

SAUDI ELECTRICITY CO.

OVERWEIGHT
CURRENT PRICE SAR21.0UPSIDE +18.6%
PRICE TARGET SAR24.9

RATING CHANGE

Major regulatory changes, upgrade to Overweight

We upgrade SEC to Overweight with a revised PT of SAR24.9. We believe the recent electricity sector reforms will significantly improve SEC's financial position and ensure its sustainability. Revenues recognition will be based on Regulatory Asset Based (RAB) model from 2021f, while other reforms include 1) cancellation of government fees, 2) reclassification of government liabilities to subordinated perpetual equity like instrument and 3) adjusting dividends eligibility. The stock trades at 2021f PE and EV/EBITDA of 11.4x and 6.2x, lower than the peer group average of 15.3x and 9.0x, respectively.

- Implementing RAB model in 2021f:** Starting from 2021f, revenues will be determined by RAB model, which we believe will significantly improve SEC's financial position. According to the new model, the company will be eligible to earn a WACC of 6% of on the regulatory asset base (determined by the regulator). We estimate regulatory asset base to be c75% of SEC's total PPE (SAR430bn in Q3 20), which leads to an operating income of cSAR19.3bn in 2021f vs our previous estimate of SAR6.2bn. We believe the RAB model will create a robust framework to determine the returns on SEC's long term capital intensive projects and reduces investment risk.
- Cancellation of government fees:** Following 2018 tariff adjustment, SEC paid the difference between the new and old tariff to the government by including it as part of cost of service. SEC paid SAR14.7bn and SAR14.5bn in 2018 and 2019, respectively. The government will cancel these fees from 2021f, which we believe will increase SEC's cash flow profile. Based on 2019 financials, the pro forma operating income would be SAR21bn (vs SAR6.5bn reported). We believe the RAB model implicitly assume the removal of government fees.
- Reclassification of government liabilities:** SEC's government related liabilities of SAR168bn will be reclassified to subordinated perpetual equity-like instrument with a profit rate of 4.5%. We believe the re-classification will increase interest expense by SAR7.6bn annually and will reduce net debt levels to SAR124bn in 2021f (vs SAR215bn earlier). This will reduce net debt/EBITDA to 3.1x from 6.0x earlier. We note that the finance charge might be treated as part of equity. However, to be conservative, we have included them as part of the income statement for now.
- Upgrade to Overweight with a PT of SAR24.9:** We upgrade SEC from Neutral to Overweight with a revised PT of SAR24.9 (SAR17.3 earlier). We believe the new changes will significantly improve SEC's operating model. The stock trades at 2021f PE and EV/EBITDA of 11.4x and 6.2x, lower than the peer group average of 15.3x and 9.0x, respectively.

Summary Financials

SAR mn	2019	2020f	2021f	2022f	2023f	2024f	2025f
Revenues	65,040	64,553	65,775	67,285	68,837	70,534	72,275
Gross Income	6,124	6,047	19,518	19,695	19,790	19,851	19,787
Gross margin (%)	9.4%	9.4%	29.7%	29.3%	28.7%	28.1%	27.4%
EBIT	6,535	5,551	19,307	19,555	19,718	19,844	19,865
EBIT margin (%)	10.0%	8.6%	29.4%	29.1%	28.6%	28.1%	27.5%
Net income	1,388	35	7,598	8,608	8,831	8,977	9,077
Net margin (%)	2.1%	0.1%	11.6%	12.8%	12.8%	12.7%	12.6%
EPS (SAR)	0.33	0.01	1.82	2.07	2.12	2.15	2.18

Source: Company, NCBC Research estimates

Please refer to the last page for important disclaimer

الأهلي كابيتال
NCB Capital

This is an extract of our published report, the full version of which can be found on the Alahlicapital.com website.

STOCK DETAILS

M52-week range H/L (SAR)	22.2/14.5
Market cap (\$mn)	23,377
Shares outstanding (mn)	4,167
Listed on exchanges	TADAWUL

Price perform (%)	1m	3m	12m
Absolute	1.7	31.1	1.0
Rel. to market	(4.9)	21.9	(9.3)

Avg daily turnover (mn)	SAR	US\$
3m	151.2	40.3
12m	63.5	16.9

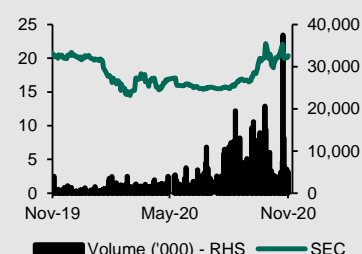
Reuters code	5110.SE
Bloomberg code	SECO AB
	www.se.com.sa

VALUATION MULTIPLES

	19a	20f	21f
PE (x)	63.8	NM	11.4
PB (x)	1.2	1.2	0.4
EV/EBITDA (x)	9.6	9.7	6.2
Div Yield (%)	3.3	3.3	3.3

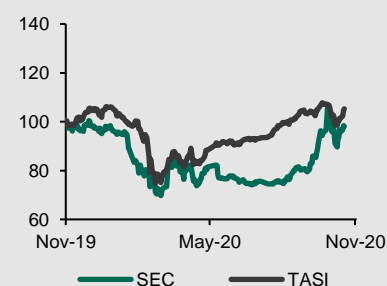
Source: NCBC Research estimates

SHARE PRICE PERFORMANCE



Source: Tadawul

RELATIVE PERFORMANCE



Source: Tadawul

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OVERWEIGHT: Target price represents an increase in the share price in excess of 15% in the next 12 months

NEUTRAL: Target price represents a change in the share price between -10% and +15% in the next 12 months

UNDERWEIGHT: Target price represents a fall in share price exceeding 10% in the next 12 months

PRICE TARGET: Analysts set share price targets for individual companies based on a 12 month horizon. These share price targets are subject to a range of company specific and market risks. Target prices are based on a methodology chosen by the analyst as the best predictor of the share price over the 12 month horizon

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