

Buy the Saudi Aramco IPO at a 7.4% forward dividend yield!

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Saudi Aramco is the biggest, most profitable company in history (\$110 billion revenues in 2018, \$40 billion more than Apple). It has been the economic engine of the Arab world's preeminent superpower since Chevron geologists struck the mother of all gushers in a Dammam salt dome in 1937 and changed the history of the Middle East forever. Oil and gas is still 90% of the Saudi government's revenues and 50% of the kingdom's GDP in the largest economy of the Arab world. Saudi Aramco, like the East India Company or Gazprom, impacts global geopolitics since it is the financial foundation of the House of Saud's realpolitik on the world stage. Now 5% of Saudi Aramco will trade on the Saudi stock exchange two months after a Houthi missile/drone attack on the kingdom's Abqaiq oil processing hub, which took out 5.7 million barrels a day offline, 5% of the daily global supply of black gold. After an initial panic buying spree Brent spiked to \$72 but has not fallen to \$61 a barrel as I write.

I just returned from an overseas trip but have been deluged with calls asking for my take on the Saudi Aramco IPO, even though I had published a valuation estimate in the financial press. Yet the markets like the ocean's tides are all about now and not about then. Saudi Arabia had expected the Aramco IPO to command a valuation of \$2 trillion, this is not credible given the realities of the global economy, Gulf geopolitics and current energy valuations. However, I still believe Aramco will be the largest listed oil company on the planet after its IPO. I will not be surprised if Saudi Aramco trades in the Apple-Microsoft market cap league at \$1.1 – 1.2 trillion.

Yet the Saudi Aramco IPO deal has been anything but smooth sailing. Multiple delays have frustrated fund managers in Wall Street and the City of London. Crude oil prices are exactly half their level in June 2014, when Daesh terrorists seized Mosul and then Saudi Oil Minister Ali Al Naimi gambled that the kingdom's refusal to play the role of OPEC's swing producer would destroy the competitive threat from US shale. Five years later, crude oil is \$61, well below the kingdom's budget breakeven price of \$85 a barrel and American shale oil produces 12 million barrels a day. The world's new swing producer is the Permian Basin in West Texas, not the oilfields of the Gulf, West Siberia, West Africa or, alas, the North Sea/Alaska.

The ongoing US-Iran tensions in the Gulf and the protests in Lebanon, Iraq, Algeria and Sudan are also swords of Damocles for the crude oil market and capital flows into MENA. Many hedge funds and fund managers I know expected Saudi Aramco to be listed in London or New York and will not commit money to a Tadawul IPO since it is impossible to short or hedge risk with index options. That said, I expect the Saudi Aramco IPO will be accumulated by Gulf/Asian sovereign wealth funds and a spectrum of Gulf institutional, government and strategic investors. Saudi family offices will also bid for the IPO – they better.

What will be the optimum price to buy the Saudi Aramco IPO, if Brent remains in a \$60 – 65 range as I expect (it may not)? The valuation will be largely dependent on Saudi Aramco's public commitment to give a minimum \$75 billion dividend per annum until 2024. This makes a \$2 trillion market cap impossible as no sane investor will buy Saudi Aramco at a mere 3.7% dividend yield when BP and Shell offer 6.7% – 6.8% with far bigger free floats and no state involvement. So I expect fund manager interest at \$1.1 trillion market cap where the dividend yield will be 7.4%, a premium over BP, Shell, Exxon, Chevron and Total, my lovely, lovely Seven Sisters. This is below the pricing talk I hear on the Aramco IPO grapevine, now at \$1.4 – \$1.8 trillion. So I will wait and watch and seize my moment – if it comes in the secondary market.

I also expect the current risk premium in Middle East assets to compress a tad if the US dollar sags against the Euro (it will) since tail risk on China trade war fund flows out of the greenback have abated, the US-Asia growth differentials and relative yields have both fallen, a bearish omen against the King Dollar. Ipso facto, this means a US Dollar Index at 93 – 94 and Brent at \$65 – 68 if geopolitical risk in Venezuela/Iran rises at the same time as a slight dip in US shale output this winter. In such a scenario, I can easily envisage a nimble investor can well earn a 20% total return if he/she/it buys at my projected valuation levels at a 7.4% dividend yield. This is not geeky rocket science but a simple macro extrapolation. My best idea would be to buy the Saudi Aramco IPO and hedge sector risk by selling emerging market state owned colossi Petrobras and PetroChina ADRs, as their dividend payouts are too low relative to Saudi Aramco while their governance is a joke even by the modest standards of the emerging markets.

There is no doubt in my mind that Saudi Aramco will be a major component of the MSCI emerging markets, possibly as high as 8 – 10% of the constituent's aggregate market value. Yet the weighting on the MSCI emerging market index will be much lower due to Aramco's minimal free float, a more critical criterion for MSCI than mere market cap. Yet I expect Saudi Aramco to be at least 0.7% of the MSCI emerging market index, a member of the Fab Four with my beloved Tencent (go Springboks!), Alibaba and the Republic of Samsung. Yet again, the miniscule free float rules out any major dilution impact on the Seven Sisters. ENI's Enrico Mattei died in a plane crash in 1958 (big oil CEO's often do as last happened in Moscow to Total's M de Margerie) but the Sette Sorelli lives on forever! A version of this Press Release is available [here](#). ■