SAUDI ELECTRICITY COMPANY

Recommendation Upgrade Following Increase in LTFV

21 MAY 2008

SAUDI ARABIA | UTILITIES

ST Rec.: Accumulate	Current Price*: SAR 12.75
LT Rec.: Buy	LT Fair Value : SAR 18.00

• **Results in Line:** Saudi Electricity Company reported a 1Q2008 net loss of SAR771 million, up from a net loss of SAR434 million in 1Q2007 and broadly in line with expectations. It is worth noting that the company traditionally makes a loss in both its first and final quarters as a result of the relatively cooler weather from October to March, which leads to lower demand for power during these periods. SEC attributed its losses to the increasing cost of materials and services, and the increasing depreciation expense, which resulted from the increase in its asset base, with some new plants and stations coming online in 1Q2008.

• **Build-out Phase to Mute Short Term Earnings Growth:** In order to meet the growing demand for electricity in Saudi Arabia, the company will undertake a significant capital expenditure program in the short term. Indeed, SEC has announced that it will spend SAR28 billion on capex in 2008 alone. With the majority of its build-out phase to be completed by 2010, we expect earnings growth for SEC to accelerate from 2010 and beyond.

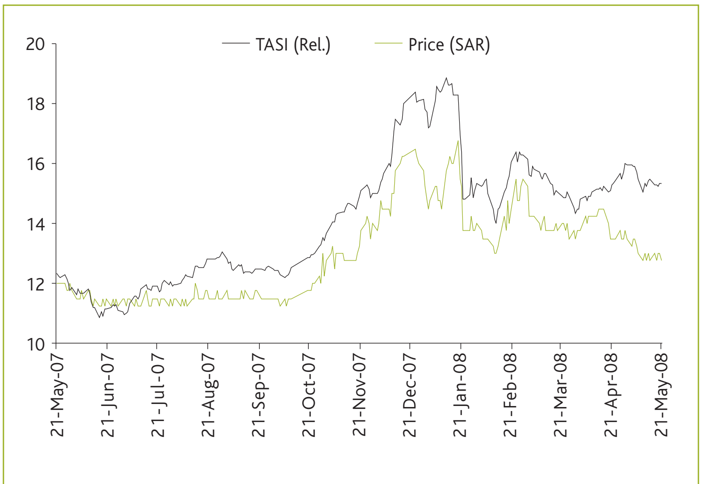
• **Potential Upside from Increase in Tariffs:** We believe that further potential upside lies in the possibility that tariffs, which are low as a result of government restrictions imposed on SEC, could be adjusted upwards in the future, boosting the company's returns, although this is not currently within our forecasts.

• **Attractive Dividends for Public Shareholders:** SEC’s proposed dividend payment of SAR0.70 per share for FY2007 provides a dividend yield of 5.5% (at the current share price). With the government (which owns approximately 81% of the company directly or indirectly) continuing to waive its right to dividends until 2010, the proposed dividends will only be distributed to public shareholders therefore increasing the value of shares held by the public relative to those held by the state.

• **Increase in LTFV to SAR18.0/Share from SAR14.3/Share:** We believe our estimates for the full year and beyond remain underpinned and continue to look for a FY2008e net profit forecast of SAR1.6 billion. However, a change in the company’s net debt figure since we last set our Long Term Fair Value, changes the debt and equity mix of SEC. Due to the company’s lower cost of debt (given its Government interest-free loans), this change leads to a disproportionately larger fall in our WACC, and coupled with the impact of our valuation point moving forward by six months since we last published on the stock means that our LTFV estimate rises from SAR14.3 to SAR18.0 per share, offering 41% upside to the current share price of SAR13.0.

• **Upgrade Recommendation:** We continue to believe that SEC will play the key role in helping the Kingdom meet its future electricity needs, with the company being responsible for the vast majority of the electricity generation and all of the electricity transmission and distribution activities. However, this will result in extensive capital expenditure in the short term, although the company benefits from governmental support through interest-free loans and dividend waivers. Given the upside offered by our new LTFV and the company looking attractive on both a P/BV (1.1x) and a dividend yield basis (5.5%), we upgrade our LT recommendation from Accumulate to Buy. However, our ST Accumulate recommendation (from Neutral) takes into account high P/E multiples and no effective trigger for the shares to perform in the near-term.

FLASH NOTE



	2007a	2008e	2009e
EPS	0.36	0.38	0.39
PER (x)	35.1	33.6	32.3
DPS	0.70	0.70	0.70
Div.Yield (%)	5.5%	5.5%	5.5%
BVPS	11.54	11.80	12.06
PBV(x)	1.10	1.08	1.06
CFPS	1.89	2.04	2.19
PCF(x)	6.7	6.2	5.8

Stock Data	
Last Ex-Div Date	*SAR0.7 on 20 Apr 08*
Mkt. Val. (mn)	*SAR53,124*
Shares (mn)	*4,167*
Av. Mthly Liqd. (mn)	*SAR 2,558*
52-Week High / Low	*SAR 16.75 / 11.25*
Bloomberg / Reuters	*SECO AB/5110.SE*
Est. Free Float	*19%*

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**Price as of 21 May 2008*

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Table 1: Saudi Electricity 1Q2008 Results, Main Highlights

Income Statement	1Q2007a	1Q2008a	Y-o-Y
Electricity Sales	3,302	3,538	7.1%
Meter Reading & Maintenance	173	183	5.9%
Connection Tariff	189	211	11.9%
Revenue	**3,664**	**3,933**	**7.3%**
Fuel	(820)	(972)	18.5%
Purchased power	(243)	(300)	23.3%
Operation and Maintenance	(1,622)	(1,820)	12.2%
Total COGS	(2,685)	(3,091)	15.1%
Gross Profit	**979**	**842**	**-14.0%**
Gross Profit Margin	27%	21%	
SG and A	(35)	(46)	30.3%
EBITDA	**944**	**796**	**-15.7%**
EBITDA Margin	26%	20%	
Depreciation	(1,479)	(1,627)	10.0%
Net Operating Profit	**(535)**	**(831)**	**55.3%**
NOP (EBIT) Margin	-15%	-21%	
Other Income	101	60	-40.6%
Earnings before Taxes	**(434)**	**(771)**	**77.6%**
Inc. Tax (Zakat)	0	0	
Net Profit after Taxes	**(434)**	**(771)**	**77.6%**
EPS	**(0.10)**	**(0.19)**	

Source: SEC, EFG-Hermes estimates

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