Global Research Equity

Saudi Arabia

Saudi Electricity Company

Em'powering' Economic Growth

December 2006

بيت الاستثمار العالمي
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Saudi Electricity Company

Reuters Code:
5110.SE

Listing:
Saudi Stock Exchange

CMP:
SR11.75 (As on Dec 03, 2006)

December, 2006

BUY

Investment Summary

- Saudi Electricity Company (SEC) was incorporated under Royal Decree M/16 in December 1999 in the Kingdom of Saudi Arabia (KSA). The formation of the SEC was the result of the reorganization and restructuring of the electricity sector in KSA by merging all the former public utility joint stock companies (10 public companies covering almost the whole Kingdom) and General Electricity Corporation projects (11 projects covering different areas in the northern region of the Kingdom) in Saudi Electricity Company. SEC's principal activities are generation, transmission and distribution of electric power.

- Currently, the company has 4,166.6mn shares outstanding. The Government of Saudi Arabia owns 74.3% stake in the company, Saudi Arabian Oil Company has 6.9% stake while the remaining 18.8% is owned by public.

- In KSA, SEC has the largest installed capacity for power generation plants as it accounts for almost 90% of the total installed capacity base in Saudi Arabia. As of December 2005 the aggregate capacity of SEC's power plants was at 29,051 MW.

- In Saudi Arabia, over 2000-2005, power generating capacity increased at a CAGR of 4.6% from 25,790 MW in 2000 to 32,301 MW in 2005. SEC accounted for almost 90% of the country's total power generation capacity while Saline Water Conversion Corporation (SWCC) and other large producers accounted for 8% and 2% respectively in 2005.

- At the time of SEC's inception in 2000, its capacity base was 22,060 MW which increased to 29,051 MW as of December 2005, representing a CAGR of 5.7% in capacity base over 2000-2005.

- Over the last few years Saudi Arabia has witnessed rapid growth in power demand which grew at a CAGR of 6.7% during 2000-2005 as against this the growth in capacity addition was at 4.6%, which reflects the efficiency at which the available capacity have been utilized.

- Despite the growth in installed capacity the peak load on the system remained in high terrain which increased from 84% recorded in August 2000 to 92.6% in August 2005, which shows growing demand for power in the country.

- Among the upcoming projects, SEC is developing several new power plants at a total investment outlay of SR46.5bn (US$12.4bn), which will add a total of about 19,175 MW during the period 2006–2015. The company will also invest SR30.0bn (US$8.0bn) in transmission projects during 2006-2015. The other planned power projects are under separate Independent Water & Power Projects (IWPPs) and Independent Power Projects (IPPs).

- The electricity demand in the country is growing at the rate of 6% per annum. Strong growth in the volume of investments in different sectors of the economy has seen the demand for power growing constantly in the recent years in Saudi Arabia. The unprecedented expansion of industrial projects and construction sector has given a big boost to the energy sector in the country.

- Saudi Arabia's Water and Electricity Ministry estimates that the country will require up to 20,000 MW of additional power generating capacity by 2015.

- GCC countries are establishing regional power grid, and SEC could be the early beneficiary of this initiative as Saudi's power grid will get connected to this regional grid in the first phase.

- During 2002-2005, SEC's revenue and net profit grew at a CAGR of 5.6% and 11.2% to reach SR18.8bn and SR1.48bn respectively.

- During first nine months of 2006, the company's total revenue grew by 4.5% to reach SR15.2bn as compared to SR14.5bn reported during the corresponding period of the previous year. Its net profit grew by 8% to SR1.91bn as compared to SR1.76bn reported during 9M of 2005.

- We initiate our coverage of SEC with a 'BUY' recommendation. Based on the combination of Discounted Cash Flow Method and Peer Group Valuation Method, we have valued the company's shares at an intrinsic value of SR15.3 per share, which is 30.2% higher than the current stock price of SR11.75 per share.

Table 1: Investment Indicators

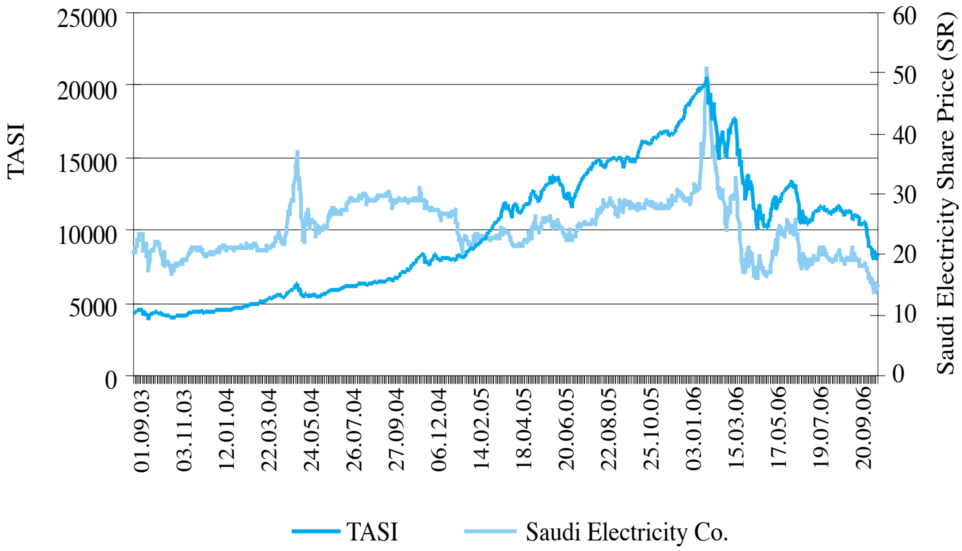
Price (as on December 03, 2006)	Shares in issue	Market Cap. (SR bn)	52-week H/L (SR)
SR 11.75	4.2 bn	49.0	53.4 /11.75

Year	Sales (SR'000)	Net Profit (SR'000)	EPS (SR)	BVPS (SR)	ROAE (%)	P/E (x)	P/BV (x)
2007 E	21,822,050	1,864,782	0.45	11.56	3.9%	26.3	1.0
2006 E	20,261,865	1,651,223	0.40	11.32	3.5%	29.6	1.0
2005 A	18,761,289	1,483,042	0.36	11.10	3.2%	81.8	2.6
2004 A	17,575,792	1,299,632	0.31	10.88	2.9%	85.6	2.5

- *Historical P/E & P/BV multiples pertain to respective year-end prices, while those for future years are based on market price in the Saudi Stock Exchange as on Dec. 03, 2006.*
- *EPS, Book Value, P/E and P/BV for FY2004 and FY2005 are based on post-split capital.*

*Source: SEC and **Global** Research estimates*

Exhibit 1: Share Price Performance Chart



*Source: Tadawul and **Global** Research*

Organizational Profile

In Saudi Arabia, SEC is the major provider of electric power all over the Kingdom

SEC was incorporated under Royal Decree M/16 in December 1999 in the Kingdom of Saudi Arabia (KSA). The formation of the SEC was the result of the reorganization and restructuring of the electricity sector in KSA by merging all the former public utility joint stock companies (10 public companies covering almost the whole Kingdom) and General Electricity Corporation projects (11 projects covering different areas in the northern region of the Kingdom) in Saudi Electricity Company. SEC's principal activities are the generation, transmission and distribution of electric power. The company is the major provider of electric power to its consumers all over KSA, serving governmental, industrial, agricultural, commercial and residential consumers. In KSA, SEC has the largest installed capacity for power generation plants. As of December-2005 the aggregate capacity of SEC's power plants was 29,051 MW. The company's employee strength was at 28,895 as of December 2005.

SEC has 31.6% equity stake in the Gulf Cooperation Council for Interconnection Authority (GCCIA), which was established by the GCC member countries to enhance the efficiency of electricity transmission and distribution within the member countries. The company also owns 50% of the capital of Water and Electricity Company (WEC) in Saudi Arabia, which was formed by SEC in participation with Saline Water Conversion Corporation. WEC was established to promote private investments in the Independent Power and Water projects in the Kingdom. Apart from this SEC also has 8% stake in Al-Shuaiba Company for Water & Electricity, which was established to develop and operate Al-Shuaiba - III project for the dual production of water and electricity. The company's aggregate investments in these companies amounts to SR339.6mn as of December 31, 2005 which increased from SR87.8mn in FY2004.

During 2002-2005, SEC's revenue grew at a CAGR of 5.6% which consist of three main segments, namely, Electricity sales, Meter reading & maintenance & bill preparation tariff and Electrical service connection tariff. Its revenue from these three segments grew at a CAGR of 5.5%, 4.4% and 10.6% respectively during 2002-05. The total revenues of the company stood at SR18.8bn for FY2005, an increase of 6.7% over FY2004. In FY2005, the revenue from the sale of electricity grew by 6.8% to SR17.4bn while that from meter reading and service connection tariff registered a y-o-y growth of 3.6% and 8.6% to reach SR660.4mn and SR671.3mn respectively.

The net profit of SEC grew at a CAGR of 11.2% during 2002-2005 and in FY2005 its net profit grew by 14.1% on a y-o-y basis to reach SR1.48bn. During first nine months of 2006, the company's total revenue grew by 4.5% to reach SR15.2bn as compared to SR14.5bn reported during the corresponding period of the previous year. Its net profit grew by 8% to SR1.91bn as compared to SR1.76bn reported during 9M of 2005.

Shareholding

Currently, the company has 4,166.6mn shares outstanding. The Government of Saudi Arabia owns 74.3% stake in the company, Saudi Arabian Oil Company has 6.9% stake while the remaining 18.8% is owned by public.

Table 2: Shareholding Pattern

Shareholder	% Holding
Government of Saudi Arabia	74.3
Saudi Aramco	6.9
Other Shareholders (Public)	18.8

Source: SEC Annual Report

Stock Split

In accordance with the Capital Market Authority's announcement dated 27 March 2006, the shares of the company were split into five shares for every one share. Accordingly, the number of shares of the company has now increased from 833.3mn ordinary shares of SR50 each to 4,166.6mn ordinary shares of SR10 each.

Dividend

With regard to the declaration of dividend, the company's Articles of Association stipulates that a preliminary payment of dividend not less than 5% of paid-up share capital is to be declared from the remaining profits after deducting reserves, and there also exists a stipulation which says that the Government would waive its share of dividends for a period of ten years from the date of the company's formation provided that dividends do not exceed 10% of the par value of the shares. If dividends exceed 10% of the shares par value, the Government's share shall be treated similar to the share of other shareholders. The company had declared dividend of 7% for FY2005 which was at the same level for FY2004.

Liquidity

The company's shares have enjoyed healthy liquidity in the past. During 2005, the average daily volume traded of the stock was 23.4mn shares, with a stock turnover of 167%. The growing performance of SEC increased its market capitalization (m-cap) significantly over the last few years. The year 2004 saw the market capitalization go up by 32% to SR111.2bn which increased by 9% in 2005 to SR121.2bn. However, during the current year with the sharp fall in the Saudi stock market the m-cap of SEC declined to SR49bn as of Dec. 03, 2006. Among listed power companies in the region, SEC has the largest market cap accounting for almost 75% of the total market cap of listed power companies, and its market cap accounts for about 5% of the total market cap of Saudi Stock Exchange.

Table 3: Liquidity of the Stock

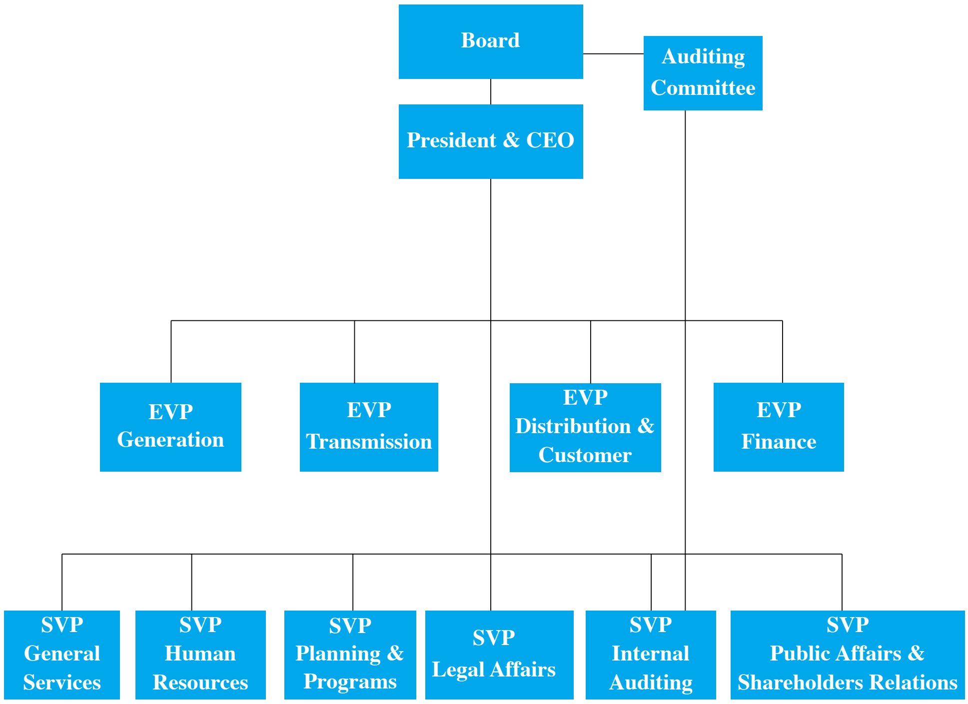
	2003	2004	2005	2006 (till Sept.30)
Volume of Shares traded (mn)	6,234	7,633	6,964	6,774
Shares turnover (%)	149.6%	183.2%	167.1%	162.6%
Market Capitalization (SR bn)	84.4	111.2	121.2	79.2

*Source: Zawya and **Global** Research*

Management

The company's board comprise of nine directors chaired by His Excellency, Engr. Mahmoud Abdullah Taiba. The company's board members are directly looking after audit functions of the company. SEC's management team comprised of different executive members who are the heads of various functional groups such as generation, transmission, distribution, finance, human resources, legal affairs, internal auditing, public affairs & shareholders relations, planning & programs and general services.

Exhibit 2: Organization Chart



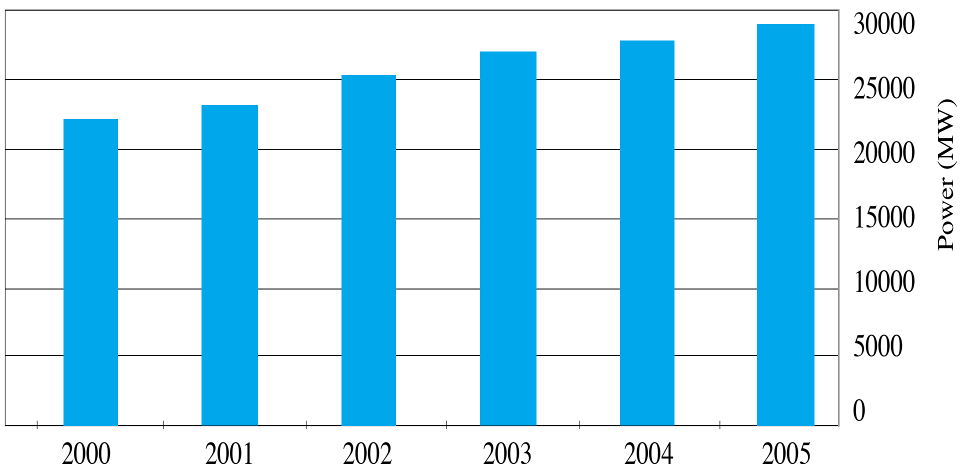
Source: SEC

Operations

The company's operations are broadly classified into three major areas generation, transmission and distribution which complement each other for the purpose of providing electricity to the consumer. The company does not have transfer prices between these activities, and revenues are recognized from selling electricity to end consumer for the company as a whole, based on the official tariff decided by the government.

At the time of SEC's inception in 2000, its capacity base was at 22,060 MW which increased to 29,051 MW as of December 2005, which displays a CAGR of 5.7% in the capacity base over 2000-2005. These capacities are spread across various power stations in the Central, Eastern, Western and Southern region of the Kingdom. In 2005, the company's power capacity increased by 4.8% to 29,051 from 27,711 in 2004. The company's power capacity accounts for almost 90% of the total installed capacity base in Saudi Arabia.

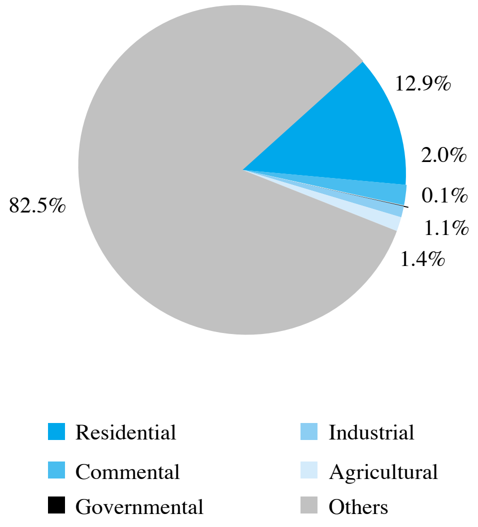
Exhibit 3: SEC's Growing Capacity base



Source: SEC

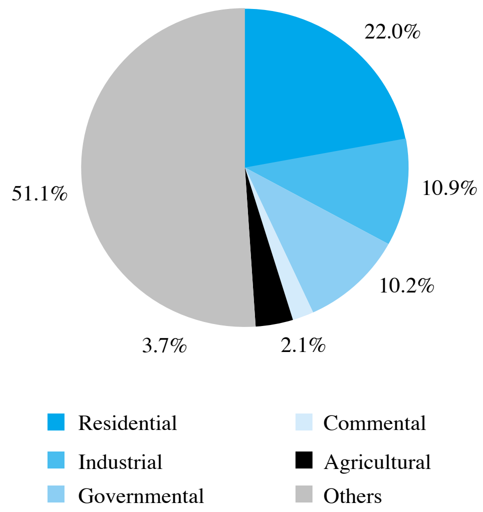
The total energy generated by the company's power plants reached 150,214 GWH by the end of 2005, registering a growth of 10.6% over 2004. The power produced by the company make up 85% of the national electricity requirements, which reflects the ample efforts made by the company to provide the power necessary to meet the national electricity demands. Over 2000-2005, the quantity of energy sold by SEC increased at a CAGR of 6.1% and in 2005 energy sales in quantitative terms reached 153,284 GWH as compared to 144,385 GWH of energy sold in 2004. By the end of 2005, SEC supplied electricity to 4,727,371 customers, whose numbers increased by 5.2% over the previous year. The company added 235,654 new customers in 2005 as compared to 244,819 new customers added in 2004.

Exhibit 4: Customers Split in terms of Numbers



Source: SEC

Exhibit 5: Customers Split in terms of Consumption



Source: SEC

In terms of customer segmentation, Residential segment accounted for the bulk of customers as it forms 82.5% of the total customer base of SEC. The next customer category in terms of bulk customers was Commercial segment which accounted for 12.9% of the total customers. Among the other customers are Government, Industrial, Agricultural, Hospitals, Mosques, Streets and Charitable Societies, they all together accounted for 4.6% of the total customers in 2005.

In terms of power consumption, Residential segment consumed 78,304 GWH which was 51.1% of the total power sold during 2005. Among the other bulk consumers are Industrial segment which accounted for 22.0%, Government segment 10.9%

and Commercial segment 10.2%. The rest of the categories such as Agricultural, Hospitals, Mosques, etc. accounted for the rest of the power sold.

SEC increased the length of its transmission line network from 29,631 ckm (circuit kilometer) in 2000 to 35,144 ckm in 2005, recording a CAGR of 3.5%. In 2005, the length of transmission line network increased by 4.3% to 35,144 ckm from 33,685 ckm a year before. With this magnitude of expansion in transmission network the company increased the number of electrified cities, settlements and villages to 10,385 in 2005 from 7,610 in 2000. In 2005, the company electrified 225 villages and settlements as compared to 296 villages and settlements electrified in 2004.

Going forward, the company has plans to demerge transmission business under separate subsidiary and SEC will act as a holding company.

Saudi Economic Overview

The power sector in any country has a high correlation with the economic environment under which it operates. Therefore, the economic characteristics and fundamentals of the economy needs to be considered while studying the power sector of any country. Over the last few years, Saudi Arabia has continued its upward momentum by registering a double growth in its nominal Gross Domestic Product (GDP), which grew by 13.8% in 2003, 16.8% in 2004 and 22.7% in 2005. Thus, the year 2005 was its third year in a row of double digit growth and the prevailing economic conditions are ideal to report fourth year of double digit growth. The economy is getting a significant boost from high crude oil prices and increased production level which is around 9.2mn barrels per day. The strong oil prices have also contributed to a healthy current account surplus and the year 2005 was seventh year in a row to witness current account surplus.

With regard to government finances, the economy is witnessing growing budgetary surpluses over the last several years on the back of buoyant revenues and declining debt. The government budget for the year 2006 anticipated revenues of SR390bn (US$104bn), expenditure of SR335bn (US$89.3bn) and estimated the surplus of SR55bn (US$14.7bn). The growing fiscal surpluses also enabled the Government to bring down its public debt, which as a percent of GDP is estimated to have declined to 41.2% in 2005 from 93.3% in 2001. The public debt is estimated to have declined by 22.6% in 2005 to SR475bn.

With this magnitude of economic boom the country’s economic reforms has also kept pace and witnessed significant boost in foreign direct investments over the last few years. Among the other major development on the macro economy front was Saudi membership in the World Trade Organization (WTO). In December 2005, Saudi Arabia became the 149th member of the WTO after over 12 years of negotiations. In the process of preparing for membership, Saudi Arabia enacted 42 new trade-related laws, created nine new regulatory bodies, and signed 38 bilateral trade agreements. To become a member, Saudi Arabia made major commitments to reduce tariffs, open services sectors of the economy to greater foreign participation, and to implement all WTO rules upon membership without recourse to transition periods. Saudi Arabia also agreed to join several sectoral initiatives upon accession that sharply lower tariffs and other trade barriers for telecommunications services, information technologies, pharmaceuticals, civilian aircraft and parts, and chemicals. Since joining the WTO, Saudi Arabia has taken a series of measures to improve the country’s investment climate, removing obstacles facing private investors, allowing foreign manpower recruitment and speeding up licensing procedures.

With regard to developing infrastructure facilities, Saudi Arabia will have a total of six special economic zones with the addition of the three zones to be announced later this year. Saudi Arabia will require at least US$600bn in investment over the next 20 years, according to SAGIA including US$170bn alone in electricity generation and water desalination capacity. It is estimated that US$300bn would be needed for petrochemicals, US$100bn for ports, highways and railways, and another US$100bn in IT-related businesses, such as life-sciences and healthcare.

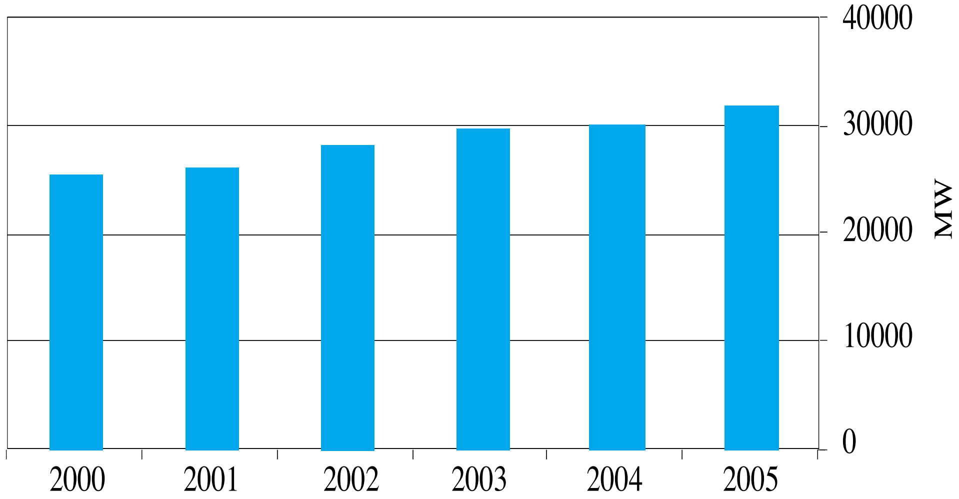
It is expected that the current economic boom is likely to continue at least till 2010 as several large scale projects are going to be implemented in the next five years. Thus, the economy of Saudi Arabia is on a path of high growth trajectory which can be narrated as the strong oil revenues will mean a record budget and current account surplus, continued reduction of government debt and strong growth in spending by the government.

Current Scenario of Power Sector in Saudi Arabia

In GCC, Saudi Arabia accounts for about 48% of the total power generating capacity in the region. In terms of per capita installed capacity Saudi Arabia has 1,313 Watt of power capacity as against GCC region's per capita average of 1,835 Watt. In Saudi Arabia, the formation of SEC opened the door to private sector construction of new power plants on BOO (Build-Own-Operate) and BOT (Build-Own-Transfer) bases. In June 2005, the country's first IPP came online was SADAF's (Saudi Petrochemical Company) co-generation power plant with a capacity of 250 MW. It was the first captive Independent Power Producer (IPP) Cogeneration plant in the Middle East.

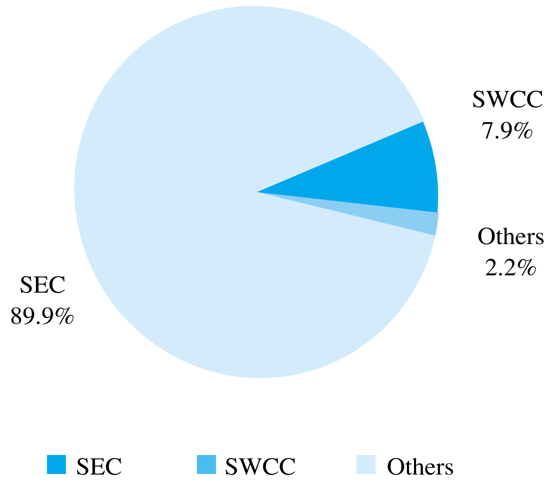
In Saudi Arabia, over 2000-2005, power generating capacity increased at a CAGR of 4.6% from 25,790 MW in 2000 to 32,301 MW in 2005. The year 2005 witnessed capacity addition of 1,775 MW or a growth of 5.8% over 30,526 MW reported in 2004. Out of the total capacity addition 1,775 MW during 2005, SEC added 1,340 MW, SWCC added 94 MW and other producers added 341 MW. SEC accounted for almost 90% of the country's total power generation capacity while SWCC and other large producers accounted for 8% and 2% respectively in 2005.

Exhibit 6: Country's Installed Power Capacity



Source: SEC

Exhibit 7: Industry's Capacity Split



Source: SEC

In November 2001, Electricity and Cogeneration Regulatory Agency (ECRA) was established as an independent watchdog of the country's power sector and its scope of activities are issuance of license, governance of IPPs (Independent Power Producers), tariff fixation and revision, dispute settlement, etc. In Saudi Arabia electricity tariffs are determined by the Council of Ministers based on recommendations from the ECRA. The maximum rate of 26 Halala (1SR=100 Halala) per Kilowatts/hours (KWH) has been fixed by the ECRA. Unlike in some of the Gulf countries, in Saudi there does not exist any provision of free or subsidized electricity for local citizens. The residential sector accounts for about 51% of Saudi's electricity consumption, but this share is likely to decline gradually as power demand associated with other sectors such as oil & gas and industrial projects are set to get a boost in the coming years.

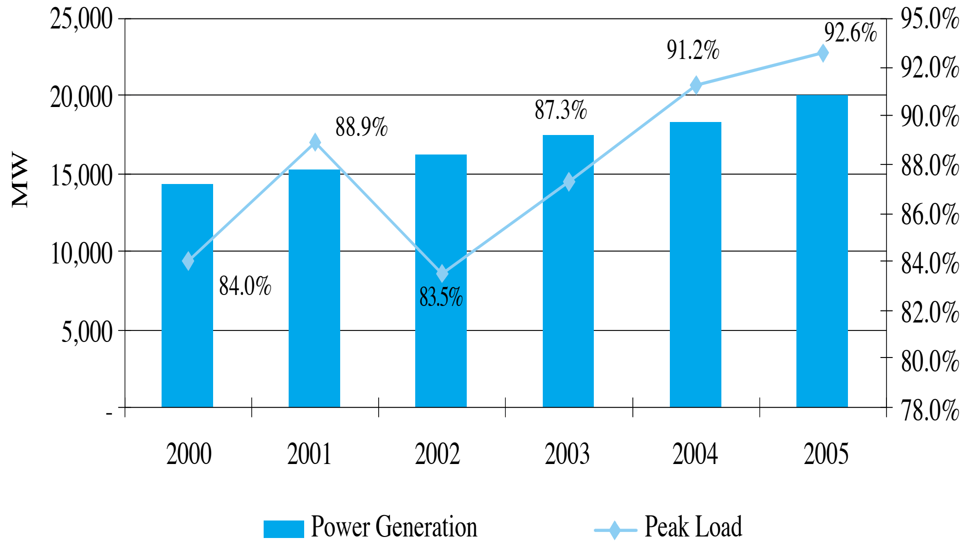
Going forward, Saudi Arabia is considering the hiving off its transmission and distribution networks of electricity, which are currently managed by SEC. This activities will be run by a separate company which in turn would be held by the SEC as a holding company.

Industry's Capacity Usage

Over the last few years Saudi Arabia has witnessed rapid growth in power demand which grew at a CAGR of 6.7% during 2000-2005 as against this the growth in capacity addition was at 4.6%, which reflects the efficiency at which the available capacity have been utilized.

Despite the growth in installed capacity the peak load on the system remained in high terrain which increased from 84% recorded in August 2000 to 92.6% in August 2005, which shows growing demand for power in the country. In volume terms, peak load power requirements went up from 21,673 MW in 2000 to 29,913 MW in 2005.

Exhibit 8: Industry's Power Generation and System Peak load



Source: SEC

Planned Projects in Power Sector

Among the upcoming projects, Saudi Electricity Company is developing several new power plants at a total investment outlay of SR46.5bn (US$12.4bn), which will add a total of about 19,175 MW of power generation capacity during the period 2006–2015. The company will also invest SR30.0bn (US$8.0bn) in transmission projects during 2006-2015.

Table 4: Planned Investment Projects of SEC

Projects	2006-2015	
	Capacity	Investment Outlay
Power (MW)	**19,175**	**SR46.5bn**
Transmission Line Project	**-**	**SR30.0bn**

Source: SEC

The other planned power projects are under separate IWPPs and IPPs. Apart from these, Marafiq (Power and Water Utility Company for Jubail and Yanbu) is also developing power and water projects in the industrial city of Jubail. These projects are as enumerated below:

I. Independent Water & Power Projects (IWPPs)

- To develop IWPPs, Water & Electricity Company (WEC) was established by the Supreme Economic Council to promote private investments in the IWPPs. WEC, a limited liability company, owned on a 50:50 basis by SEC and Saline Water Conversion Corporation (SWCC), will be the single off-taker of the generated power & water by the IWPPs that will be implemented on a Build Own & Operate (BOO) basis with a concession of 20 years.

- As per the original plan there were four IWPPs which had been planned. Now, as per the recent media reports, WEC has delayed the Al-Jubail project (1,100 MW of power and 340,000 cubic meters per day of water) which was expected to be the fourth in WEC's IWPP series. The size of Ras Al-Zour project has been increased to 3,000 MW of power and 1,000,000 cubic meters of water per day from the earlier envisaged 2,500 MW of power and 800,000 cubic meters per day of water.

- The initial stage of the IWPP will entail the following 3 projects:

Table 5: IWPP Projects

Project	Power (MW)	Water (Cubic meters per day)	Schedule of Implementation	Capital Outlay (US$ mn)
Shoaiba (Phase 3)	900	880,000	Q1-2009	2,460
Shuqaiq (Phase 2)	850	212,000	Q2-2010	1,250
Ras Al-Zour	3,000	1,000,000	Q2-2011	3,750

Source: WEC Website

- The transmission & distribution of power & water produced by the 4 IWPPs will require additional investments of US$3.2bn.

II. Other Independent Power Projects (IPPs)

- Saudi Aramco, SABIC and SADAF forming the major group of driving forces in power generation enterprises for their captive plants usage;

- In late 2003, Saudi Aramco launched 4 new IPPs at Ras Tanura 150 MW; Juaymah 300 MW; Uthmaniyah 300 MW; and Shedgum 300 MW with a combined capital investment exceeding SR2bn. These projects have been established in cooperation with private sector (consortium of Saudi Oger & International Power) on a BOOT basis (with a concession period of 20 years).

- Ma'aden (Saudi Arabian Mining Company) is planning an independent power generation plant at Ras Al-Zour which will have capacity of 1,800 MW to meet demand for its Integrated Aluminum Complex.

III. Marafiq Power & Water Projects

Marafiq (Power and Water Utility Company for Jubail and Yanbu) was established by Saudi Basic Industries Corporation (SABIC), Saudi Aramco, Royal Commission for Jubail & Yanbu and the Public Investment Fund to offer electricity andwater to the twin cities of Jubail and Yanbu. Marafiq currently owns and manages the 1,060 MW power plant, located in Yanbu industrial city, and various water treatment plants such as cooling water, drinking water, sanitary waste water, and industrial waste water facilities.

Marafiq is planning an IWPP in the industrial city of Jubail with an estimated cost of SR9.4bn (US$2.5bn). However, the project cost is expected to rise in line with the change in scope of the Request for Proposals (RFPs). It will be implemented in two phases. The first phase will have capacity of 2,500 MW of power and 800,000 cubic meters of desalinated water per day, which will be implemented by 2009. This is as per the revised RFP as compared to originally planned 2,400 MW of power and 300,000 cubic meters of water per day. Phase II will have capacity of about 1,500-2,000 MW of power and 100,000 cubic meters of water per day and an announcement is yet to be made on its timing.

Demand Forecast

As per the Electricity Ministry, the country will require additional 20,000 MW of power capacity by 2015

Strong growth in the volume of investments in different sectors of the economy has seen the demand for power growing constantly in the recent years in Saudi Arabia. The unprecedented expansion of industrial projects and construction sector has given a big boost to the energy sector in the country. The electricity demand in the country is growing at the rate of 6% per annum. Saudi Arabia's Industry and Electricity Ministry estimates that the country will require up to 20,000 MW of additional power generating capacity by 2015. Water and Electricity Minister, Abdullah Al-Hussayen, has indicated that the Kingdom would require nearly SR350bn of investments for water and sewage projects and SR340bn for electricity projects during the next 20 years.

Major Demand Drivers

Saudi Arabia has favourbale demographic situation, the population growth rate is the country is one of the highest in world, which offers good scope for further growth for any core sector and power is one of them. The government is also focusing on developing residential projects under national housing projects in various regions of the Kingdom. This will further drive the demand from the residential sector which is the biggest consumer of power. Apart from this, Saudi Arabia is embarking on a number of new mega-projects in a wide range of industries. The bulk of them are focused on those sectors of the economy in which the Kingdom has comparative advantages - oil and petrochemical industries.

Some of the mega projects include:

- The SR100bn King Abdullah Economic City in Rabigh.
- The SR37.5bn Aramco-Sumitomo Chemical refining and petrochemical joint venture called Petro-Rabigh, collocated with the King Abdullah Economic City
- The SR37.5bn Aramco-Total export refinery
- The SR22.5bn Aramco-ConocoPhillips export refinery
- SABIC's Saudi Kayan Petrochemicals Company (Kayan)

- Maaden's Ras Al-zour Mining Industrial City and

- The Saudi LandBridge project, aimed at connecting various parts of the Kingdom by rail.

The largest private sector investment in Saudi Arabia will be the King Abdullah Economic City which will be developed by Dubai-based Emaar Properties in collaboration with Aseer and Binladen Group of Saudi Arabia in a joint venture called Emaar the Economic City.

The two similar projects recently announced include the Prince Abdulaziz bin Musaad Economic City in Hail and the Knowledge City in Madinah.

Saudi Aramco's program to expand crude oil production capacity has been underway. Work continues on its US$20bn crude oil expansion program, which aims at raising Saudi oil production capacity from the current 11.3 million bpd to 12.5 million bpd by 2009. Recently, Aramco signed joint venture agreement with Total of France and ConocoPhillips of the US to set up two export refineries, one on each coast, that would cost SR22.5bn (US$6bn) each. Both refineries, which will produce mainly gasoline for export will use the Kingdom's heavy crude oil, which is less sought after by international buyers.

The work on the Gas Initiative has made strides too. This involves exploration for gas in Aramco's joint ventures with several foreign oil and gas companies, with the intention of supplying gas for local industrial use and power generation, eventually freeing up more crude oil for export. Total cost of the gas initiative is currently estimated by Aramco to be SR41.25bn (US$11bn).

Apart from these large scale upcoming projects, the power demand will also be driven by the implementation of GCC Power Grid and Saudi Arabia will be the major beneficiary of this initiative as its network will get connected to the regional grid in the first phase and also because it has largest capacity in the region.

GCC Power Grid – *aiming towards integrated power system*

GCC countries are implementing regional power grid

When analyzing Saudi's power sector, it is necessary to discuss about the GCC power grid project since Saudi will play a major role in the first phase of the project. GCC countries are in the midst of implementing a power grid project, which will link the power grids of all the six GCC countries. The GCC States have established the GCC Interconnection Authority, a joint stock company with a capital of SR4,129.2mn (US$1,100mn), with the aim of funding the power interconnection project for the GCC States. The governments of GCC States are acquiring and managing the project through an independent institution run on commercial basis, where governments contribute 35% of the capital and 65% will be raised through loans to cover the implementation expenses of the project. This commission, founded on July 29, 2001, has its headquarter in Dammam. The Saudi Electricity Company owns the share of the Kingdom and the Saudi partner, with 31.6% of the Commission's capital. The Gulf Cooperation Council Interconnection Authority has been established to interconnect the six GCC States in order to reduce the volume of capital investments required for building interconnection infrastructure, facilitate the provision of electricity, and increase the reliability of power system network in each State.

Table 6: Share Holding Pattern of GCCIA

Country	Nominal Value (Million US $)	% Holding
Kingdom of Bahrain	99.0	9.0
State of Kuwait	293.7	26.7
Sultanate of Oman	61.6	5.6
State of Qatar	128.7	11.7
Kingdom of Saudi Arabia	347.6	31.6
United Arab Emirates	169.4	15.4
Total	**1,100.0**	

Source: GCCIA

The objective of forming the regional grid is to harness the surplus power generating capacity in each Gulf state and to create an adequate and reliable power supply system for the region. The GCC Interconnection Grid will be developed in three phases:

Phase I: Interconnection of Kuwait, Saudi Arabia, Bahrain and Qatar. This system is the GCC North Grid.

Phase II: Interconnection of the Independent systems in the UAE as well as Oman. This is the GCC South Grid.

Phase III: Interconnection of the GCC South Grid with the GCC North Grid. This phase will complete the interconnection of the six Gulf States.

Tendering for the first section of the project has been completed with the total value of the 14 contracts awarded being US$1.1bn. The Phase-I of the project will be implemented by 2008. The second phase of the project will integrate the power grids of UAE and Oman, while the final phase will involve the merger of the mega-grids created in the earlier phases. The entire project is likely to be implemented in full scale by 2010.

The new power grid will enable GCC states to export or import electricity according to peak demand needs and also reduce power costs by bypassing the necessity of building several more large generating stations in the region. There will be huge strategic and financial gains from the project and it will pave the way for an active energy trading system among the GCC countries. As per the GCC Interconnection Authority, the completion of this project should lead to enormous cost savings.

Outlook

Over the next few years the peak demand is likely to be in double digit in Saudi Arabia

Demand for power in Saudi Arabia is growing at the rate of 6% per annum. The peak demand had growth of about 7% a year, which is likely to be in double digits over the next few years, mainly because of massive investments are being planned in mega energy, industrial and real estate projects as discussed above. Expanding populations and social developments are other major drivers for demand at this high rate. Apart from these domestic demand drivers, the upcoming GCC power grid will also add to the demand growth and Saudi will have a major role to play as it has the largest capacity in the region.

To fulfill the likely growth in demand, several IPPs are coming up apart from the new projects under SEC. As per SAGIA overall power capacity in Saudi Arabia is forecasted to grow to 59,000 MW by the year 2024 requiring an estimated investment of SR430bn (US$115bn). To achieve this target the ministry will present several joint projects to the private sector, local and foreign, in order to increase power generation capacity. With electricity demand expected to more than double over the next 20 years, an encouraging number of investors have shown interest in establishing new power generation companies, in the country. The regulatory authority (ESRA) will license newly-formed companies while the Saudi Electricity Company (SEC) will handle electricity distribution

At the moment, the total number of electricity subscribers exceeds 4.7mn in Saudi Arabia, where more than 10,160 cities, towns and villages have been electrified. It has been predicted that the power supply will cover all settlements and villages not previously supplied with electricity by 2008, raising the number of electrified cities and villages to 11,112. The company also has target to increase its customer base to 5.7mn by 2009.

Thus, the sector has tremendous growth potential in the booming economy which will witness growing demand not only from the home turf but also from the region with the upcoming GCC power grid.

Financial Performance

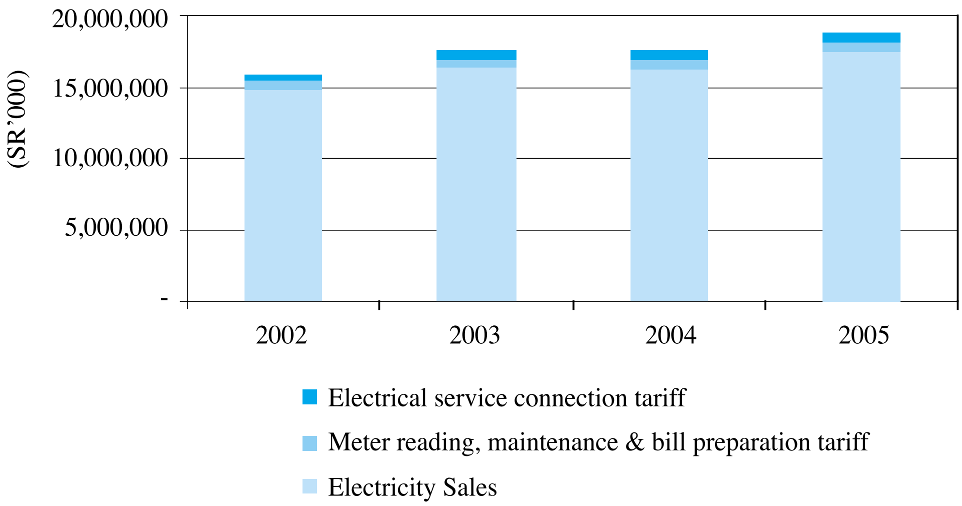
The operations and revenues of the company are affected by seasonal weather changes during the year. Revenues are considerably lower during the winter months due to lower consumption of energy whereas higher revenues are earned during the summer months due to the increase in consumption of energy because of high temperatures in the country. These changes are reflected in the financial results of the company. Therefore, the results of operations for the interim periods, first quarter and last quarter, may not be an accurate indication of the actual results for the full year.

We have analysed the performance of the company based on various key financial parameters, which are discussed as below:

Revenue Analysis

Over 2002-05, SEC's revenue grew at a CAGR of 5.6% which consist of three main segments namely, Electricity sales, Meter reading & maintenance & bill preparation tariff, and Electrical service connection tariff. Its revenue from these three segments grew at a CAGR of 5.5%, 4.4% and 10.6% respectively during the period 2002-05. The electricity sales consist of generation, transmission and distribution activities which complement each other for the purpose of delivering electricity to the end consumer. The company does not have any transfer prices between activities, and revenues are recognised from selling electricity to the end consumer. The total revenue of the company stood at SR18.8bn for FY2005 which shows an increase of 6.7% from that reported at the end of FY2004. In FY2005, the revenue from sale of electricity grew by 6.8% to SR17.4bn while that from meter reading and service connection tariff registered a y-o-y growth of 3.6% and 8.6% to SR660.4mn and SR671.3mn respectively.

Exhibit 9: Trend in Segmental Revenue



*Source: Company's Annual Reports & **Global** Research*

Revenue Composition

Revenues from the sale of electricity is the company's main source of income and other revenue components are ancillary to the main revenues. Therefore, electricity sales formed 93% of the company's total revenues. Meter reading, maintenance and bills preparation services represent the monthly fixed tariff based on the capacity of the meter used by the consumers. Electrical service connection tariff are revenues recognized on the equipments used in serving the consumers. During the period under consideration, contribution of all the revenue components to the aggregate revenue remained almost constant. The revenue contribution from the sale of electricity remained at about 93% and that in case of meter reading and connection tariff were at 3.5% for each.

Table 7: Revenue Compositions (in SR '000)

Segment Revenue	2003	% of Agg.	Growth	2004	% of Agg.	Growth	2005	% of Agg.	Growth
Electricity sales	16,373,914	93.3%	10.2%	16,320,524	92.9%	-0.3%	17,429,591	92.9%	6.8%
Meter reading & maintenance	609,282	3.5%	5.0%	637,219	3.6%	4.6%	660,372	3.5%	3.6%
Electrical service connection tariff	562,145	3.2%	13.4%	618,049	3.5%	9.9%	671,326	3.6%	8.6%
Aggregate Revenue	**17,545,341**		**14.3%**	**17,575,792**		**0.2%**	**18,761,289**		**6.7%**

*Source: Company's Annual Reports & **Global** Research*

Costs Analysis

Cost of Sales

During the period 2002-05, due to the sharp increase in cost of sales the profitability of the company did not grow at a similar pace as its total revenue increased. During the period under review, the company's cost of sales increased by 7.5% (CAGR), while its total revenue grew comparatively at a lower CAGR of 5.6%. Therefore, its gross profit witnessed negative CAGR of 8.8%. During the year 2002, its cost of sales as a percentage of total revenue was 86.4% while in FY2005 it increased to 91.2%. This was mainly due to the sharp increase in operation & maintenance expenses and also due to increased cost of purchased power, both of which have grown at a CAGR of 12.7% and 8.2% respectively. The cost of sales increased to SR16.1bn in FY2004 from SR14.9bn in FY2003, an increase of 7.9%. This increased by 6.2% in FY2005 to SR17.1bn.

Table 8: Trend in Cost of Sales and Gross Profit

(in SR '000)	2002	2003	2004	2005	CAGR
Total Revenue	15,929,577	17,545,341	17,575,792	18,761,289	5.6%
Cost of Sales	(13,763,492)	(14,929,162)	(16,114,612)	(17,115,957)	7.5%
as a % of total revenue	86.4%	85.1%	91.7%	91.2%	
Gross Profit	2,166,085	2,616,179	1,461,180	1,645,332	-8.8%

*Source: Company's Annual Reports & **Global** Research*

Cost of Fuel - a major cost component

In a fuel-based power generation company, it is the major feedstock and account for the largest share of the costs. As a fuel SEC uses natural gas, diesel, crude oil and heavy fuel oil. Over the last few years, the cost of fuel as a percentage of total revenue moved in the range of 23% to 24.5%, which increased from 22.9% in FY2003 to 24.4% in FY2005. The cost of fuel accounted for 26.7% of the total cost of sales in FY2005 as compared to 25.9% in FY2004.

Cost of Purchased Power

The company imports power from SWCC and other large producers to cope with the rising demand. Over 2002-2005, the cost of purchased power grew at a CAGR of 8.2% and in FY2005 it witnessed a growth of 21% to SR1.2bn as against this the growth rate in earlier years was miniscule at about 2-2.5%. This as a percentage of total cost of sales were moved from 5.9% in FY2004 to 6.7% in FY2005.

Operations and Maintenance Expenses

These are the expenses related to the generation, transmission, and distribution activities as well as a portion of the general services and related supporting activities expenses. Over 2002-2005, these expenses grew at a CAGR of 12.7% and in FY2005 it increased by 6.8% to SR5.8bn. Among the all expense category these expenses have witnessed the highest growth during the last few years. This as a percentage of total cost of sales increased from 30.1% in FY2003 to 33.7% in FY2005.

Other Income

The company's other income and expenses includes gain on disposal of fixed assets, reconnection fees, penalties, sales of tender documents and other miscellaneous items. Though the company has shown all these under one head, as part of presentation in financial statements we have shown it separately. This was at SR266.9mn in FY2005 as compared to SR338.8mn in FY2004.

Profitability Margins

Over the last two years all the profitability margins remained almost constant

In FY2004, a significant increase in operations & maintenance costs had a severe effect on the company's gross margins. The expenses under this head grew by 20% in FY2004 to SR5.4bn from SR4.5bn reported in FY2003. In FY2004 total sales also remained almost constant. Therefore in FY2004, gross profit margin declined to 8.3% from 14.9% in FY2003. With this, the gross profit regressed by a whopping 44.1% to SR1.5bn in FY2004. However, in FY2005, gross profit increased by 12.6% to SR1.64bn and GPM also improved to 8.8% with increased sales and compressed costs. With regard to net profit margin, it remained in the range of 7.5% to 8% over the last few years. The company reported a net profit of SR1.48bn in FY2005 over SR1.3bn reported in the previous year. This resulted into a per share earnings of SR0.36 (post-split) as compared to SR0.31 (post-split) in FY2004.

Table 9: Profitability Indicators

	FY2003	FY2004	FY2005
Gross Profit Margin	14.9%	8.3%	8.8%
Net Profit Margin	8.0%	7.4%	7.9%
Return on Average Assets (%)	1.4%	1.2%	1.3%
Return on Average Equity (%)	3.2%	2.9%	3.2%

Source: ***Global*** *Research*

Over the last few years, SEC's return on average equity and return on average assets, both have moved in a narrow range. Its ROAE moved between 3% to 3.2% during 2003 to 2005 while ROAA was in the range of 1.2% to 1.4% in the same period.

Balance Sheet Structure

Assets

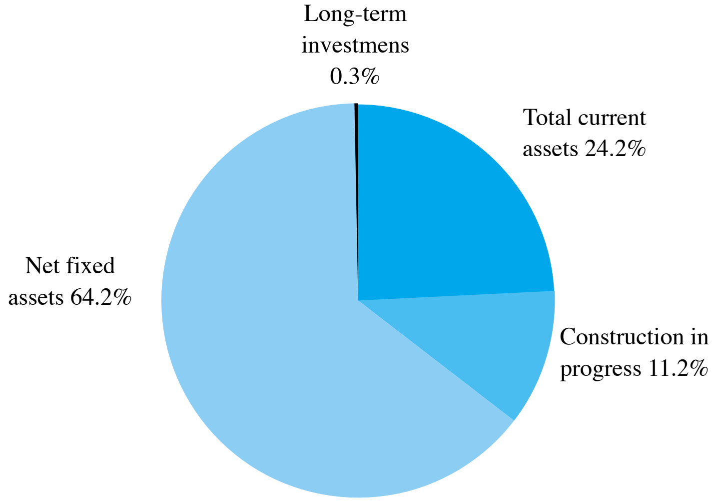
Being capital intensive in nature fixed assets accounted for the largest share of the company's asset base

Over 2002-2005, the total assets of the company grew at a CAGR of 6.7% and in each of the last two years the y-o-y growth rate was at 7.7%. At the end of FY2005 total assets stood at SR117.6bn as compared to SR109.2bn reported in FY2004. SEC's business being capital intensive in nature has its fixed assets accounted for the largest share of the company's asset base. However, its share of the total assets declined during the last two years from 73.2% in FY2003 to 68.2% in FY2004 and 64.2% in FY2005. The construction work in progress was also one of the major asset components accounted for 11.2% of the total assets in FY2005 whose share increased from 7.8% in FY2004.

The company also has long terms investments made in GCCIA, WEC and Al-Shuaiba Co. for Water and Electricity which increased to SR339.6mn in FY2005 from SR87.8mn in FY2004. As of December 2005, SEC has 31.6% stake in GCCIA, 50% in WEC and 8% in Al-Shuaiba Co. for Water and Electricity.

The share of current assets in the total asset base increased to 24.2% in FY2005 from 23.9% and 21.2% in FY2004 and FY2003 respectively. Among the current assets, inventories as a proportion of total assets accounted for 3.1% in FY2005 and receivables & accrued revenue comprised 19.4% of total assets in FY2005.

Exhibit 10: Composition of Total Assets (FY2005)



*Source: Company's Annual Reports & **Global** Research*

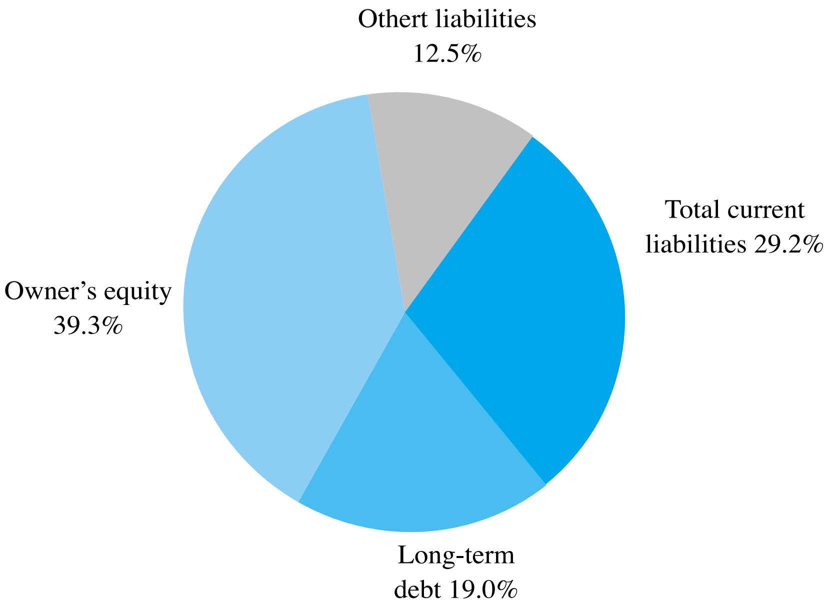
Funding Structure

The company's funding structure changed during FY2005 as it obtained fresh long term loan from commercial banks to finance capital projects. Therefore, non-current portion of long term loans increased by 52.1% to reach SR7.3bn in FY2005. The company also has borrowings from the government, which increased from SR14.6bn in FY2004 to SR14.9bn in FY2005. This borrowings are interest free subordinated long-term loan with a grace period of twenty five years. The share of long term debt in the company's funding structure increased to 19% in FY2005 as compared to 17.7% in the preceding year.

Among the other major liability component is deferred revenue, which represents electrical service connection tariff received from customers is deferred and recognized on a straight line basis over the average useful lives of the equipment used in serving the consumers. This was at SR9.96bn in FY2005 as compared to SR9.6bn in FY2004.

The contribution of owner's equity to the company's total funding structure declined to 39.4% in FY2005 which was hovering in the range of 41.5%-44.5% during the previous years. The owners' equity stood at SR46.3bn in FY2005 as compared to SR45.3bn in the previous year.

Exhibit 11: Composition of Total Liabilities (FY2005)



*Source: Company's Annual Reports & **Global** Research*

Analysis of Interim Results

Despite marginal increase in sales, adjusted net profit shows good growth

The company's performance for the first six months of 2006 was not so encouraging as its revenue grew marginally by 4.2% and its net profit declined by 7.2%. During the first six months of 2006, the company reported a total revenue of SR8.8bn as compared to SR8.4bn reported during the corresponding period of the previous year. The sales from electricity sales increased marginally by 3.9% to SR8.1bn, while that from the meter reading and electrical service connection tariff grew by 7.8% and 7.2% to SR350.9mn and SR349.1mn, respectively. The cost of sales witnessed growth of 4.9% to SR8.4bn which was at SR8.0bn in 1H-2005. As cost of sales grew at a much higher rate as compared to total sales, the company's gross profit declined by 9.2% to SR414.7mn. The general and administration expenses declined by 8.7% to SR189.7mn which provided some cushion to the bottomline. The company's net profit declined by 7.2% to SR292.3mn, however, which was without Zakat as no provision has been made for Zakat during 1H-2006.

The point worth noting while analyzing the company's interim financials are that the operations and revenues of the company are affected by seasonal weather changes. Revenues are considerably lower during the winter months due to lower consumption of energy whereas higher revenues are earned during the summer months due to the increase in consumption of energy because of high temperatures. These cyclical variations are reflected in the interim financial results of the company. Therefore, the results of operations for the interim periods, first quarter and last quarter, would be on lower side as compared to other two quarters. Therefore, during first and last quarters of ever year, the company's sales remains on lower side which could not cover its operating expenses for those particular quarters and it has been reporting losses in these two quarters every year. This year, in Q1-2006, the company's total sales grew marginally by 1.9% to SR3.4bn and it reported increased net loss of SR436.1mn as compared to SR303.1mn reported during corresponding period of the previous year.

The Q2-2006 proved very good for the company as its total sales grew by 6.5% to SR5.4bn. Its cost of sales witnessed a growth of 4.8% to SR4.6bn which increased its gross profit by 17% to SR791.1mn. The general and administration expenses declined by 18.5% during the quarter. On the back of these, the company reported increased net profit of SR728.5mn as compared to SR580.5mn reported during Q1-2005, an increase of 25.5%.

Table 10: Summary of 1-H 2006 Financial Results

(Amount in SR '000)	June 2005 (3 Months)	June 2006 (3 Months)	Change	June 2005 (6 Months)	June 2006 (6 Months)	Change
Electricity sales	4,694,548	4,989,741	6.3%	7,772,295	8,075,207	3.9%
Meter reading, maintenance and bill preparation tariff	165,747	184,763	11.5%	325,656	350,982	7.8%
Electrical service connection tariff	165,135	176,391	6.8%	325,595	349,102	7.2%
Total Sales	**5,025,430**	**5,350,895**	**6.5%**	**8,423,546**	**8,775,291**	**4.2%**
Fuel	(1,335,619)	(1,300,451)	-2.6%	(2,055,459)	(2,097,122)	2.0%
Purchased power	(236,174)	(299,652)	26.9%	(437,959)	(561,424)	28.2%
Operating and maintenance	(1,422,428)	(1,470,605)	3.4%	(2,754,055)	(2,802,725)	1.8%
Depreciation	(1,355,045)	(1,489,056)	9.9%	(2,719,133)	(2,899,334)	6.6%
Gross Profit	**676,164**	**791,131**	**17.0%**	**456,940**	**414,686**	**-9.2%**
General and administrative expenses and provisions	(127,833)	(104,196)	-18.5%	(207,735)	(189,750)	-8.7%
Other income and expenses	44,219	41,534	-6.1%	78,009	67,420	-13.6%
Net profit before Zakat	**592,550**	**728,469**	**22.9%**	**327,214**	**292,356**	**-10.7%**
Zakat	(12,070)	-	-100.0%	(12,070)	-	-100.0%
Net Profit for the period	**580,480**	**728,469**	**25.5%**	**315,144**	**292,356**	**-7.2%**

*Source: Company Reports & **Global** Research*

During first nine months of 2006, the company's total revenue grew by 4.5% to reach SR15.2bn as compared to SR14.5bn reported during the corresponding period of the previous year. Its net profit grew by 8% to SR1.91bn as compared to SR1.76bn reported during 9M of 2005.

SWOT Analysis

Strengths/Opportunities

- Strong macro economic fundamentals offer good growth prospects.
- Saudi Arabia has the largest power capacity in the GCC region as its share is at 48% of the region's total power capacity.
- Saudi could be the early beneficiary of GCC power grid as the country's grid will get connected to the regional grid in the first phase.
- SEC is the largest company in the field of power generation in the Gulf region.
- SEC's power capacity accounts for almost 90% of the total installed capacity base in Saudi Arabia.
- Over the years 2001-2005, despite the growth in country's power generating capacity, the peak load factor (PLF) increased to 92.6% in 2005 from 88.9% in 2001, indicating growing demand for power in the country.
- Apart from the hydrocarbon sector, several other large scale projects are coming up in Saudi Arabia which offer good growth potential.
- The company is well positioned to leverage upon its strong balance sheet.

Weaknesses/Threats

- Large operations under a single entity.
- Recent power cut in the Central and Eastern provinces caused heavy losses to industries in Saudi Arabia.
- Scope of competition from the upcoming independent power projects.
- There has to be a successful implementation of a planned hiving off of its transmission business under a separate subsidiary.
- Widening of scope of regulations through ESRA.

Key Monitorables

Some of the key factors which will have a significant bearing on the company's business and its operations are listed below:

- Scope of policy initiatives by ECRA.
- Successful and timely implementation of upcoming power projects under SEC.
- Future capex plans under the company.
- Implementation of demerger plan of transmission business under separate subsidiary.
- Future strategies of the company to ensure dominance in the power sector.
- Successful implementation of GCC power grid project.

Valuation and Recommendation

Being in the core sector of the economy SEC has excellent growth prospects and will continue to be a quality stock in the region. Our valuation rating for the stock is supported by combination of DCF Method and Peer Group Valuation Method.

a) DCF Valuations – As per this method we have arrived at a fair value of SR15.27 for the stock, which represents a premium of 30.0% to the current market price of SR11.75 per share as on Dec. 03, 2006.

Key points to be noted for DCF valuations are:

i. Risk free rate: For risk free rate, we have taken the yield on the 10-year Saudi Government bond that matures in 2016. As per the details available from Reuters this bond was having a yield of 5.084% as of November 27, 2006.

ii. A market risk premium of 5.5% has been assumed.

iii. A beta of 1.19 is taken for SEC, which is based on last four years trading history of the stock on Tadawul Stock Exchange.

iv. Based on the above assumption, the cost of equity works out to 11.6% using the Capital Asset Pricing Model (CAPM).

v. The cost of debt financing has been assumed at around 5.8%, which is based on Libor plus certain margin.

vi. The Weighted Average Cost of Capital has been estimated to be at 8.0%. The Weighted Average Cost of Capital (WACC) will be skewed more towards cost of debt financing, which we have assumed at around 5.8%. The reason for the lower cost of capital for SEC emanates from the lower cost of debt which forms about 60% of the total capital.

vii. We have assumed a terminal growth rate of 4.5%, looking at the prospects of the economy and for the company.

viii. Our DCF valuation model is based financial forecast of 5-years (2006-2010).

A summary sheet of the DCF valuation is shown below.

Table 11: DCF Calculations

SEC (Amount in Saudi Riyal '000)	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10
FCFF	282,697	697,885	1,276,864	2,421,836	3,585,435
Discounted Cash Flow	281,040	642,606	1,088,752	1,912,684	2,639,310
NPV of FCFF	6,564,391				
NPV of Terminal Value	79,583,040				
Total Enterprise Value	86,147,431				
Less: Debt	(24,467,580)				
Add: Investments & Cash	1,949,361				
Total Equity Value	**63,629,212**				
Number of shares outstanding (in '000)	4,166,594				
DCF value per share (SR)	**15.27**				
Current Share Price (SR)	11.75				
Upside/(Downside) Potential (%)	30.0%				

*Source: **Global** Research*

Sensitivity Analysis

A sensitivity analysis for different estimated long-run future growth rates and weighted cost of capital is provided. The table provides estimated fair values for SEC's stock based on a range of varying inputs. The shaded area at the center shows the most probable range of alternatives.

Table 12: Sensitivity Analysis of SEC

		Terminal Growth Rate				
	15.27	**2.5%**	**3.5%**	**4.5%**	**5.5%**	**6.5%**
Cost of Capital	**6.0%**	9.06	12.08	16.84	25.47	47.27
	7.0%	8.54	11.45	16.04	24.35	45.35
	8.0%	8.05	10.85	**15.27**	23.27	43.51
	9.0%	7.58	10.28	14.54	22.25	41.75
	10.0%	7.13	9.73	13.84	21.27	40.08

*Source: **Global** Research*

b) **Valuations based on multiples** – In Saudi Arabia, SEC is the only listed company from power sector, therefore, for peer group valuation we have used the valuation of regional listed companies from the sectors. We believe that the comparative valuation would be more appropriately reflected through the book value multiple i.e. P/BV as the book value multiples of a stock are a reflection of various factors such as the expected profitability, growth potential as perceived by the market, predictability and the sustainability of revenues, quality of earnings and the quality of management among others.

The market cap. weighted average P/BV of the peer group comes to 1.36x. Therefore, on the basis of that SEC's stock valuation comes to SR15.4 based on its forecasted book value for FY2006. As the book value multiples vary with time and are dependent on several factors such as market sentiment and other qualitative factors, we have provided 20% weightage to the book value multiple and 80% to the DCF value calculation.

Weighted Average Valuation

The value derived through the combination of both the methods is SR15.3 per share. The stock currently trades at around SR11.75, which implies that the value arrived by using above methods is 30.2% higher than the current market price.

Table 13: Weighted Average Price

Valuation Approach	Fair Value/ Share (SR)	Weightage	Weighted Price (SR)
DCF Method	15.3	80%	12.2
Peer Group Valuation Method	15.4	20%	3.1
Estimated Fair Value/Share			**15.3**

*Source: **Global** Research*

Outlook

Strong growth in the volume of investments in different sectors of the economy has seen the demand for power growing constantly in the recent years in Saudi Arabia which witnessed a growth of 6% per annum in the last few years. The peak demand grew by about 7% per annum, which is likely to be in double digits over the next few years. Going forward, in the Kingdom, several large scale projects are coming up in different sectors valued at billions of dollars and the power and water sectors are the backbone of any industrial or infrastructure project. We have seen that peak demand is rising every year on a growing capacity base, therefore, we believe that, going forward, the country will to focus keenly on expanding its capacity base which should outpace the growth in demand. Secondly, setting up of GCC power grid will open up another window of opportunity for the company to expand its business by trading in power with other GCC countries. In a nutshell, all these factors acting in favor of SEC offers good growth potential for the company. Hence, we initiate our coverage of SEC with a ‘**BUY**’ recommendation.

BALANCE SHEET

	Saudi Electricity Company							
(Amount in SR '000)	**2003 (A)**	**2004 (A)**	**2005 (A)**	**2006 (E)**	**2007 (E)**	**2008 (E)**	**2009 (E)**	**2010 (E)**
Assets:								
Bank & cash equivalents	1,782,086	1,185,875	1,007,916	2,172,273	3,170,146	3,200,753	3,927,521	6,254,223
Consumers receivable & accrued revenue	15,907,855	19,349,198	22,750,051	25,528,006	28,126,530	30,416,182	32,997,620	35,009,511
Inventories	3,148,380	3,564,705	3,654,403	3,692,529	3,840,402	3,913,587	4,112,796	4,184,599
Prepayments and other receivables	687,611	1,987,355	1,078,408	1,262,792	1,356,074	1,475,489	1,574,184	1,641,019
Total Current Assets	**21,525,932**	**26,087,133**	**28,490,778**	**32,655,600**	**36,493,153**	**39,006,010**	**42,612,121**	**47,089,352**
Long-term investments	80,185	87,764	339,639	487,707	585,248	673,036	773,991	890,090
Construction in progress	5,543,650	8,542,433	13,211,241	14,889,431	14,926,282	14,087,460	12,829,932	11,944,092
Gross fixed assets	158,769,038	164,273,415	170,662,233	177,855,195	185,711,133	194,515,796	203,364,025	212,211,500
Less: accumulated depreciation	(84,541,951)	(89,784,449)	(95,141,041)	(101,063,619)	(107,266,371)	(113,772,924)	(120,585,619)	(127,586,476)
Net fixed assets	74,227,087	74,488,966	75,521,192	76,791,576	78,444,762	80,742,872	82,778,406	84,625,024
Total Assets	**101,376,854**	**109,206,296**	**117,562,850**	**124,824,315**	**130,449,446**	**134,509,378**	**138,994,450**	**144,548,558**
Liabilities:								
Bank overdrafts	-	200,456	-					
Accounts payable	22,353,516	27,804,623	32,114,648	36,469,425	39,597,370	42,494,082	45,940,465	49,572,456
Accruals and other payables	1,667,835	1,222,296	1,176,700	1,212,280	1,247,588	1,239,411	1,220,796	1,299,140
Current portion of long-term loans	1,230,344	1,148,832	991,222	1,251,093	1,534,674	1,409,981	1,281,801	1,086,272
Total Current Liabilities	**25,251,695**	**30,376,207**	**34,282,570**	**38,932,798**	**42,379,632**	**45,143,474**	**48,443,062**	**51,957,868**
Non-current portion of long-term loans	4,034,974	4,831,214	7,349,395	8,340,617	8,536,621	7,745,741	6,477,286	5,660,760
Deferred revenue	8,929,723	9,580,115	9,957,130	10,433,170	11,152,590	11,809,923	12,615,828	13,484,444
Employees' end of service benefits	3,518,220	3,660,541	3,842,627	4,034,758	4,236,496	4,448,321	4,670,737	4,904,274
Consumer deposits	830,783	883,720	930,732	981,922	1,035,928	1,098,084	1,163,969	1,233,807
Total Non-Current Liabilities	**17,313,700**	**18,955,590**	**22,079,884**	**23,790,467**	**24,961,635**	**25,102,069**	**24,927,820**	**25,283,285**
Government loan	14,552,136	14,552,136	14,938,060	14,938,060	14,938,060	14,938,060	14,938,060	14,938,060
Owner's Equity:								
Share capital	41,665,938	41,665,938	41,665,938	41,665,938	41,665,938	41,665,938	41,665,938	41,665,938
Statutory reserve	319,659	449,622	597,926	763,048	949,527	1,161,565	1,404,720	1,680,285
General reserve	213,668	525,327	530,510	530,510	530,510	530,510	530,510	530,510
Retained earnings	2,060,058	2,681,476	3,467,962	4,203,493	5,024,145	5,967,762	7,084,340	8,492,611
Total Shareholder's Equity	**44,259,323**	**45,322,363**	**46,262,336**	**47,162,989**	**48,170,119**	**49,325,776**	**50,685,508**	**52,369,345**
Total Liabilities & Shareholder's Equity	**101,376,854**	**109,206,296**	**117,562,850**	**124,824,315**	**130,449,446**	**134,509,378**	**138,994,450**	**144,548,558**

OPERATING STATEMENT

	Saudi Electricity Company							
(Amount in SR '000)	**2003 (A)**	**2004 (A)**	**2005 (A)**	**2006 (E)**	**2007 (E)**	**2008 (E)**	**2009 (E)**	**2010 (E)**
Electricity sales	16,373,914	16,320,524	17,429,591	18,823,605	20,268,652	22,124,576	24,202,214	25,893,102
Meter reading & maintenance & bill preparation tariff	609,282	637,219	660,372	711,551	764,917	824,198	894,255	965,795
Electrical service connection tariff	562,145	618,049	671,326	726,709	788,481	847,612	927,734	1,007,167
Sales	**17,545,341**	**17,575,792**	**18,761,289**	**20,261,865**	**21,822,050**	**23,796,386**	**26,024,203**	**27,866,065**
Cost of Sales	(14,929,162)	(16,114,612)	(17,115,957)	(18,436,759)	(19,798,685)	(21,542,139)	(23,452,126)	(24,957,167)
	85%	91.7%	91.2%	91.0%	90.7%	90.5%	90.1%	89.6%
Fuel	(4,015,105)	(4,171,344)	(4,573,978)	(4,969,432)	(5,391,462)	(5,973,635)	(6,607,204)	(7,120,603)
Purchased power	(931,484)	(952,047)	(1,151,615)	(1,324,357)	(1,483,280)	(1,661,274)	(1,860,627)	(2,085,762)
Operations & maintenance	(4,498,481)	(5,399,635)	(5,766,420)	(6,220,392)	(6,721,192)	(7,400,676)	(8,171,600)	(8,749,944)
Depreciation	(5,484,092)	(5,591,586)	(5,623,944)	(5,922,578)	(6,202,752)	(6,506,553)	(6,812,695)	(7,000,857)
Gross Profit	**2,616,179**	**1,461,180**	**1,645,332**	**1,825,105**	**2,023,365**	**2,254,247**	**2,572,077**	**2,908,898**
Employees' expenses & benefits	(959,317)	(148,894)	(140,367)	(149,938)	(161,483)	(176,093)	(208,194)	(222,929)
General & administration expenses	(217,591)	(15,850)	(1,469)	(18,236)	(21,822)	(26,176)	(28,627)	(30,653)
Allowances for doubtful accounts	(117,979)	(191,454)	(112,131)	(94,244)	(93,836)	(88,940)	(83,352)	(79,018)
Allowance for slow moving inventory	(11,004)	(101,779)	(132,206)	(121,916)	(100,119)	(72,864)	(69,982)	(96,577)
Operating Income	**1,310,288**	**1,003,203**	**1,259,159**	**1,440,772**	**1,646,104**	**1,890,174**	**2,181,923**	**2,479,721**
Income from long-term investments	165	7,579	(712)	975	1,170	1,346	1,548	1,780
Gain (loss) on disposal of fixed assets	10,076	20,881	53,113	35,571	37,142	38,903	40,673	42,442
Reversal of allowances & accruals	-	138,221	77,400	70,434	66,912	63,567	59,117	54,979
Reconnection fees	22,547	34,413	34,844	35,889	36,966	38,814	40,755	43,200
Penalties	32,936	27,804	64,701	77,641	89,287	102,680	123,217	147,860
Sales of tender documents	4,218	18,250	15,765	18,130	20,849	25,019	32,525	42,282
Other income & expenses	77,494	91,637	21,790	22,880	24,023	25,465	26,993	28,612
Income before Zakat	1,457,724	1,341,988	1,526,060	1,702,292	1,922,455	2,185,969	2,506,750	2,840,877
Zakat	(49,281)	(42,356)	(43,018)	(51,069)	(57,674)	(65,579)	(75,202)	(85,226)
Net Profit	**1,408,443**	**1,299,632**	**1,483,042**	**1,651,223**	**1,864,782**	**2,120,390**	**2,431,547**	**2,755,651**
P&L Appropriation Account:								
Op Balance of Retained Earnings	1,301,688	2,060,058	2,681,476	3,467,962	4,203,493	5,024,145	5,967,762	7,084,340
Adjustments								
Net Profit for the year	1,408,443	1,299,632	1,483,042	1,651,223	1,864,782	2,120,390	2,431,547	2,755,651
Trfr to Legal Reserve	(140,844)	(129,963)	(148,304)	(165,122)	(186,478)	(212,039)	(243,155)	(275,565)
Directors Remuneration	(1,100)	(1,000)	(1,000)	(1,000)	(1,000)	(1,000)	(1,000)	(1,000)
Dividends paid for the previous year	(508,129)	(547,251)	(547,252)	(749,570)	(856,652)	(963,733)	(1,070,815)	(1,070,815)
Cl Balance of Retained Earnings	2,060,058	2,681,476	3,467,962	4,203,493	5,024,145	5,967,762	7,084,340	8,492,611

CASH FLOW STATEMENT

(Amount in SR '000)	2003 (A)	2004 (A)	2005 (A)	2006 (E)	2007 (E)	2008 (E)	2009 (E)	2010 (E)
	Saudi Electricity Company							
Operating								
Operating Activities (a)	8,307,575	7,829,254	7,847,738	7,945,546	8,424,915	8,960,323	9,577,772	10,121,418
Net Profit	1,408,443	1,299,632	1,483,042	1,651,223	1,864,782	2,120,390	2,431,547	2,755,651
Allowance for doubtful receivables	117,979	191,454	144,022	94,244	93,836	88,940	83,352	79,018
Allowance for slow moving inventory	11,004	(112,964)	-	121,916	100,119	72,864	69,982	96,577
Income from long term investments	(165)	(7,579)	712	(975)	(1,170)	(1,346)	(1,548)	(1,780)
Depreciation	5,484,092	5,591,586	5,623,944	5,922,578	6,202,752	6,506,553	6,812,695	7,000,857
(Gain) loss on disposal of fixed assets - net	(4,016)	(20,881)	(53,113)	(35,571)	(37,142)	(38,903)	(40,673)	(42,442)
Provision for employees' end of services benefits	384,516	142,321	182,086	192,131	201,738	211,825	222,416	233,537
Electrical service connection tariff	810,288	650,392	377,015	-	-	-	-	-
Proceeds from customer deposits, net of refunds	46,153	52,937	47,012	-	-	-	-	-
Provision for zakat	49,281	42,356	43,018	-	-	-	-	-
Working Capital (b)	53,188	1,832	1,852,017	1,173,732	129,617	244,479	395,092	1,384,210
Dec/(inc.) in receivables	(4,039,825)	(3,628,045)	(3,506,242)	(2,872,199)	(2,692,360)	(2,378,591)	(2,664,790)	(2,090,910)
Dec/ (inc) in prepayments and other receivables	410,632	(1,304,496)	860,871	(184,384)	(93,283)	(119,415)	(98,695)	(66,835)
Dec / (inc) in inventories	293,581	(303,361)	(89,698)	(160,042)	(247,993)	(146,049)	(269,191)	(168,380)
Inc/(dec) in accounts payable	3,220,528	5,451,107	4,705,392	4,354,777	3,127,945	2,896,712	3,446,384	3,631,990
Inc/(dec) accruals and other payables	168,272	(213,373)	(118,306)	35,580	35,308	(8,178)	(18,615)	78,345
Total Operating (a+b)	8,360,763	7,831,086	9,699,755	9,119,278	8,554,532	9,204,802	9,972,864	11,505,628
Payment of Directors fees	-	-	-	(1,000)	(1,000)	(1,000)	(1,000)	(1,000)
Net Cash from Operating (a+b)	8,360,763	7,831,086	9,699,755	9,118,278	8,553,532	9,203,802	9,971,864	11,504,628
Investing								
Fixed assets & construction-in-progress	(7,023,875)	(8,866,305)	(11,334,410)	(8,871,152)	(7,892,789)	(7,965,841)	(7,590,701)	(7,961,636)
Income from long-term investments	-	-	-	975	1,170	1,346	1,548	1,780
Net (payments for) proceeds from investments	(7,043)	-	(252,587)	(148,068)	(97,541)	(87,787)	(100,955)	(116,099)
Proceeds from disposal of fixed assets	19,200	34,938	62,545	35,571	37,142	38,903	40,673	42,442
Total Investing	**(7,011,718)**	**(8,831,367)**	**(11,524,452)**	**(8,982,674)**	**(7,952,018)**	**(8,013,379)**	**(7,649,435)**	**(8,033,512)**
Financing								
Bank overdrafts	-	200,456	(200,456)	-	-	-	-	-
Dividends paid	(448,058)	(511,114)	(513,377)	(749,570)	(856,652)	(963,733)	(1,070,815)	(1,070,815)
Inc./(Dec.) in long terms & govt. loans	(1,031,747)	714,728	2,360,571	1,251,093	479,585	(915,572)	(1,396,636)	(1,012,055)
Movement in deferred income	-	-	-	476,040	719,420	657,333	805,905	868,616
Consumer deposits	-	-	-	51,190	54,006	62,156	65,885	69,838
Total Financing	**(1,479,805)**	**404,070**	**1,646,738**	**1,028,752**	**396,359**	**(1,159,817)**	**(1,595,660)**	**(1,144,415)**
Net change in cash	(130,760)	(596,211)	(177,959)	1,164,357	997,873	30,607	726,769	2,326,701
Net cash at beginning	1,912,846	1,782,086	1,185,875	1,007,916	2,172,273	3,170,146	3,200,753	3,927,521
Net cash at end	1,782,086	1,185,875	1,007,916	2,172,273	3,170,146	3,200,753	3,927,521	6,254,223

RATIOS

	Saudi Electricity Company							
	2003 (A)	2004 (A)	2005 (A)	2006 (E)	2007 (E)	2008 (E)	2009 (E)	2010 (E)
LIQUIDITY RATIOS								
- Current Ratio	0.9	0.9	0.8	0.8	0.9	0.9	0.9	0.9
- Quick Ratio	0.7	0.7	0.7	0.7	0.8	0.8	0.8	0.8
- Inventory Stock (days)	81	76	77	73	69	66	62	61
- Receivales Outstanding (days)	290	366	410	435	449	449	445	445
- Payables outstanding (days)	506	568	639	679	701	695	688	698
PROFITABILITY								
- Gross Profit Margin (%)	14.9%	8.3%	8.8%	9.0%	9.3%	9.5%	9.9%	10.4%
- Operating Profit Margin (%)	7.5%	5.7%	6.7%	7.1%	7.5%	7.9%	8.4%	8.9%
- Net Profit Margin (%)	8.0%	7.4%	7.9%	8.1%	8.5%	8.9%	9.3%	9.9%
- Return on Average Assets (%)	1.4%	1.2%	1.3%	1.4%	1.5%	1.6%	1.8%	1.9%
- Return on Average Equity (%)	3.2%	2.9%	3.2%	3.5%	3.9%	4.3%	4.9%	5.3%
TURNOVER RATIOS								
- Inventory Turnover	4.52	4.80	4.74	5.02	5.26	5.56	5.84	6.02
- Debtors Turnover	1.26	1.00	0.89	0.84	0.81	0.81	0.82	0.82
- Creditors Turnover	0.72	0.64	0.57	0.54	0.52	0.52	0.53	0.52
LEVERAGE RATIOS								
- Current Liability/Equity	0.6	0.7	0.7	0.8	0.9	0.9	1.0	1.0
- Capital Expenditure Ratio	1.2	0.9	0.7	0.9	1.1	1.1	1.3	1.3
- Long term Debt/Equity	0.4	0.4	0.5	0.5	0.5	0.5	0.4	0.4
RATIOS USED FOR VALUATION								
- Number of Shares Outstanding	4,166,593,800	4,166,593,800	4,166,593,800	4166593800	4166593800	4166593800	4166593800	4166593800
- EPS (SR) - Pre Stock Split	1.69	1.56	1.78	-	-	-	-	-
- EPS (SR) - Post Stock Split	0.34	0.31	0.36	0.40	0.45	0.51	0.58	0.66
- Book Value Per Share (SR) - Pre Stock Split	53.11	54.39	55.52	-	-	-	-	-
- Book Value Per Share (SR) - Post Stock Split	10.62	10.88	11.10	11.32	11.56	11.84	12.16	12.57
- Market Price Year End (SR) - Pre Stock Split	101.25	133.50	145.50	-	-	-	-	-
- Market Price Year End (SR) - Post Stock Split	20.25	26.70	29.10	11.75	11.75	11.75	11.75	11.75
- P/E (x)	59.91	85.60	81.76	29.65	26.25	23.09	20.13	17.77
- P/BV (x)	1.91	2.45	2.62	1.04	1.02	0.99	0.97	0.93

** Market price for 2006 and subsequent years are as per closing prices on Saudi Stock Exchange on Dec 03, 2006.*

1:5 stock split affected from April 2006.

The following is a comprehensive list of disclosures which may or may not apply to all our researche. Only the relevant disclosures which apply to this particular research has been mentioned in the table below under the heading of disclosure.

Disclosure Checklist

Company	Recommendation	Ticker	Price	Disclosure
Saudi Electricity Company	Buy	5110.SE	SR13.5	1,10

1. Global Investment House did not receive and will not receive any compensation from the company or anyone else for the preparation of this report.
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Global rating	Definition
Buy	Fair value of the stock is >10% from the current market price
Hold	Fair value of the stock is between +10% and -10% from the current market price
Reduce	Fair value of the stock is between -10% and -20% from the current market price
Sell	Fair value of the stock is < -20% from the current market price

Global Research

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