

Saudi Aramco IPO part of Kingdom's diversification plan



Reuters/Regis Duvignau

An abundance of oil coupled with weak demand from Europe and Asia, among other factors, caused oil prices to plummet in 2014¹. While they have more recently increased, partly owing to an OPEC pact² last year to cut production, they are still low enough to threaten the financial stability of countries that rely heavily on revenues from oil exports, such as Saudi Arabia, and could impede their diversification plans.

The rationale for diversification

Given current and predicted oil supply and prices, it is understandable why Saudi Arabia has embarked on a broad economic transformation³ aimed at diversifying government revenue streams. Similar transformations have been witnessed over the years in other oil producing countries, such as Bahrain, where its focus has been on becoming a finance center, and Dubai (UAE), which established itself as a trade, banking and media hub.

At the center of Saudi Arabia's economic transformation is the IPO (Initial Public Offering) of Saudi Aramco⁴, the state owned oil company and its crown jewel. The Saudi government plans to list 5 percent of the company on the local and international stock

markets. Deputy Crown Prince Mohammed bin Salman, who oversees Saudi Arabia's economic policy and the transformation plan, estimated the company's valuation as high as \$2 trillion USD⁵, which would make the IPO worth \$100 billion USD. This is four times the size of the valuation of Alibaba at the time of its IPO and the biggest one in history.

For Saudi Arabia, the IPO will provide much-needed funds for its diversification. Proceeds and ownership of Saudi Aramco will be transferred to the Public Investment Fund (PIF)⁶, the country's sovereign wealth fund, which will become the world's largest sovereign wealth fund valued at \$2 trillion USD, ahead of the Norwegian sovereign wealth fund at \$850 billion USD (though most of that is from state-owned assets which are illiquid).

The PIF will aid in the Kingdom's economic expansion by increasing the amount of foreign investment as well as investing in industries beyond oil, such as financial services, mining, technology, and others.

Another important outcome is that the volume and quality of Saudi Arabia's oil reserves will be exposed to unprecedented scrutiny and multiple audits. This sends a clear message to both local and international communities that the Saudi government is willing to leave no stone unturned in making the new economic and social reform focused on reducing reliance on oil and development of service sectors (named Vision 2030) a success.

Diversifying at the business level

Saudi Aramco is taking steps to diversify its business as well. The company is making additional investments in the downstream refining industry in Asia and the U.S. It is also looking to expand into alternative industries such as petrochemicals and new sectors like renewables such as wind and solar. The capital raised through the IPO and the issuance of the recent sukuk (Islamic bond) will serve to facilitate this diversification.

Saudi Aramco’s strategy will in turn have ramifications for competitors like ExxonMobil, as Saudi Aramco is positioned to overtake ExxonMobil as the world’s largest refiner⁷. The acquired refineries in Asia will help the company establish a hold over the Asian market⁸ as contracts require plants to use a large percentage of oil from Aramco.

Another outcome of the Aramco IPO will be its impact on international stock exchanges and investment banks. Exchanges from Tokyo and Singapore to UK, Hong Kong and the U.S. are all clamoring to have the IPO listed in their country, while international investment banks such as the boutique firm Moelis & Co, Evercore, JP Morgan Chase, HSBC, Morgan Stanley, and local advisers like NCB Capital and Samba Capital, will reap millions in underwriting and advisory fees.

With the longer-term divergence from fossil-fuel reserves alongside environmental-preservation movements, diversification is a growing necessity. Companies like Saudi Aramco and governments such as the one in Saudi Arabia understand the importance of economic fortitude and dispersed operations for their longevity. We expect this trend to continue and strengthen.

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