Written by **Bob Adelmann** on November 4, 2019

Saudi Arabia's Aramco IPO Fraught With Danger for Investors

When Saudi Arabia's crown jewel, oil producer Aramco (officially called the Saudi Arabian Oil Company), announced on Sunday its "intention to float" some shares in the long-awaited initial offering of shares of the state-owned oil company to the investing public (an IPO, or Initial Public Offering), it triggered two events: a "road show" or "book building" tour by the company to generate enthusiasm among mostly institutional investors for the upcoming offering of shares in December; and the issuing of a "prospectus" outlining the risks entailed by that offering. The prospectus is due out next week.

Investors would do well to read that prospectus very carefully before investing. Though it might not include every risk a new investor would be taking in buying shares when they come to market in December, those risks that will be exposed should provide plenty of reasons to exercise caution before investing.

At the press conference heralding the plan, Aramco Chairman Yasir el-Rumayyan declared: "Today is a profoundly important day for the kingdom of Saudi Arabia." That's about the only thing that was clear. Missing from his announcement was any mention of how much the company is worth or how much of it was going to be sold to the public. Information about the company has remained opaque since the Saudis completed its takeover of the Arabian-American Oil Company in 1988.

The powers-that-be used that opacity to their advantage: "We're huge, we have vast reserves and we will use them as a hammer to our advantage, so don't mess with us!" It should be remembered that following U.S. support of Israel in the Yom Kippur War in 1973, the Saudis used that advantage to punish the United States (results included long gas lines, federal 55 mph mandates on the nation's highways, daylight savings edicts, etc.).

The company's prospectus is likely to reveal that, while vast, Aramco's proven reserves aren't the largest in the world. That honor goes to Venezuela which, with its 300+ billion barrels of proven reserves, puts Aramco's 270 billion barrels decisively into second place.

It's also likely to report that the company's profits, although huge, have recently declined sharply, along with the world's price of crude. Crude oil prices have dropped some 14 percent since May, which has pressured Aramco's profits, which are down some 18 percent for the first nine of months of this year compared to the same period last year.

The prospectus should also mention the fallout from charges that Saudi Crown Prince Mohammed bin Salman had a hand in the murder and dismemberment of *Washington Post* journalist Jamal Khashoggi in October 2018. That fallout not only revealed the thuggish nature of the prince but a credit downgrade of Aramco by FitchRatings from A+ to A.

The prospectus should also note that the prince is pressuring many of the wealthy families in Saudi Arabia to ante-up to purchase at least half of the initial offering. These are the same people he charged with corruption and incarcerated last year, so his pressure amounts to coercion and blackmail. Said Gary Ross, CEO of Black Gold Investors: "Selling a small piece of Aramco in a captive market gives [the prince] more control to prop up the value of Aramco over its fair value." Agreeing with Ross that the potential exists for price manipulation due to that "captive market," Rory Fyfe, managing director at Mena Advisors warned: "With domestic players being strong-armed into investing, international investors are … going to have to value this well below the expectations of [the crown prince]."

It should also note that the prince — who is the de facto sole ruler of the country — initially hoped to value his crown jewel at $2 trillion. Those hopes have been dashed, with banks and other interested parties suggesting that the company is worth less, perhaps much less. The Bank of America, for example, estimates that Aramco is only worth $1.2 trillion. The prince initially suggested back in 2016 that he would sell five percent of the company in order to fund his Vision 2030 — a plan to diversify his country's economy away from its nearly total dependence upon oil — with enormous investments in health, education, infrastructure, recreation, and tourism.

He needs $100 billion to fund his grand scheme. He'll be lucky to get a quarter of that. Aramco's "intention to float" suggests that the prince will only sell one or two percent of his precious company in hopes that that faux price will support additional offerings in the future.

It's also clear that the prince is manipulating the numbers to make his jewel shine more brightly to potential investors. As *Bloomberg* noted, "Saudi Arabia and Aramco have reworked the company's tax burden to boost profits and hence its appeal to investors…. Those measures boosted the valuation of Aramco but analysts and investors [have concluded that] they weren't enough to reach the $2 trillion [number]." The prospectus should also note that, in order to make his offering more palatable to the unsuspecting, the prince is ordering Aramco to boost its dividend substantially in order to compete with other, better established and more transparent, oil companies, such as ExxonMobil. As the *Wall Street Journal* noted, "Aramco has promised to pay an [annual] $75 billion dividend to investors which would, at a [company valuation of $1.5 trillion] generate a dividend yield of 5 percent," making it comparable to Exxon whose yield on its common stock is also five percent.

Another warning should be obvious from the prospectus when it is released: More than 20 international banking firms entered the bidding to bring the shares to the unsuspecting market, with JPMorgan Chase, Morgan Stanley, and Goldman Sachs being among the finalists. They are in it for the fees. They are middlemen and could not care less about whether the final offering serves the needs of the average investor looking for safety and yield.

The prospectus should also note the basis upon which the company is ultimately valued: the projected world price of crude over the next two to five years. As *Bloomberg* noted, most of the banks' valuations "are based on oil prices staying above $60 a barrel and assume [that] Aramco will be able to raise oil production by 2021." Predicting the future price of oil is a risky business indeed, especially in light of a slowing world economy and the slow but accelerating shift from internal combustion engines to electric and battery-assisted power for the world's automobiles.

There are other risks as well in the prospectus that the prince hopes few will read before investing when shares are offered to the public in December: significant legal, accounting, and marketing costs; disclosing fully the previously opaque financial and business information that might prove helpful to Aramco's competitors; the risk that the $100 billion sought won't be achieved; and loss of control of the company over time to interests inimical to its own. For instance, interests in the initial offering have been expressed by two Chinese oil companies that are merely proxies for the communists running China.

As always investors in such ventures should remember that if the deal looks too good to be true, it probably is.

Image: Screenshot of ad at saudiaramco.com

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