



## Energy Sold Surprisingly Declines

Key takeaway from 2Q16 results was -5% decline in sold energy, primarily to high margin Industrial users. Slowing economy, Ramadan and efficiency gains may have been contributing factors as SAR 0.34 EPS (-28% Y/Y) missed our SAR 0.55 estimate. This in our view is a blip as longer term objective of energy subsidy reform remains on the cards. We continue to advocate SECO as a direct and quantifiable beneficiary of the NTP. Maintain Buy recommendation and SAR 31 target price.

### Revenues weaker than expected

Average realized sale price jumped +16% during 1H16 to 15.4 halalah/kwh versus year ago period, propelling total revenues to SAR 13.2 bln (+11% Y/Y) shy of our forecast SAR 14.6 bln. Industrial users curtailed consumption mainly by relying on captive energy. Higher energy costs have featured less prominently in 2Q16 results across our coverage universe, suggesting that efficiency gains are taking hold. Further, we believe with Ramadan coinciding entirely with 2Q may have contributed to consumption pattern. Although total customers increased +7% Y/Y to 8.35 mln, sold energy per customer declined -11%. As a result, the full impact of tariff hike was diminished by lower usage. Premature to conclude if slowing economy is tapering energy consumption until at least one more quarter.

### Higher fuel costs dent margins

Gross margins contracted to 11.8% from 17.5% in 2Q15 on +68% increase in fuel costs and some SAR 80 mln higher than expected depreciation. Although we were conservative in our cost of sales assumptions, weaker revenues led to lower gross profit.

### Earnings shrink

As expected, tariff hike may negatively impact receivables prompting the Company to book higher provisions. Overall weakness across all profit lines drove -28% Y/Y earnings contraction to SAR 1,426 mln, widely missing our estimate SAR 2,279 mln.

### Next tariff hike

With the objective of rationalizing government expenditure, we believe focus will remain on restructuring the energy sector subsidies. Further tariff hikes remain on the horizon but the increase in fuel costs may pause, translating into disproportionate advantage for SECO. The Company has long argued that tariffs have to be the centerpoint of any discussion on optimizing energy usage in the country, and 2Q results are hinting at efficiency gains.

SECO (SAR mln)	2Q16	2Q16E	2Q15	Y/Y Chg	1Q16	Q/Q Chg	Variance
Revenues	13,213	14,561	11,917	11%	8,902	48%	-9%
Electricity sales	12,135	13,545	11,012	10%	7,606	60%	-10%
Meter reading	295	301	291	1%	292	1%	-2%
Connection tariff	569	591	514	11%	548	4%	-4%
Transmission	79	106	88	-11%	331	-76%	-26%
Other	136	18	12	1042%	124	10%	662%
Gross profit	1,563	2,480	2,087	-25%	(1,204)	-230%	-37%
Gross margin	11.8%	17.0%	17.5%		-13.5%		
EBITDA	5,698	6,434	5,537	3%	2,778	105%	-11%
EBITDA margin	43.1%	44.2%	46.5%		31.2%		
Operating profit	1,274	2,234	1,869	-32%	(1,383)	-192%	-43%
Operating margin	9.6%	15.3%	15.7%		-15.5%		
Net income	1,426	2,279	1,971	-28%	(1,374)	-204%	-37%
Net margin	10.8%	15.7%	16.5%		-15.4%		
EPS	0.34	0.55	0.47		(0.33)		

## SAR 31

12-Month Target price

## Buy

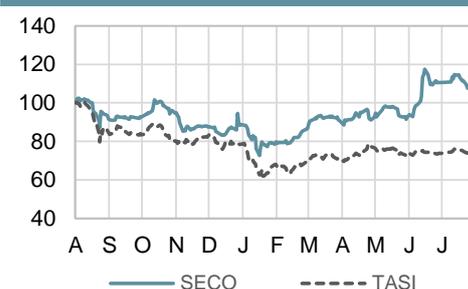
Recommendation

Stock Details		
Last Close Price	SAR	18.85
Upside to target	%	64.5
Market Capitalization	SAR mln	78,521
Shares Outstanding	mln	4,166
52-Week High	SAR	21.80
52-Week Low	SAR	12.40
Price Change (YTD)	%	20.0
12-Mth ADTV	mln	2.0
EPS 2016E	SAR	0.51
Reuters / Bloomberg	5110.SE	SECO AB

2Q2016 (SAR)	Actual	SFC Est
Revenues (mln)	13,213	14,561
Gross Profit	1,563	2,480
EBIT (mln)	1,274	2,234
Net Income (mln)	1,426	2,279

Price Multiples			
	2015	2016E	2017E
P / E	50.9x	37.2x	32.9x
Adj EV / EBITDA	17.2x	15.2x	14.1x
P / S	1.9x	1.5x	1.3x
P / B	1.3x	1.3x	1.2x

### 1-Year Share Performance



Source: Bloomberg, Tadawul, SFC

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## Research and Advisory Department

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### Rating Framework

#### **BUY**

Shares of company under coverage in this report are expected to outperform relative to the sector or the broader market.

#### **HOLD**

Shares of company under coverage in this report are expected to perform inline with the sector or the broader market.

#### **SELL**

Shares of company under coverage in this report are expected to underperform relative to the sector or the broader market.

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