
From: Richard Kahn <[REDACTED]>
Sent: Monday, February 27, 2017 7:32 PM
To: jeffrey E.
Subject: Fwd: ***HOW TO THINK ABOUT the SAUDI ARAMCO IPO...(it's a perpetual bond offer)***

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Begin forwarded message:

From: =/b>"Ens, Amanda" <[REDACTED]>
Subject: =/b>***HOW TO THINK ABOUT the SAUDI ARAMCO IPO...(it's a perpetual bond offer)***
Date: =/b>February 27, 2017 at 12:39:59 =M EST
To: =/b>"Rich Kahn"<[REDACTED]>
Reply-To: =/b>"Ens, Amanda" <[REDACTED]>

HOW TO THINK ABOUT the SAUDI ARAMCO IPO...(it's a perpetual bond offer)

The Aramco IPO process continues to gain momentum and the press is still anchoring the market on the \$100bn figure for a 5% stake in a \$2tr total valuation. That figure is starting to be questioned, however, with WoodMac reportedly giving an alternative DCF value of only \$400bn, which depends on tax scenario assumptions. As the debate heats up, here are 3 points worth considering re: how to value Aramco:

1. Does Saudi Aramco have an equity story? Consider this: Aramco supposedly has 260-270bn barrels of reserves. Round numbers, Saudi produces c. 10mb/d = 3.65bn barrels per year, so more than 70 years of reserves. Would the market really care if the expert work shows that Aramco has 80 years of reserves or only 60? I would argue that the equity value here is not about the reserves in the ground.
2. So what really matters is the dividend payout policy. That will surely be clearly articulated in the offer document, and of course investors will have to make a judgement call on the risk that the policy gets revised at some point in the future...
3. Which means valuation is function of the spread over the Saudi sovereign rate. Saudi Arabia is rated A1 at Moody's, the fifth-highest investment grade; and the record bond offering in October priced 30 year money at 210bps over US Treasuries. Right now the US 30-year is just under 3%. So for argument's sake let's say that Aramco should yield 6%...to be worth \$2tr, using the perpetual bond formula, it would need to pay out \$120bn a year to investors forever. That might be a big ask given the royalties and the 85% income tax rate? To be worth WoodMac's \$400bn, it would need to pay out \$24bn. To put that in perspective, RDS's 7% yield implies a payout of about \$15bn per year...

NB: If the Aramco IPO goes well, maybe other OPEC nations will IPO stakes in their NOCs?

Happy to discuss.

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