Saudi Aramco
Oil & Gas
Aramco AB: Saudi Arabia
9 August 2021

الراجحي المالية
Al Rajhi Capital

US$1.875trn	1.78%	US$49.5mn
Market cap	Free float	Avg. daily volume

Target price	35.00	-0.4% over current
Current price	35.15	as of 08/08/2021

Existing rating

Underweight	Neutral	Overweight

Earnings

(SARbn)	2020	2021E	2022E
Revenue	768	1,227	1,421
Y-o-Y	-30.5%	59.8%	15.8%
Operating profit	383	688	762
Operating margin	49.9%	56.1%	53.7%
Net profit	185	355	387
Y-o-Y	-44.1%	92.1%	8.8%
Net margin	24.1%	28.9%	27.2%
EPS (SAR)	0.93	1.78	1.93
DPS (SAR)	1.40	1.40	1.40
Payout ratio	151.3%	78.8%	72.4%
Dividend yield	4.0%	4.0%	4.0%
P/E (Curr)	38.0x	19.7x	18.1x
P/E (Target)	37.8x	19.7x	18.1x

Source: Company data, Al Rajhi Capital.

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Saudi Aramco

Q2: Earnings in-line; TP maintained at SAR35/sh.

Aramco reported in-line Q2 results with top-line and bottom-line improving on the back of higher oil prices, increased production, and better refining and chemical margins. Q2 DPS was also in line at SAR0.3518/sh. During the quarter, the company generated a robust FCF of US$22.6bn (US$40.9bn in H1 2021), up by ~23% q-o-q, supported by oil prices and an efficient capex program. The FCF now sufficiently covers its quarterly dividend payment (US$18.76bn) and also its incremental capex. The gearing ratio also improved by 3.6pps to 19.4% in Q2 2021. Going forward, sustainable recovery in oil prices (assumed ~US$68/bbl. average price for 2021) amid healthy oil demand, a gradual rise in production as per the new agreed output quota, better-operating efficiencies, and healthy refining and chemical margins would ensure a strong cash flow generation for Aramco in 2021. Further, the decision to sell a 49% stake in Aramco Pipeline subsidiary (Aramco Oil Pipelines Co.) further strengthens its financial structure this year, enabling the company to cover its annual dividend commitment, fund its incremental capex (+30% y-o-y), and improve its gearing ratio to the 5-15% target.

Overall, we remain positive on Aramco, given its ability to maintain dividends backed by healthy FCF generation (as long as it remains over US$1.3bn, which is the payment to non-government shareholders based on 1.78% free float), optimization of its capex program, and healthy balance sheet. We reiterate our target price of SAR35/share, which is based on a 4% dividend yield on 2021 DPS of SAR1.4/sh.

Figure 1 Aramco's Q2 2021 results

(SAR bn)	Q2 2021	Q2 2020	Y-o-Y	Q1 2021	Q-o-Q	ARC est	vs ARC
Revenue	**312**	**123**	**153.5%**	**272**	**14.8%**	**306**	**2.1%**
Operating costs	(133)	(70)		(120)		(132)	
Operating profit	**179**	**53**	**237.4%**	**152**	**17.9%**	**174**	**2.9%**
Operating margin	57.3%	43.1%		55.8%		56.9%	
Net profit (before minority)	**95**	**25**	**287.8%**	**81**	**17.2%**	**94**	2.1%
Net margin	30.6%	20.0%		29.9%		30.6%	

Source: Company data, Al Rajhi Capital

Q2 results: Q2 revenues jumped 14.8% q-o-q to ~SAR312bn (in line with our and consensus estimates), mainly driven by improved oil prices and hydrocarbon production. Further, higher refining and chemical margins, and controlled operating expenses offset increased royalty expenses related to oil production, pushing operating profits to SAR179bn (in-line). Overall, net income (before minority) reported at SAR95bn, matching our estimate of SAR94bn (consensus of SAR90bn)

The OPEC+ recent deal aids stability to the market. Post sustainable recovery in the global economy, OPEC+ countries, last month, agreed to boost the oil production by a further 2mmbpd over Aug-Dec 2021, implying a gradual production rise of 0.4mmbpd each month. OPEC+ also plans to fully phase out the 5.8mmbpd reductions by the end of Sep 22, subject to market conditions. Further, Saudi Arabia will also witness a revision in its baseline production from 11mmbpd to 11.5mmbpd from May 2022, implying higher Saudi oil production going forward. Overall, we believe that the gradual rise in supply may prevent a tighter market and provide the much-need stability in the oil market. While the demand is likely to remain healthy with the economies continuing recovering post roll-out of the vaccination program, the emergence of Delta variants may pose a credible threat to oil demand's recovery. Nonetheless, oil prices are likely to remain at around US$70 in H2 2021, implying an average price of US$68/bbl for 2021 (+56% y-o-y rise). Higher oil prices and increased production could help all the major IOCs including Aramco to witness strong earnings this year.

Annual dividend to remain intact. For Q2 2021, the company declared a total ordinary dividend of US$18.76bn/SAR70.33bn (SAR0.3518/share; in line with our expectation). Given improving oil market dynamics, sustainable earnings recovery, healthy FCF, and strong balance sheet, we expect the company to distribute at least US$75bn (~SAR280bn; SAR1.4/sh.) dividend for 2021, implying a dividend yield of ~4% based on the current price. If oil prices sustain at the current level (US$71/bbl as of 6 August 2021), then there is a possibility of an increase in the distribution beyond the current dividend pledge, in our view.

Q2 2021 operational data

- Average hydrocarbon production for Q2 2021 reported at 11.7mmboed (vs. 11.5mmboed in Q1 2021), largely in line with our expectations.
- Supply reliability: 100% in Q2 2021 (100% in Q1 2021).
- Gearing: 19.4% in Q2 2021 (vs. 23% in Q1 2021).

Capex: Q2 capex recorded at ~SAR28bn (~US$7.5bn), up by 20% y-o-y; however, it came in lower than our estimate. For 2021, the company reiterated its annual capex guidance at around USD35bn (2020 capex: US$27bn), implying a capex of ~US$19bn in H2 2021 (H1 2021 capex: US$15.7bn).

Valuation: Despite showing multiple methods for valuing the company in our initiation (Dividend haven. Initiate at US$2trn), we used the required dividend yield (4%) method for valuing Aramco given the "soft guarantee" of dividends (SAR1.4/share). Consequently, our TP stands at SAR35/sh., implying a Neutral rating based on the current market price. We view Aramco more like a bond and hence value it unconventionally.

Risks: Key downside risk to our valuation is a surge in interest rates which looks unlikely at this point. Other downside risk factors to our estimates are lower-than-expected dividends, geo-political tensions, delay in recovery in oil prices, and further slowdown in the global economy.

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