

Saudi aramco ipo to bring transparency and innovation to saudi arabia

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The past couple of years have not been kind to those economies heavily reliant on oil, and no country has been affected more than the Kingdom of Saudi Arabia, the largest exporter of petroleum in the world. Gone are the days of the stratospheric oil price in excess of US\$100 a barrel, which have made Saudi Arabia one of the wealthiest nations in the world. In its place, an oil price that dipped below \$30 in January and is likely to stay in the \$50-\$55 range for the rest of the year. With the budget suffering a large deficit since 2014 and around 80% of budget revenues generated by oil, the Saudi Government has recognized that it urgently needs either an oil price in excess of \$100 a barrel, or to - and this realization has come not a moment too soon.

The planned initial public offering for Saudi Aramco is predicted to be one of the highest valued offerings ever. Initial conservative estimations put the IPO at \$2.6 trillion. However, this valuation is based on an oil price of \$10/barrel, with the extent of Aramco's oil reserves yet to be clarified. Based on the claims from Saudi Aramco that they have 261 billion barrels of proved reserves, an oil price of \$40/barrel raises the possibility that this valuation could be even as high as \$10 trillion.

The IPO is part of the Saudi Arabian Government's Vision 2030, the economic restructuring plan led by Deputy Crown Prince HRH Mohammad bin Salman Al Saud. By selling a minority stake, the new Crown Prince wants to signal the internationalization of Saudi Arabia. The plan is ambitious, but certainly it is timely. Over the course of the next 14 years, the government plans to

diversify national wealth by utilizing the funds raised from the forthcoming IPO to kick-start the diversification process.

The strategy behind the IPO is logical. The government needs to kick-start new sources of income for the nation and Aramco is one of the greatest assets available. The need for money is driving the process together with the rise of the Crown Prince. While the cash injection to the government is essential, another important aspect of the public offering is the efficiency advantages that having private sector involvement in the government-run institution will bring.

Saudi Aramco is a huge government-run institution, which lacks transparency and no doubt runs with some inefficiencies. As a publicly listed company, Saudi Aramco will be required to institute new transparency measures; they will have to run an annual meeting for shareholders, issue financial results and also it will no longer be straight-forward to make critical decisions without first getting the buy-in from shareholders. Even though these measures will be forced by any IPO, they may well be advantageous to bringing forward a change in the way the company is run overall.

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The decision to go to IPO is without doubt a sensible way to provide much needed capital to support the economic diversification strategy. However, going to IPO is tactical, you need to find the correct price that reflects the true value of the business and the public offering should ideally be carefully timed to support a high valuation. It's always preferable to do major

economic restructuring when both the market and your business are in good conditions, which is not the case here. This IPO is not a case of selling when the business is trading at a high; it's an IPO based on need. Saudi Arabia has a major cash flow issue, and so strategic timing is not a luxury that they can enjoy currently.

Saudi Arabia is somewhat on the back foot now and, while I think this IPO will generate a lot of market interest - particularly because Saudi Arabia has historically been - we are eagerly awaiting the IPO to observe the market valuation. Some analysts argue that Saudi Aramco is simply too big for an IPO. Valuing only 260 billion barrels of oil at a nominal and very low price of \$10/barrel puts the IPO at \$2.6 trillion. By comparison, the world's most highly valued traded company, Apple Inc, has an estimated value is \$600 billion.

Another important concern for the valuation is that stock market investors rarely value state-owned and managed companies based only on the financial numbers. The internationalization of Saudi Arabia will mean gradual changes away from a very closed off society. Risk is significantly higher, and even more so in this case with the Saudi government notoriously secretive about their operations. Investors will no doubt have reservations that the Saudi government will put their interests ahead of the shareholders and it will be interesting to see how this impacts the overall valuation for Saudi Aramco.

One of the most exciting prospects for the Saudi Aramco IPO though is that the government will be forced to reveal the details of at least a portion of the oil reserves that they maintain, which has been a closely guarded state secret until now.

There is so much unknown about the IPO at this time, but it is undoubtedly one of the most exciting developments in the financial markets currently. With and alternatives to oil products increasingly being popularized, it is sensible for Saudi Arabia to diversify and innovate. Will they get the valuation they desire? Only time will tell.

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