Investors hoping for a slice of the world's biggest, and most profitable, corporation will have to wait a while longer after Saudi Aramco again decided to hold off plans to conduct an initial public offering (IPO) over an acceptable valuation. However, Aramco will eventually privatise a stake in the company to equity investors – a central component of its Vision 2030 economic diversification programme – potentially paving the way for further oil and gas IPOs from the region.

Gulf Monitor | Rachna Uppal | Aramco IPO

Crown Prince Mohammed bin Salman has made the privatisation of national oil company (NOC) Aramco – which last year contributed more than 75% to the Saudi economy – one of his key personal objectives. His goal is to raise $100bn from an equity listing for reinvestment in the Saudi economy as part of an ambitious development agenda. Once the IPO is approved, Aramco will become the first NOC from the six Gulf Arab states to list on the stock exchange and open up direct investment to international players.

This is unprecedented development in a region heavily dependent on oil wealth to support state revenues. Privatisation of strategic state assets is still widely regarded by local populations as a step too far in the pursuit of increased foreign investment and national economic development.

Private disquiet among both government and company officials about an equity listing, and lower oil prices than needed for the targeted valuation of $2trn led to the kingdom's decision last week to delay proceedings to conduct an IPO before the end of the year.

Would others follow? Valuations remain a worry

So far, the Abu Dhabi National Oil Company (ADNOC) is the only Gulf NOC to test a listing, through the IPO of a minority stake of its fuel retail distribution business. The unit was listed on the local Abu Dhabi stock exchange in 2017.

Last year the emirate's state-owned investment company Mubadala had to scrap plans to carry out an IPO of its 25% stake in Spanish oil refiner Cepsa after investors cautioned against what was considered an unattractive valuation amid plunging global equities.[1]

If successful, the IPO would have been the biggest by an oil company in a decade. A year on, and Mubadala has divested a 37% stake in the company to US investment firm Carlyle Group for an undisclosed amount estimated to be worth billions. Mubadala remains the majority shareholder, having bypassed an expensive, time-consuming and market-led IPO process.

Similarly, convincing analysts that a $2trn valuation of Aramco is justified has proven difficult; most estimates sit somewhere between $1trn and $1.5trn.

The company may eventually push ahead with plans, but needs to sell more than the previously reported 5% stake in order to raise the full $100bn. This would not only be politically controversial, but a highly improbable gamble amid current conditions.

Stock market and private sector reforms help engage investors

While Gulf stock markets are well established, foreign participation has until quite recently been limited, due to a mix of ownership limits as well as investor restrictions on investing in frontier markets.

Regional governments have in recent years sought to actively address these issues, increasing foreign ownership limits and diversifying the type of companies that list on the stock market. Tadawul and the Capital Market Authority have issued regulations for cross-listing, allowing companies from other Gulf countries to list on the Saudi exchange, in an effort to boost volumes and liquidity. Regulatory and disclosure requirements have also been bolstered. More significantly, four of the six regional exchanges are now included in Emerging Market indices, helping to boost inflows.

Foreign and national investors often express frustration at the lack of listed companies which are more strategically aligned to the Gulf economies; most stock markets are still heavily dominated by the financial sector.

In Kuwait, which holds the world's seventh largest oil reserves, only six of the 175 listed companies are officially from the oil and gas sector, with a handful more listed as basic materials, including petrochemical companies. In June Boursa Kuwait's acting CEO Mohamed al Osaimi, said he would like to see more listings that are representative of the country's economy, and specifically mentioned the petrochemical sector.[2]

There is clearly a long way to go – in the second quarter of this year there were only two IPOs from across the GCC, down from five in the same period a year ago. Everyone is counting on Aramco to give markets the momentum they need while at the same time wondering what kind of impact such a massive listing on a local exchange will make.

Debt markets remain attractive

Several oil and gas companies in the GCC have instead sought to diversify funding through the more attractive debt capital markets. Aramco sold $12bn in bonds earlier this year amid phenomenal investor appetite for the company's debt and, more recently, the chief financial officer of ADNOC admitted the company was evaluating a possible bond issue to take advantage of historically low rates and high demand for Gulf issues.[3]

State-owned Kuwait Petroleum Corporation is also reportedly mulling a bond issue as part of plans to borrow over $53bn over the next five years to fund its investment programme.

Investors see NOCs as a proxy for the sovereign and, therefore, the companies can secure attractive pricing for bond deals. There is also significant appetite globally for high-yield, high-grade emerging market debt, and there are definitely attractive opportunities in the GCC on a relative value basis. However, there are limitations to how much companies are willing to raise through debt sales – despite strong appetite and low rates, coupons are still pricey.

Fundamentally, Aramco's IPO will be seen as a test of the use of state assets to spur economic growth, deepen the domestic private sector, attract foreign investment and help deliver on ambitious development goals. It is a step forward in a process that could – and some argue, should – be replicated across the region.

Rachna Uppal is the Senior Analyst for Business and Finance at Castlereagh Associates, specialising in the Gulf region.

Sources:

[1]
https://www.bloomberg.com/news/articles/2018-10-15/abu-dhabi-delays-cepsa-ipo-citing-uncertain-market-conditions
[2]
https://www.thenational.ae/business/markets/boursa-kuwait-expects-two-ipos-in-next-12-months-acting-ceo-says-1.879852
[3]https://www.thenational.ae/business/energy/adnoc-evaluating-potential-bond-issue-amid-record-low-interest-rates-1.918362

