The Carnegie Counselor

THE CARNEGIE INVESTMENT COUNSEL NEWSLETTER THIRD QUARTER 2016

Just say no to the largest IPO

Over the last 120 years, more than 200,000 companies have become publicly-traded stocks via an Initial Public Offering (IPO). The reasons for becoming a publicly-traded company are usually: the need to raise capital, disperse risk, create a payday for the original investors, reduce debt or expand the awareness of the enterprise.

Once a company is no longer private, typically the shares will trade on a major exchange such as the New York Stock Exchange, NASDAQ, London Stock Exchange, etc. This is no guarantee of success considering less than 5,000 companies are still registered with the NYSE and NASDAQ combined. The investment banks on Wall Street will heavily promote a new company to build interest and demand to raise the capital necessary to go public. All this year there has been talk of the largest IPO in history and the investment banks are in full hype promoting the benefits of this enterprise. It will be bigger than Microsoft, Google and Facebook combined, yet Carnegie has no plans to participate.

In 1933, Saudi Arabia had neither the technology nor capital to explore its country for oil so they signed a Concession Agreement giving Standard Oil of California (SOCAL) exclusive rights. By 1939 the first oil tanker sailed away full of Saudi crude. SOCAL and Texaco created a joint effort which became the Arabian American Oil Company (ARAMCO). The infusion of capital fueled the rapid development of Saudi oil fields, and ARAMCO became the largest oil-producing company in the world. After the Arab-Israel War of 1973, Saudi Arabia placed considerable pressure on the U.S. threatening an oil embargo if another war broke out. In June of 1974 Saudi Arabia took over 60% of ARAMCO and by the end of the year the government told the remaining unwilling ARAMCO shareholders that it wanted 100% of the company. By 1980, the Saudi government had forced out the remaining shareholders and were in full control of this company founded by Americans and built with U.S. capital and technology.

The success of ARAMCO is unquestioned. The company produces more than 10% of the world's oil supply every day and controls a large chain of refineries and petrochemical

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facilities. The oil company generates an estimated $180 billion in profit per year to Saudi Arabia, which represents over 40% of its economy. It is estimated nearly 90% of the Saudi government's budget comes from oil profits. It employs over 65,000 people with revenues of over $378 billion per year. It is the most profitable company the world has ever known, so why would we not jump at the chance for Carnegie clients to participate in this largesse? The reasons are varied and borne from unbiased experience.

It is important to understand why ARAMCO would consider selling part of the company. It is expected they would only be willing to part with a 5% stake in the company, which would still raise nearly $100 billion. A minor shareholder has no control or voice in the company, so other than being forced to a higher reporting standard than previously, there is no loss of control by ARAMCO. The kingdom also knows that its century's worth of oil reserves may very likely never be used as the world shifts to greener energy sources. Coupled with advanced technology discovering new oil reserves in other countries, the cartel ARAMCO has on energy is quickly fading. It is selling now to reap some money while the going is good.

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The Saudi kingdom had a budget deficit of $98 billion last year due to an ever-increasing population living on the government dole. The House of Saud is the ruling royal family of Saudi Arabia and is estimated to have over 15,000 members composed of the descendants of Muhammad bin Saud. They are all provided drivers, armed guards, free education, healthcare and lavish living accommodations. When the price of oil fell from over $140/ barrel to below $40/ barrel, the Saudi government had to start tapping their immense bank reserves to keep the government afloat. It was estimated by a Houston-based analyst visiting Carnegie this year that they have had to spend down 30 years of savings in the last two years.

Global investment bankers have been in a race to win the prize to bring ARAMCO public. The company's net worth is estimated to be above $2 trillion. By comparison, the largest U.S. company, Apple Inc., has a market cap of ~$550 billion. If ARAMCO sells 5% of the company, raising $100 billion could reap fees for the investment bankers exceeding $1 billion. Greed is good for Wall Street but not for our clients. Even if we could overlook Saudi Arabia's poor environmental track record, lack of women's rights in the country, limited support of accounting requirements, questionable ethical standards, being an adversary to Israel, and its ties to terrorism around the world, we wouldn't buy shares of ARAMCO. In our view, it is a desperate attempt by a failing government to raise capital by selling the only asset they have left. A minor interest in a declining business managed by the Saudis is not an investment we will support.

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