages

Riyadh office stock projection



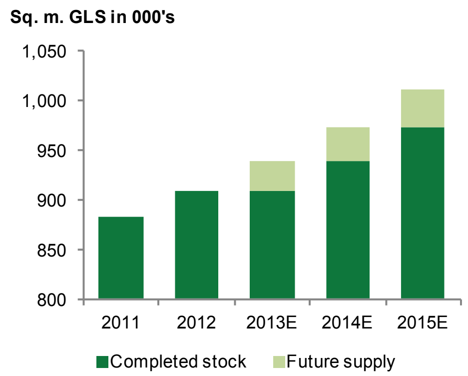
Source: Jones Lang LaSalle

Jeddah office stock projection



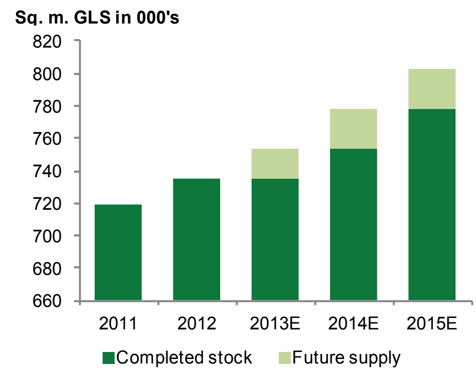
Source: Jones Lang LaSalle

Riyadh residential stock projection



Source: Jones Lang LaSalle

Jeddah residential stock projection



Source: Jones Lang LaSalle

Positive macroeconomic outlook: Saudi Arabia is among the fastest growing economies in the world with 8.5% and 6.8% real GDP growth in 2011 and 2012. This, along with lower inflation at 4.5% (vs. 5.0% in 2011), will boost per capita GDP, which is expected to increase at 2.6% CAGR over 2012-25.

Strong banking system: KSA has a strong banking system, with adequate capitalization and abundant liquidity in the system. While private sector leading grew 16.4% y-o-y in 2012, lending to the building and construction sector surged 8.0% y-o-y in 2012 (Source: SAMA).

Demographic advantage: Saudi Arabia is expected to witness steady population growth of ~2.0% CAGR over 2013-25, along with steady growth of expatriate population driven by the oil economy. This has led to acute shortage of housing, with an estimated 275,000 new housing units required annually. Also 60% of the Saudi population is under 25 years of age and do not own a house (IMF data).

Favorable regulatory changes: Saudi Arabia has passed new laws on real estate financing, leasing and the supervision of financial companies in February 2013. These changes could help the quantum of mortgage lending in the kingdom to reach ~USD68 billion by 2025.

Strong infrastructure push by government to support tourism: Government's enhanced support to religious tourism has led to a surge in tourist inflows; BMI forecasts project 15.8 million visiting KSA tourists by 2014. Saudi Commission for Tourism and Antiquities (SCTA) expects 6-8% annual increase in religious tourist arrivals over the next five years.

Decentralization of real estate development from big cities: Advent of regional property firms in the Saudi real estate market, with 50 new licenses issued to real estate developers by the Saudi Arabian General Investment Authority over the past three years, has led to decentralization of real estate development across the country. The Kingdom is witness to hectic building activity with new mega-projects like the USD26.6 billion King Abdullah Economic City and the USD11.2 billion Jeddah Hills project underway. Also, an estimated SAR30 billion REDF funding for new projects is likely to help boost real estate supply in coming years.

The advent of regional property firms in the Saudi real estate market, with 50 new licenses issued to real estate developers by the Saudi Arabian General Investment Authority over the past three years, has led to decentralization of real estate development across the country.

Retail Sector: Structural consolidation, a key growth driver

Saudi Arabia is the largest retail market in GCC, constituting 44% of regional sales. Western-style retailing began in the 1970s, when the first store was opened. Rising income levels, fueled by high oil prices, have led to the rapid evolution of organized retailing in Saudi Arabia with the entry of modern retail formats, such as hypermarkets, supermarkets, big-box store, and malls. The KSA government's decision to allow foreign investment in retail in 2005 helped accelerate this trend by giving consumers access to international brands. Retail sales grew 10% YoY to USD109 billion in 2012, recording a CAGR of 11% in the five-year period up to 2012.

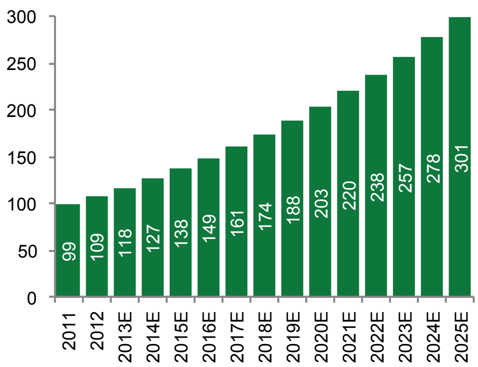
Growing acceptance of modern retail formats in recent years notwithstanding, the sector remains fragmented with the top five players accounting for a mere 11% share. This figure is well below that in some OECD countries with similar per capita incomes as KSA. Small independent stores (unorganized retail) still dominate the Saudi retail market; in grocery, hypermarkets/supermarkets hold 41% share, while in consumer electronics, big box retailers and hypermarkets account for 24% share. On retail floor space, Saudi Arabia remains largely under-penetrated, with only 4.4 million sq. mtr in 2011 (mainly in Riyadh and Jeddah) equivalent to a gross leaseable area (GLA) per capita of 0.2 that trails other regional markets

On retail floor space, Saudi Arabia remains largely underpenetrated, with only 4.4 million sq. mtr in 2011 (mainly in Riyadh and Jeddah).

Saudi retail market size to treble by 2025; strong domestic fundamentals to drive growth

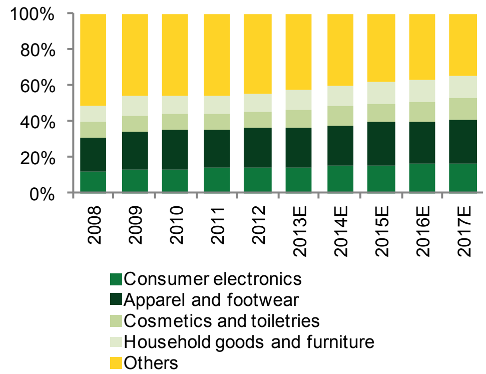
- Our analysis suggest that the Saudi Arabia retail sales is likely to expand nearly 2.7x to USD300 billion by 2025
- Within non-food retail, EIU expects consumer electronics, combined with apparel and footwear, to remain the largest segment in the predictable future and reach 41% of total non-food retail sales in 2016 from 36% in 2012 (32% in 2008).

Retail sales in KSA (USD billion)



Source: EIU, Aranca analysis

Electronics/apparel key to future growth



Source: EIU

KSA Advantage

A large market: At 28.8 million, KSA is GCC's most populated country, and hence, accounts for 44% of all GCC retail sales by value (second largest in MENA after Egypt). The Saudi population is expected to reach 37.4 million by 2025, and per capita income to grow 1.4 times to USD35,487 from USD25,263 in 2012, indicating the huge potential waiting to be tapped in the Kingdom's retail sector.

Solid demographic profile: A significant portion of Saudi Arabia's large and growing population base is young (around 51% below 25 years) and more inclined to shop directly at modern retail formats. Furthermore, trolling malls and shopping being the only sources of entertainment triggers impulsive buying.

Equal split between food and non-food: Unlike UAE, the second-largest retail market in GCC, KSA's market is evenly split between defensives and discretionary, due to low urbanization. This makes the KSA retail market less sensitive to economic cycles.

Government spending/policy support discretionary: Encouraged by high oil, Saudi Arabia unveiled a SAR252 billion plan to build 500,000 houses. The government also announced schemes that include minimum wages, unemployment benefits, and greater employment options for locals.

Retail space to expand: Shopping malls largely concentrated in main cities such as Riyadh and Jeddah. Modernization of retail sector in smaller/underdeveloped towns to increase GLA per capita in line with other regional markets. This along with Increasing number of brands mainly, from Europe and US, looking to tap the burgeoning Saudi retail sector will boost retail spending

Development of IT and access to credit support online shopping: Sacha Orloff Consulting Group estimates that the Saudi e-commerce market totaled USD3.5 billion in 2011. This is roughly 4% of total retail sales as compared to 8% and 13% in the US and the UK. The growing number of internet users and rising broadband penetration, coupled with increased availability and usage of credit cards, could stimulate online shopping in KSA.

Telecom Sector: Data/Corporate to take growth to the next level

Sector description and summary highlights:

With 53 million subscribers in 2012, Saudi Arabia's telecom sector is the largest in the Middle East. The sector was liberalized in 2005, when Mobily's entry as the second wireless operator ended state-run STC's monopoly. Thereafter, Communications and Information Technology Commission (CITC) issued many licenses in 2007 to foster competition, a prime beneficiary of which is Zain KSA. Consequently, KSA's mobile subscriber base has increased at a CAGR of 24% between 2004 and 2012. The number of broadband subscribers also increased to 14.8 million in 2012 from 24,000 in 2004, as penetration in KSA reached 51%. The broadband story has been driven by high income levels, increased accessibility to masses, and switch from 2G to 4G/LTE.

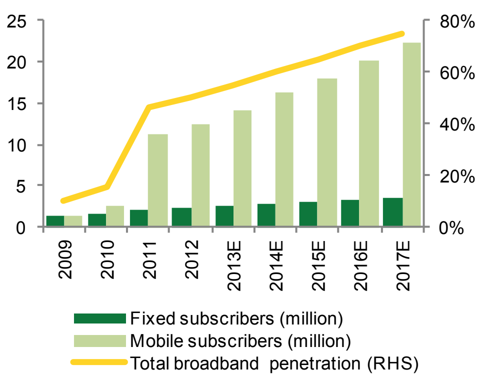
On revenue, KSA is the largest in the Middle East, recording 11% CAGR to SAR71 billion in 2012 from SAR30 billion in 2004. Although voice accounts for a major portion of revenues, the segment is close to saturation, given that each person owns two SIM cards on average. Hence, data services (broadband) could be the next frontier, led by a technology friendly young population, growing number of internet users, introduction of low-cost smartphones, low broadband penetration levels, and rising interest in Value Added Services (VAS) such as gaming, internet on mobile, video content, and application download. E-government initiatives through investments in the Yusr project, economic cities and the education sector could also emerge as growth drivers.

Saudi Telecom market - new avenues to accelerate growth momentum!

- According to market sources, Saudi Arabia's mobile subscribers increased from 2 million 2001 to 53 million in 2012, and is expected to reach 67 million by end of 2017, driven by population growth and rising incomes.
- Saudi Arabia's mobile broadband penetration is expected to rise to 65% in 2017 from 42% in 2012 (1.2% in 2008), and fixed broadband density (as a percentage of total households) to grow to 50% in 2017 from 44% in 2012 (according to market sources).
- Data, including VAS, constituted 8% of revenues in 2008, rose to 15% in 2011; market sources expect this figure to reach 25% by 2015.

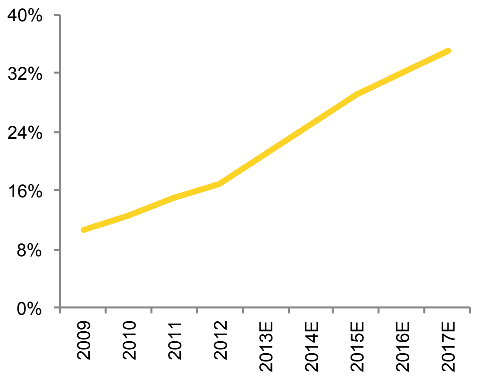
Data services (broadband) could be the next frontier, led by a technology friendly young population, growing number of internet users, introduction of low-cost smartphones, low broadband penetration levels, and rising interest in Value Added Services (VAS) such as gaming, internet on mobile, video content, and application download.

Broadband subscriber and penetration



Source: CITC, Market sources

Data revenue as % of sales



Source: EIU

KSA Advantage

Internet has strong potential: Given the lack of entertainment choices and restriction on socializing outdoor in Saudi Arabia, broadband is a major source of connectivity to the outside world through social networking platforms. While internet penetration of 54% is well below the GCC average of 75%. growth in sector could benefit the data segment of telecom companies.

Strong demographics: KSA's relatively young population could drive significant growth in demand for data, including VAS such as gaming, video content download and applications. The tech-savvy young population is a prime target for telecom companies.

Government investments: Government expects its significant investments in the IT/ education sector (economic cities, the USD6 billion Knowledge Economic City (KEC) and USD800 million 'Yusr' project) to boost demand for telecom services, particularly broadband and ICT services, which should benefit telecom companies operating in the enterprise segment space.

Enterprise (corporate) segment underserved: KSA's significant investments in the non-oil sector is increasing the need for more sophisticated ICT infrastructure. Currently, spending on ICT in Saudi Arabia is only about 10-20% of that in the US and Western Europe. According to Booz & Company, enterprise SIM penetration in KSA is 1% as compared to 7% in Europe, indicating the huge growth potential, given the corporate segment is generally the biggest user of data.

VAS to continue to surge: Declining smartphone prices and availability of high-speed internet are making VAS more widely accessible. Additionally, declining tariffs due to competition and an upgrade from 2G to 4G/LTE are also aiding the growth of VAS services.

Transportation sector: Turning to better connectivity for growth

Strong economic growth, coupled with a growing population, has improved demand for transport infrastructure in the Kingdom. According to Saudi Arabian General Investment Authority (SAGIA), the Kingdom plans to invest USD100 billion by 2020 in this sector. In its 2013 budget, the Government set aside USD17.3 billion for the infrastructure and transportation sector, 16.0% more than that in the 2012 budget.

In order to cater to the rising population and facilitate industrial expansion, significant investments are being witnessed in road and railway infrastructure. According to Zawya Projects, the railway and road infrastructure in Saudi Arabia currently have a project pipeline worth ~USD81.6 billion and ~USD4.0 billion respectively. Furthermore, the country plans to set up three new ports, two at King Abdullah Economic City and one at Jizan Economic City, to help handle more volumes. Container traffic is largely dependent upon trade and Saudi Arabia's value of goods exported is forecasted to increase from SAR1.5 trillion in 2012 to SAR2.3 trillion by 2025.

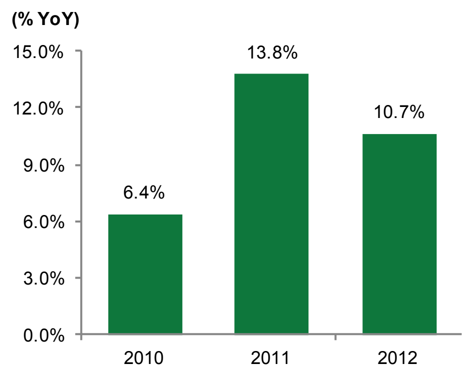
SAGIA aims to position KSA as the world's leading transportation and logistics hub, benefiting from country's strategic location and large-scale infrastructure development.

With the sector being highly energy intensive, it is expected to benefit from substantial cost advantages due to the low domestic cost of feedstock.

Transportation sector to reach USD100 billion by 2020, backed by Government expenditure

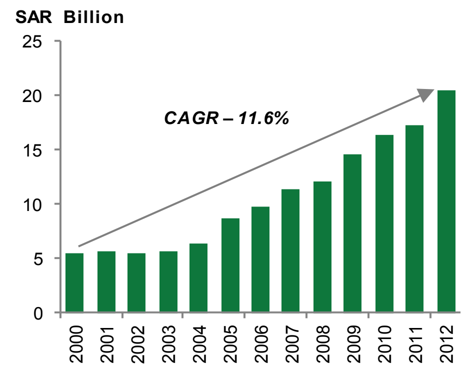
Saudi Arabia's transport, storage and communication sector GDP expanded at a CAGR of 8.3% between 2005 and 2012. Transport, storage & communication GDP amounting to SAR72.1 billion in 2012 accounted for 7.7% of the Kingdom's GDP. The transport sector is set to reach USD100 billion by 2020, according to SAGIA.

Transport & Communications GDP



Source: Ministry of Finance

Budget Data - Transport & Communications



Source: Central Department of Statistics, Ministry of Planning

KSA Advantage

Strategically located: Saudi Arabia's strategic location between Asia, Africa and Europe helps attract more traffic to its seaports and airports. Furthermore, the large-scale infrastructure development in the Kingdom will aid in positioning the country as a global hub for cargo and services.

Government Initiatives: The KSA government's focus on improving infrastructure in the Kingdom and on diversifying away from oil is expected to support the growth of the transportation and logistics sector. The budget allocation in the transportation and communication sector has been expanding at CAGR of 11.6% between 2000 and 2012. Upcoming rail, road and port projects will help sustain growth and cater to the expected increase in demand.

Low cost of energy: With the sector being highly energy intensive, it is expected to benefit from substantial cost advantages due to the low domestic cost of feedstock.

Strong domestic growth: Strong domestic growth, supported by massive capital spending coupled with establishment of planned Economic Cities, is expected to contribute to growth in domestic cargo flow. SAGIA expects the Kingdom's domestic cargo to grow at an average 4-5% annually until 2020, and international cargo to grow at 5%. Domestic demand will be driven by the planned Economic Cities that are expected to contribute to 30% of the growth in cargo flow.

Rising number of religious tourists: With the increase in the number of religious tourists each year, development of transport infrastructure for religious pilgrims has also grown at an accelerated pace.

About Aranca:

Founded in the UK in 2003, Aranca is a leading provider of high quality research and advisory services to global clients. As a trusted knowledge partner to over 1500 clients including global financial institutions and Fortune 500 firms, we have built a strong reputation for our insightful and actionable research. Aranca has a global presence including in the US, Europe, Middle East and India, and employs over 350 highly qualified and talented professionals.

تأسست شركة ارانكا في المملكة المتحدة عام 2013، كشركة رائدة في تقديم أفضل خدمات الأبحاث والاستشارات للعملاء من كافة أنحاء العالم، وأصبحت اليوم شريكاً ومصدر موثوق للمعرفة لأكثر من 1500 من المؤسسات المالية العالمية بما فيها شركات من قائمة مجلة فورتشن 500. لقد تمكنا من بناء سمعة ممتازة في مجال تقديم خدمات الأبحاث ذات المصداقية المرجعية. إن لشركة ارانكا حضور دولي يغطي دول الولايات المتحدة، أوروبا، الشرق الأوسط، والهند، كما تتمتع بكوادر مؤهلة ذات كفاءة مهنية عالية تتألف من أكثر من 350 موظف.

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