

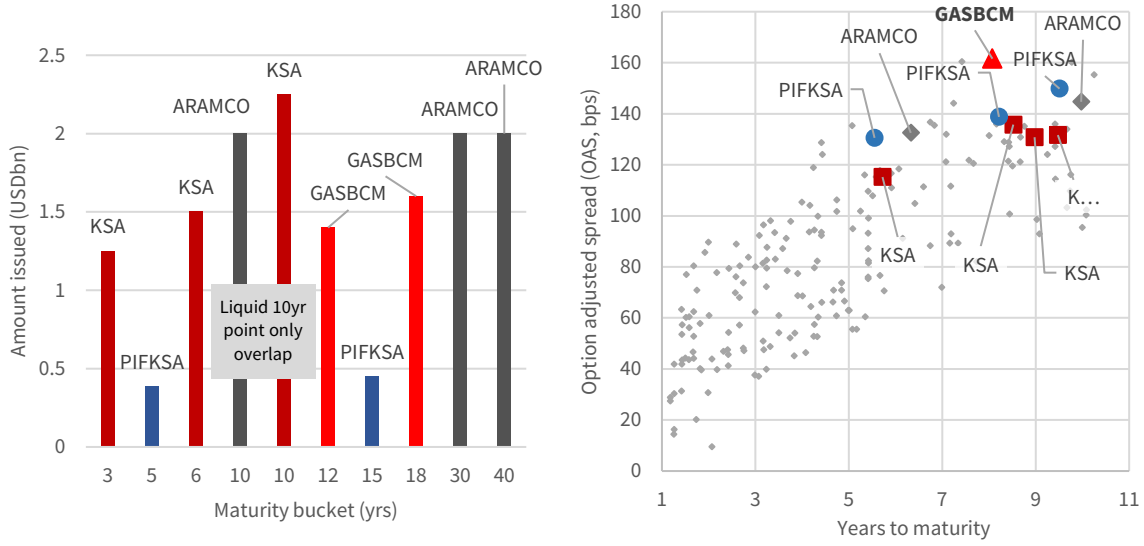
Saudi debt summer splash: takeaways for investors

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The Kingdom of Saudi Arabia (ticker: KSA) is critical to the success of global climate goals. KSA has historically had low external capital dependency, meaning there have been limited engagement opportunities for investors. However, this could be changing as KSA and subordinated entities (henceforth called **KSA+**) have been on a debt binge this summer. Through June to July the KSA+ sphere: KSA (sovereign), ARAMCO (Saudi Aramco, the national oil company), PIFKSA (Public Investment Fund, the sovereign wealth fund) and GASBCM (Greensaif, an Aramco pipeline funding vehicle), issued almost USD15bn in debt.

- **Issuance appears to have been co-ordinated across the capital structure, supporting the notion that investors could use a "KSA+" lens when considering debt exposures**. The issuance pattern by the nominally independent issuing entities is strikingly smooth across the maturity buckets, see Figure 1 left.
- **For investors with KSA/KSA+ investment restrictions but seeking to undertake climate engagement, we recommend doing so by proxy through JPMorgan and/or Citi.** The two banks have a near perfect batting average in terms of leading debt deals across the Kingdom's capital structure, having participated in all the recent summer deals and across 91-94% of all KSA+ notional issued historically.
- **The Greensaif (GASBCM) private funding vehicle trades as the widest A+ credit in our universe** (Figure 1 right), **generating some question marks about the rating**. Our analysis suggests it should be viewed as subordinated to KSA and Aramco with a likely very low recovery potential, and the ESG rating of Aramco should be superimposed on GASBCM.

Figure 1. (Left) June-July Saudi capital structure issuances by notional and maturity buckets. (Right) Benchmark A+ USD bond spreads, with Saudi capital structure names highlighted. 1-11yr maturities. Pricing 29 Jul. Source: AFII, Bloomberg.



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Capital markets activity

For background on why Saudi Arabia and Saudi Aramco is of importance for investor climate alignment and engagement, please see the ClimateAction100+ investor review with disclosure scores here and alignment scores here.

The strategy for KSA to raise capital has been clear throughout the year (see "Saudi Arabia Banks Embark on Record Bond Binge for Mega-Projects", Bloomberg, 15 Mar) and has led to a string of debt and equity issuances. Debt raises in public markets in the months May-July are shown in Table 1. Add to this the equity sale of Aramco stock in May for USD12.3bn.

Table 1. Bond issuances across the KSA capital structure in Jun-Jul, 2024. Source: AFII, Bloomberg.

Issuer	Bond	ISIN	Issue date	Maturity (yrs)	Crncy	Issue amount (USDbn)	Issue sprd (bps vs bmark)	Current sprd (bps vs bmark)	Change in sprd
Kingdom	KSA 5.25% 06/2034	YX392317	04-Jun	10.0	USD	2.25	85	93	+8
	KSA 5.25% 06/2030	YX3902781	04-Jun	6.0	USD	1.5	75	90	+15
	KSA 5.25% 06/2027	YX3886505	04-Jun	3.0	USD	1.25	60	66	+6
Wealth fund	PIFKSA 5.625% 06/2039	XS2838995947	11-Jun	15.0	GBP	0.35	125	134	+9
	PIFKSA 5.125% 06/2029	XS2838973209	11-Jun	5.0	GBP	0.3	115	130	+15
National oil company	ARAMCO 5.25% 07/2034	XS2861550817	17-Jul	10.0	USD	2	105	108	+3
	ARAMCO 5.75% 07/2054	XS2861551898	17-Jul	30.0	USD	2	145	154	+9
	ARAMCO 5.875% 07/2064	XS2861555964	17-Jul	40.0	USD	2	155	164	+9
NOC funding vehicle	GASBCM 5.8528% 02/2036	XS2850687620	31-Jul	11.6	USD	1.4	170	165	-5
	GASBCM 6.1027 08/23/42	XS2850687893	31-Jul	18.1	USD	1.6	195	201	+6

It is instructive for investors to consider issuance through the highly dependent vehicles of KSA as joint issuances (KSA+), rather than as separate transactions. The Kingdom controls Saudi Aramco as well as the Public Investment Fund. The chairman of Aramco is also the chair of PIF, and PIF was recently given another stake in Aramco, with PIF holdings now amounting to 16%. In contrast, only 2.5% of the company is free floating stock. Indeed, PIF's share of equity in Aramco (approx. USD3-400bn) is worth more than most oil major's total market capitalisation. Greensaif is a direct funding vehicle for assets on Aramco's balance sheet, see Figure 3 below: Aramco holds the majority stake of the AssetCo that distributes cashflows to the Greensaif vehicle.

The issuance pattern of the summer supports this notion of a KSA+: maturities across the entities have been spread out with almost surgical precision, see Figure 1.

Another data point that supports this notion is that two banks, Citi and JPMorgan, have a consistently high degree of participation in deals for the KSA+, see Table 2, and were on all the deals this summer so far. As AFII argues in 'The Box' methodology, engagement with bank counterparties may be one of the most important ways in which investors can exert influence over the cost-of-capital and issuance behaviour of key fossil fuel producers.

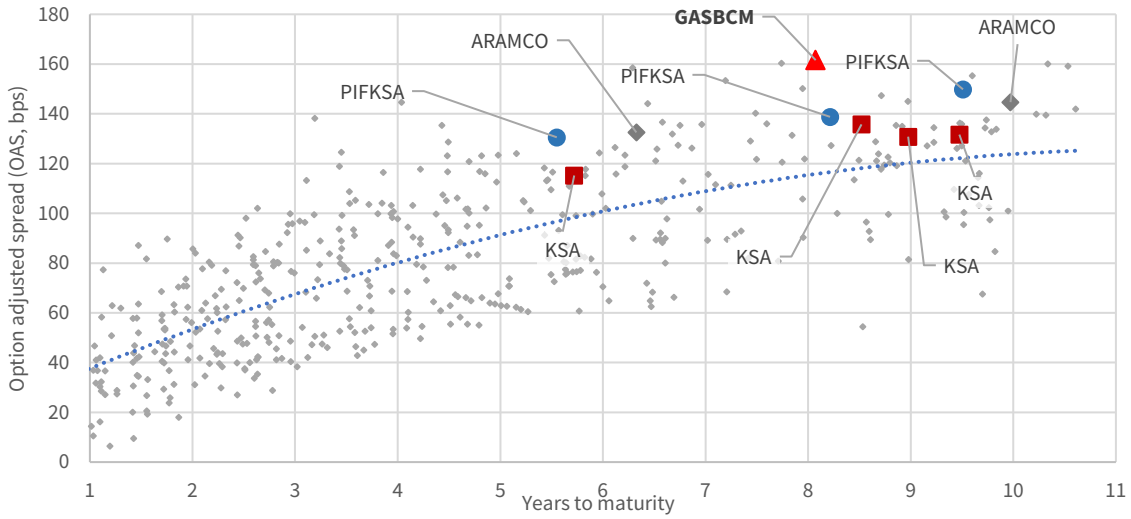
Table 2. Joint lead manager roles in KSA capital structure bond deals, 2016-to date. Total notional for all deals is USD166bn. Source: AFII, Bloomberg.

Bank	Deals (USDbn)	Pct of all
JPMorgan	155.5	94%
Citi	150.3	91%
HSBC	140.6	85%
GS	124.0	75%
BNP	104.5	63%
StanChart	82.2	50%
BofA-ML	74.8	45%
MUFG	73.0	44%
MS	67.2	40%
Mizuho	62.3	38%

Greensaif: wide spread for rating

Greensaif, the Aramco balance sheet funding vehicle operated by BlackRock as a general partner[1], is issuing "senior secured" bonds that are trading at the very wide end of the A+ rating spectrum, see Figure 2. One interpretation of this is that markets price these bonds as significantly more subordinated than credit ratings imply.

Figure 2. A+ benchmark USD bonds, 1-11y bucket on an option-adjusted spread basis. Pricing date . Source: AFII, Bloomberg.



We would agree, as we see GASBCM bonds as first-to-default, zero-recovery instruments on Saudi risk. If Aramco had difficulty honouring payments (by inability or unwillingness) this would probably lead to secondary and tertiary creditors being the first to suffer missed coupon payments. As illustrated in Figure 3, the Aramco controlled Aramco Gas Pipelines Company is delivering "distributions" to Greensaif, suggesting it has discretion over the latter's cash flow. Indeed, the bonds are explicitly dividend dependent: if Aramco were to cease dividend payments, the Greensaif bonds would eventually not pay coupons.[2] In such a situation, Greensaif lenders would – even though the bonds are nominally 'secured' – likely have a hard time taking ownership of the underlying security and recovering any value from it, as the underlying physical assets are under Saudi jurisdiction.

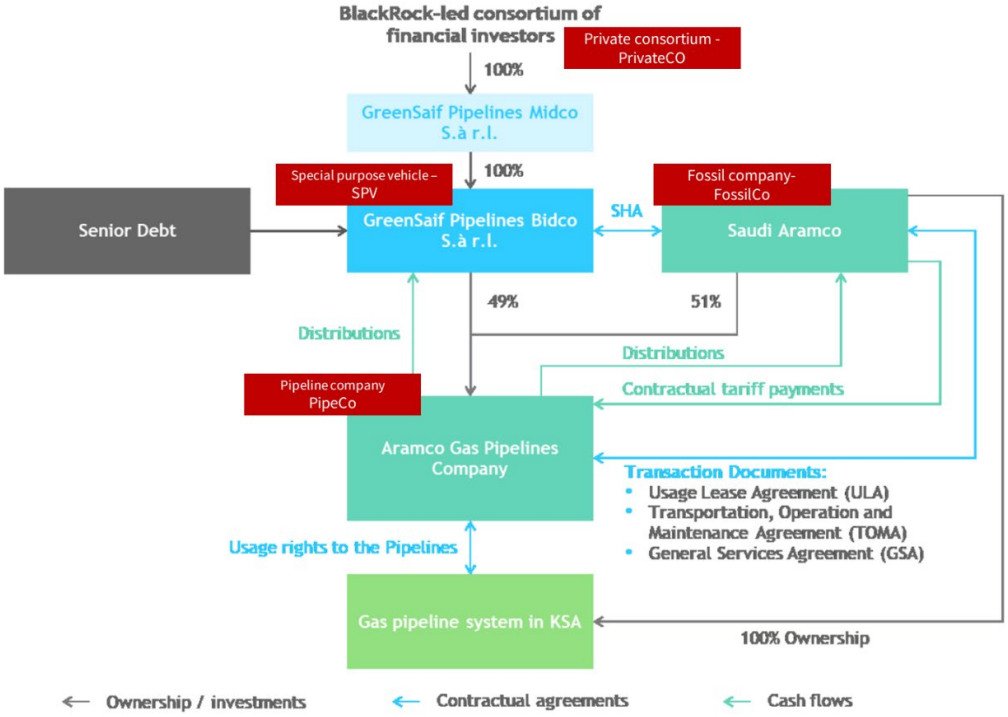
Our expectation and assumption on these bonds is thus of a 0% recovery, as well as a higher probability to default compared to other Kingdom issuance vehicles ('first-to-default'). Investors have a good proxy indicator of potential default risk: it is unlikely that Aramco's CEO would continue to hold a Board position at the general partner (BlackRock) of Greensaif if Aramco were to default on payments to Greensaif.

[1] BLK engagement in the private credit space was in the headlines recently as the company's president received a substantial retention award based on growth in its private credit businesses, see "Top BlackRock executive benefits from unusual 'points-style' bonus pay", Financial Times, 31 July 2024; "BlackRock Executive Gets $20 Million Retention Award", Bloomberg, 31 July 2024. To contextualize the private capital push in the USD15bn Greensaif vehicle, read "BlackRock's Fink says climate pressure on public companies is 'biggest arbitrage in my lifetime'", Financial Times, 3 Nov 2022. The speech was given just a few days prior to the announcement of the Greensaif deal, see "Arbitraging before the ink has dried", AFII, 8 Nov 2021.

[2] For more information, see the 'Risk disclosure' section of the Greensaif bond prospectus as of July, 2024.

For an earlier analysis of the climate alignment of the Greensaif bonds, see "GREENSAIF: A not-so-green, double-edged sword", AFII, 6 Feb 2023.

Figure 3. Financing structure of the lease-leaseback transaction in the Greensaif case. Excerpt from bond prospectus, limited print resolution as per the original. Annotations in red as per AFII. Source: JPMorgan, AFII. Originally from "Oil, gas and bond pipelines: the case of Aramco/EIG/BLK", AFII; 22 May 2022. The source contains full annotation.



Conclusions

Our data suggests that investors in Saudi-exposed bonds should consider the various issuing entities across the KSA capital structure and their issuance patterns holistically ("KSA+"). For investors and issuers that are not invested, but seek to influence one of the most important climate transition stories globally, engagement with the KSA's symbiotic banking partners Citi and JPMorgan offers one possible means. Lastly, we highlight the interesting rating dynamics of the BlackRock funding vehicle for Aramco, Greensaif. We conclude that the the credit rating seems a bit too generous and the ESG rating (if it exists) seems to diverge from Aramco's.

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