

PERSPECTIVE

Aramco's Share Sale May Revitalize Saudi IPO Pipeline

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The listing of Saudi Arabia's state-owned oil company could kick-start the kingdom's initial public offering pipeline, according to our Bassel Khatoun and Salah Shamma. They discuss what the deal could mean for Saudi Arabia and the implications it has for global capital markets.

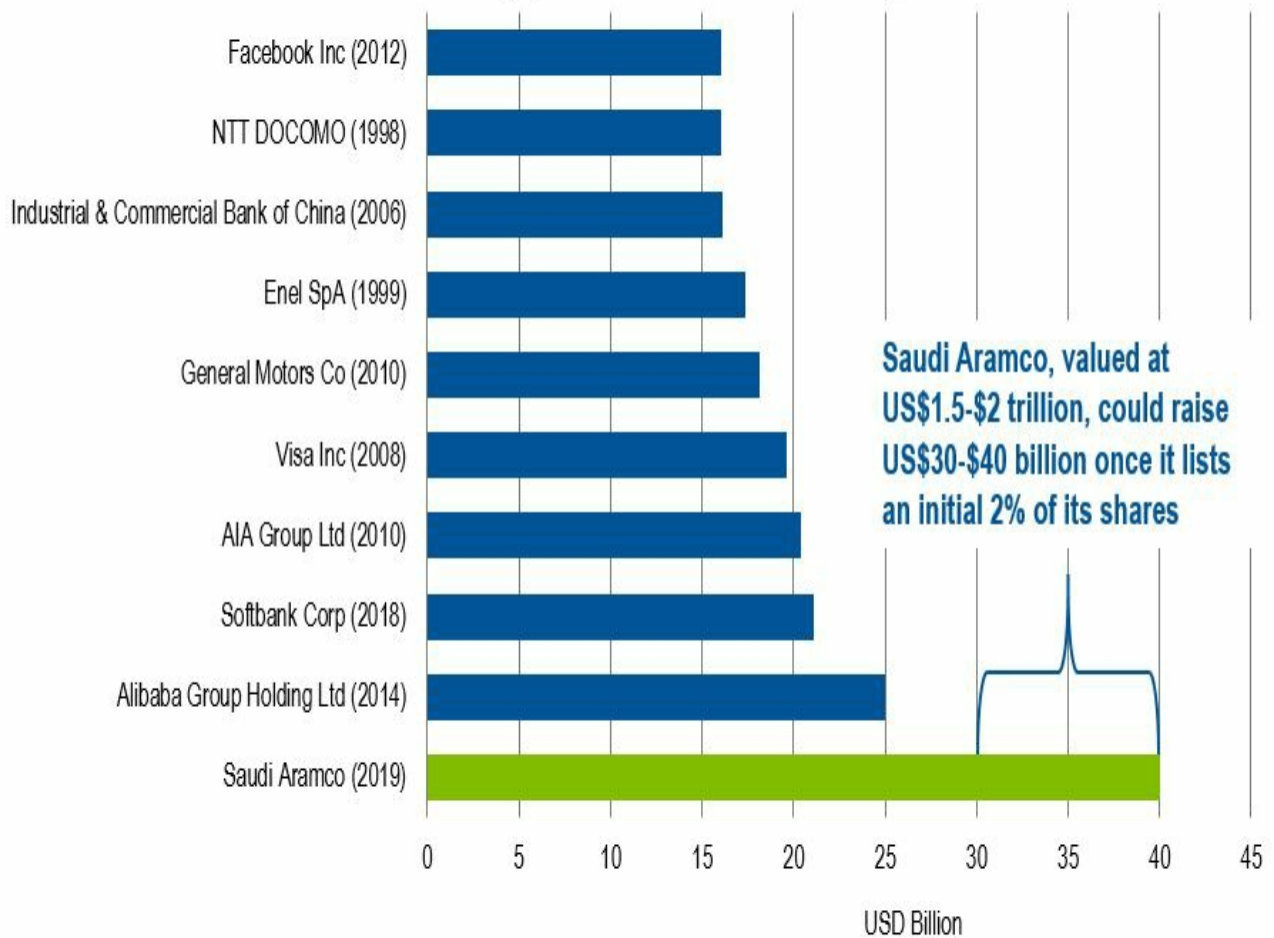
Saudi Aramco's initial public offering (IPO) is significant not just because of the company's valuation at US\$1.5-\$2 trillion, but also for the opportunity it presents to kick-start the kingdom's long-awaited privatization program. We believe this could reinvigorate the Saudi stock exchange IPO market.

Floating 5%-10% of Aramco should be a transformational deal for Saudi Arabia, in our view. A successful Aramco listing on the Saudi stock exchange (Tadawul) would provide a much-needed shot of confidence for local investors. It could also be the nudge required to bring even more Saudi companies to market. The Saudi authorities have an ambitious target of increasing the number of listed companies on the Tadawul from 193 to 250 by 2022.

We believe Saudi Aramco's IPO is a central pillar of Saudi Arabia's 2030 Vision. In our view, the broader privatization of state assets will likely accelerate the flow of foreign capital into Saudi Arabia, improve liquidity and transparency as well as continue to help diversify its economy away from its dependency on oil. The Saudi government has said it wants to raise as much as US\$200 billion through privatizations in the coming years. This includes the kingdom's target of generating US\$9 billion-\$11 billion from the privatization of assets by 2020, spanning sectors including health, water, transportation, education, municipalities, energy, sports and communication.¹

World's Biggest Initial Public Offerings (IPOs)

World's Biggest Initial Public Offerings



Source: Bloomberg, 2019.

Only two IPOs were completed on the Tadawul in the second quarter of this year, compared with four in the same period in 2018.² We feel a broader representation of different Saudi sectors on the Tadawul is needed to deepen the stock market and make it more “investable” in the eyes of international investors.

The “[halo effect](#)” of Aramco’s share sale on the country’s IPO market should not be underestimated. It’s not a stretch to imagine that with the international investor spotlight firmly on Saudi Arabia, and Aramco specifically, more local firms in the kingdom will likely look favorably on pursuing life as a publicly listed company.

WHAT’S BEEN ACHIEVED?

It is worth noting too the significant impact that Aramco's IPO will have on the Middle East and North Africa (MENA) region's capital markets and the wider emerging market universe.

Assessing the Wider Impact

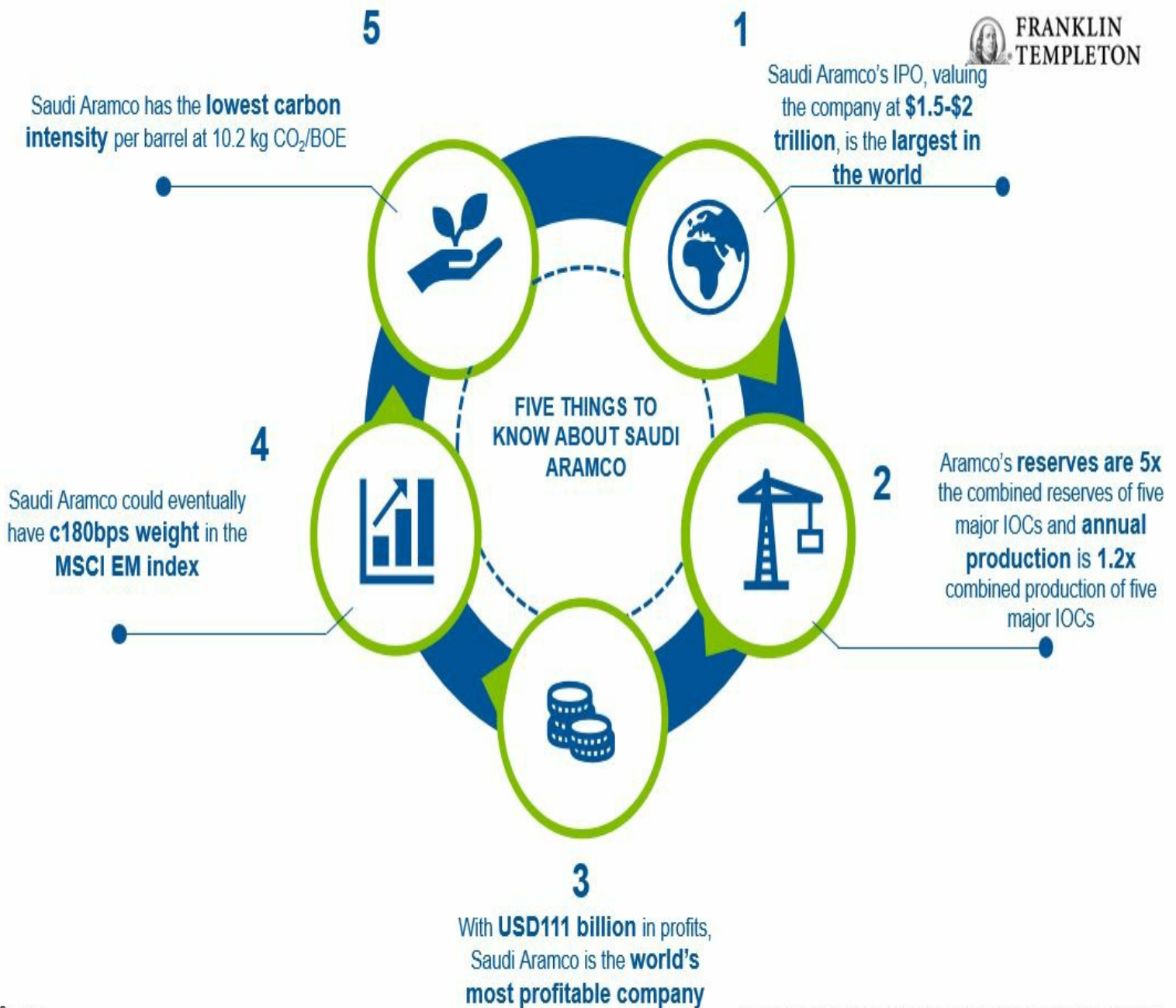
As of October 29, the MENA region accounts for 4.4% of the MSCI Emerging Market Index, with Saudi Arabia making up 2.4% of the index following its inclusion.³

This weighting should further increase to 5% when Kuwait is included in 2020. And, with Aramco likely to list 5% of the company over time, this would by our

estimations add up to 1.8 percentage points to MENA's MSCI emerging-market representation. The MENA region's overall weighting would reach close to 7%, and consequently put it on par with the likes of Emerging Europe, Brazil, South Africa and India.⁴

By bringing more local companies to market, there's an opportunity to bolster levels of corporate governance and transparency in the country as listed corporates come under the careful watch of market regulators and investors. Another upside of listing assets that were previously government-owned is that IPOs can attract large, strategic investors, often global in focus, who can bring fresh thinking and innovative ways of running a business.

In the past, we've talked about some of the "[Known Unknowns Surrounding the Public Offering of Saudi Aramco](#)." It's fair to say the company has come a long way in the past two years. Our analysis suggests Aramco's disclosures and transparency measures have improved and now appear to be more in line with industry standards and best practices. In our view, the company's mindset has moved toward a regulated, public entity.



Sources:

1. Franklin Templeton estimate.
2. Aramco Road Show Presentation, April 2019
3. Bloomberg, August 2019.

4. Saudi Arabia's weighting based on Franklin Templeton's own estimates using MSCI data.

5. Saudi Aramco.

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What's Next?

In general, we believe that as Saudi Arabia's privatization program gains momentum, the flow of foreign capital into Saudi Arabia will likely accelerate, helping increase stock market liquidity and further improve levels of corporate governance and transparency.

Rules and regulations governing IPOs in Saudi Arabia are also evolving. Work on the ground in Saudi Arabia continues at an impressive pace to eradicate some of the hurdles companies face when contemplating an IPO. The country's Capital Markets Authority (CMA) should be applauded for the hard work it has undertaken over the previous few years in making the Tadawul more accessible and attractive to global investors, meaning investors in the kingdom should continue to benefit from a more institutionalized and liquid stock market.

Recently issued regulations aimed at allowing companies from other Gulf countries to cross-list on the Tadawul is further proof of the forward-thinking approach that the Saudi regulator is adopting to help grow and develop the stock market. This is exactly the type of innovative behavior that will, over time, encourage more companies to eye a listing on the Saudi stock market. But the momentum for change can't stop here and there's still plenty of scope for further reforms.

A successful Aramco listing, in our view, would highlight just how far the local market has come in such a short space of time. The IPO could also be the much-needed catalyst to carry out other future marquee privatizations laid out in the country's Vision 2030 strategy. We believe this latest development bodes well for the development of Saudi Arabia's stock market and reinforces the kingdom's reputation as a rising star within the emerging market universe.

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1. Source: Saudi Government, October 2018.

2. Franklin Templeton estimate, based on calculation of index weighting.

3. The MSCI Emerging Markets Index captures large- and mid-cap representation across 24 emerging-markets countries. Indexes are unmanaged and one cannot directly invest in them. They do not reflect any fees, expenses or sales charges. MSCI makes no warranties and shall have no liability with respect to any MSCI data reproduced herein. No further redistribution or use is permitted. This report is not prepared or endorsed by MSCI. Important data provider notices and terms available at www.franklintempletondatasources.com.

4. PwC IPO Monitor Report, 2019.
