Saudi Aramco
Oil & Gas
Aramco AB: Saudi Arabia
28 August 2022

US$2.270trn	5.81%	US$58.92mn
Market cap	Free float	Avg. daily volume

Target price	42.00	+8.5% over current
Current price	38.70	as of 28/08/2022

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Existing rating

Underweight	Neutral	Overweight

Earnings

(SARbn)	2021	2022E	2023E
Revenue	1,347	2,076	2,039
Y-o-Y	75.4%	54.1%	-1.8%
Operating profit	772	1,209	1,198
Operating margin	57.3%	58.3%	58.7%
Net profit	395	638	591
Y-o-Y	113.7%	61.4%	-7.4%
Net margin	29.3%	30.7%	29.0%
EPS (SAR)	1.80	2.90	2.69
DPS (SAR)	1.27	1.28	1.28
Payout ratio	70.8%	44.1%	47.6%
Dividend yield	3.3%	3.3%	3.3%
P/E (Curr)	21.5x	13.3x	14.4x
P/E (Target)	23.4x	14.5x	15.6x

Source: Company data, Al Rajhi Capital.

Saudi Aramco

Q2: In-line operating performance; Remain Neutral

Aramco reported record quarterly earnings since its IPO in 2019 (slightly above our and consensus estimates), aided by higher oil prices (+16% q-o-q), increased hydrocarbon production (+2% q-o-q) and better refining margins. The company generated FCF of US$34.6bn in Q2 2022 (vs. US$30.6bn in Q1 2022; significantly above the dividends of US$18.8bn), driven by increased operating cash flows. Further, the gearing ratio improved to 7.9% as on June 30, 2022 (within its target of 5-15%) from 14.2% as on Dec 31, 2021, providing enough room to increase the spending (US$40-50bn capex guidance for 2022 vs US$31.9bn in 2021) and further deleveraging its financial position.

We see Q2 record performance as an exception and may not be repeated in the near term, given the slowdown in the global economy amid rising inflation, lower demand (particularly in China amid the lockdown), and easing geopolitical tensions. Average oil prices are already down by ~9% so far in Q3 and are likely to remain below the Q2 2022 level. However, total hydrocarbon production is expected to increase by ~4% q-o-q in Q3, aided by an ongoing ramp-up in production amid the OPEC+ agreement. Overall, we expect Aramco to witness a slight decline in earnings in Q3. However, the medium to long-term outlook remains positive, driven by i) healthy demand, ii) an increase in MSC from 12mmbd to 13mmbd by 2027, iii) higher gas production (+50% by 2030) iv) a robust balance sheet. Despite rising production, the company's upstream carbon intensity (targeting 15% reduction by 2035) still remains low compared to its major global peers. The stock currently offers a dividend yield of 3.3%, which will continue to provide support to the share price. We remain Neutral on Aramco with a TP of SAR42/sh.

Figure 1 Aramco's Q2 2022 results

(SAR bn)	Q2 2022	Q2 2022	Q2 2021	Q2 2020	*ARC Est.*	*Cons Est.*	*q-o-q*	*y-o-y*	*% ch vs 2020*	*vs ARC*	*vs Cons*
Revenue	**562.1**	**467.0**	**312.4**	**123.2**	**559.1**	**578.1**	***20.4%***	***79.9%***	***356.1%***	***0.5%***	***-2.8%***
Op. costs	(237.6)	(189.3)	(133.2)	53.1	(233.9)	NA	*25.5%*	*78.3%*	*-547.5%*	*1.6%*	*NM*
Op. profit	**324.5**	**277.7**	**179.1**	**53.1**	**325.2**	**NA**	***16.8%***	***81.2%***	***511.2%***	***-0.2%***	***NM***
Op. margin	*57.7%*	*59.5%*	*57.3%*	*43.1%*	*58.2%*	*NA*					
Net profit	**181.6**	**148.0**	**95.5**	**24.6**	**171.3**	**170.7**	***22.7%***	***90.3%***	***637.7%***	***6.0%***	***6.4%***
Net margin	*32.3%*	*31.7%*	*30.6%*	*20.0%*	*30.6%*	*29.5%*					

Source: Company data, Al Rajhi Capital

Q2 results. Top-line increased ~20% q-o-q to ~SAR562bn, in line with our estimate (SAR559bn) but slightly lower than the consensus (SAR578bn) estimate. The sequential growth was mainly driven by higher oil prices and increased sales volume. Further, as expected, production costs were up by 25.5% q-o-q, resulting in a largely in-line operating profit. During the quarter, the company witnessed an improvement in the share of results of JVs and associates as well as generated higher finance and other income – both were higher-than-expected. Accordingly, net income (before minority) was reported at ~SAR182bn, above our estimate of SAR171bn (consensus: SAR171bn).

Valuation. For 2022, we expect the company to maintain DPS at SAR1.28, although it can potentially/gradually increase it further. This is because 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 and keep our TP unchanged at SAR42/sh., implying a Neutral rating.

Risks. The 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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"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.

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