Saudi Aramco
Oil & Gas
ARAMCO AB: Saudi Arabia
10 August 2023

US$2.139trn	9.81%	US$62.46mn
Market Cap	Free Float	Avg. Daily Volume

Target price	35.00	5.6% above current
Current price	33.15	as at 09/08/2023

Existing rating

Underweight | **Neutral** | Overweight

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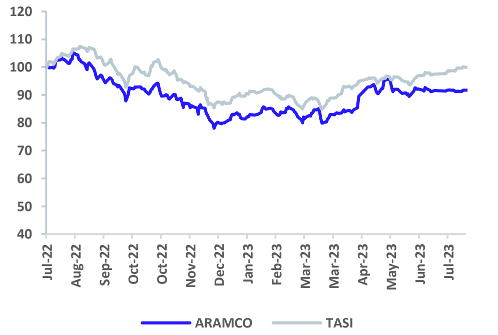
Performance(Rebased to 100)



Earnings

SAR(bn)	2022A	2023E	2024E
Revenue	2,007	1,620	1,716
Y-o-Y	49.0%	-19.3%	5.9%
Operating income	1,144	867	968
Operating margin	57.0%	53.5%	56.4%
Net Profit	597	454	494
Net Margin	29.8%	28.0%	28.8%
EPS (SAR)	2.47	1.87	2.04
DPS (SAR)*	1.17	1.21	1.21
Payout ratio	47.5%	64.5%	59.2%
Dividend Yield**	3.9%	5.2%	3.9%
P/E (Current)	13.4x	17.7x	16.2x
P/E (Target)	13.9x	18.4x	16.9x

Source: Company data, Al Rajhi Capital.
*DPS includes only base dividend
** Dividend Yield calculation includes performance linked dividend.

Saudi Aramco

Performance linked dividends to boost yield in the short run

Aramco's Q2 earnings came largely in line with expectations, driven by lower realised crude oil prices (-2.7% q-o-q). The company has declared a base dividend of SAR0.3024/sh for Q2 2023 besides a performance linked dividend of SAR0.1530/sh. The announcement of performance linked dividend, earlier and higher than expected reiterates the company's strong financial position despite challenging macros. The company reported Q2 2023 FCF of US$23.2bn. Further, the gearing ratio improved to -10.5% as of June 2023 versus -10.3% as of Mar 2023.

We believe that earnings pressure for Aramco may continue for 2023 at the back of lower production by the company in line with the voluntary output reduction by OPEC+. However, H2 2023 may be marginally better than H1 2023 underpinned by the recovery and stability in crude oil prices. The crude oil prices slipped lower sequentially in Q2 2023 fuelled by continued global slowdown and higher inflation levels. Nonetheless, we expect the oil market fundamentals to remain resilient, as OECD commercial inventory levels appear balanced at 2.8mmbpd as per June 2023. Besides, the world oil consumption is hovering above pre-pandemic levels and is further expected to rise with weakening of macroeconomic challenges. Furthermore, we continue to maintain a positive view on the company, mainly due to its i) healthy balance sheet coupled with the strong operating cash flow capable of maintaining a high capex outlay and dividend outflow, ii) on-track and well defined long-term upstream and downstream expansion plan, iii) progress in the Al-Jafurah gas field project which shall drive growth in the unconventional space, iv) intention to increase its oil production capacity to 13mmbpd by 2027 and v) company's confidence in its fundamentals by rewarding shareholders through performance linked dividends. Nevertheless, resilient oil prices will contribute positively to the earnings in order to offset the impact of production cut. Overall, post Q2 2023 earnings, we slightly increase our TP to SAR35.0/sh (earlier SAR34.5/sh) implying 'Neutral' rating.

Performance Linked Dividends: In our view, Aramco's strong profitability and robust cash flows will enable the company to keep paying higher Performance linked dividends for the coming 6 quarters as the horizon for free cash flow calculation will increase. Post that, Aramco will go back to the original mechanism of single year cash flow that will be distributed over the following four quarters and the dividend may vary. Our calculations are based on forward oil price estimate of ~US$85/bbl for Q3 2023 and Q4 2023 with lower oil production pegged at 9.5mmbpd for FY24.

Figure 1 **Performance Linked Dividend Declaration**

(SAR bn)	Q2 2023	Q3 2023*	Q4 2023*
Free Cash Flow for Performance Linked Dividend	127	139	152
FCF net of base dividend for Performance Linked Dividend	53	66	79
Performance Linked Dividend (50-70%)	***37***	***40***	***47***
Performance Linked Dividend (USD bn)	***9.97***	***10.60***	***12.66***

Source: Al Rajhi Capital; *ARC estimates

Q2 2023 results: Top-line decreased ~2.5% q-o-q to ~SAR448bn and was slightly above our estimates of SAR435bn. However, top-line ex other income was broadly in line with our estimates. Weaker oil prices despite increase in overall hydrocarbon production at 13.5mmboed (vs 12.8 mmboed q-o-q) lead to margin compression in chemical and refining business. The operating profit was a tad bit above our estimates, while net income (before minority) was reported at ~SAR113bn, modestly in line with our estimates of SAR112n (consensus: SAR117bn).

Figure 2 **Q2 2023 Earnings**

(SAR bn)	Q2 2023	Q1 2023	Q2 2022	ARC Est.	Cons Est.	y-o-y	q-o-q	vs ARC	vs Cons
Revenue	448	460	648	435	424	-30.9%	-2.5%	3.0%	5.7%
Op. costs	-236	-238	-324	-226	NA	-27.2%	-0.8%	4.5%	*NM*
Op. Profit	**213**	**222**	**324**	**210**	**NA**	**-34.5%**	**-4.3%**	**1.4%**	***NM***
Op. margin	*47.4%*	*48.3%*	*50.0%*	*48.2%*	*NA*				
Net Profit*	**113**	**120**	**182**	**112**	**117**	**-37.9%**	**-5.6%**	**0.6%**	**-3.9%**
Net margin	*25.2%*	*26.0%*	*28.0%*	*25.8%*	*27.7%*				

Source: Company data, Al Rajhi Capital; *Net profit before minority

Valuations: For 2023, we expect the quarterly run rate of base dividend to be in line with the current levels of Q2 2023. Given the company's intention to reward its shareholders by way of performance-linked dividends, we expect the overall dividends to potentially increase over the next 2 quarters, the payment of which shall be spread out over FY24. In consequence to that, the company will continue to trade at high dividend yield for the coming quarters. We believe the company is driven by longer-term goals and is likely to exhibit resilience and stability. To capture this potential growth, we use the DCF valuation method (8.83% cost of equity; 7.8% WACC), implying a TP of SAR35.0/sh maintaining our Neutral rating on the stock.

Risks: The key downside risk to our valuation is a steep fall in crude prices. Other downside risk factors to our estimates are lower-than-expected dividends, deepening of geo-political tensions, lower than-expected production, and further slowdown in the global economy.

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"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

"Target price": We estimate target value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

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