

November 21, 2019

Rating Neutral  
12-Month Target Price SAR 18.00

Price as on Nov-20, 2019 SAR 20.90  
Upside to Target Price (13.9%)  
Expected Dividend Yield 3.3%  
Expected Total Return (10.5%)

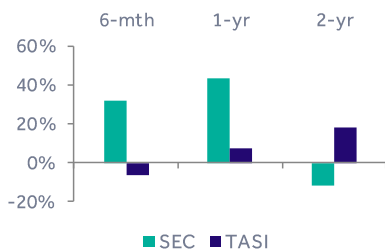
### Market Data

52 Week H/L SAR 21.6/14.4  
Market Capitalization SAR 87,082 mln  
Shares Outstanding 4,167 mln  
Free Float 17.8%  
12-Month ADTV 1,966,313  
Bloomberg Code SECO AB

### 1-Year Price Performance



Source: Bloomberg



## SAUDI ELECTRICITY Co

Initiating Coverage

### Profitability Pressured

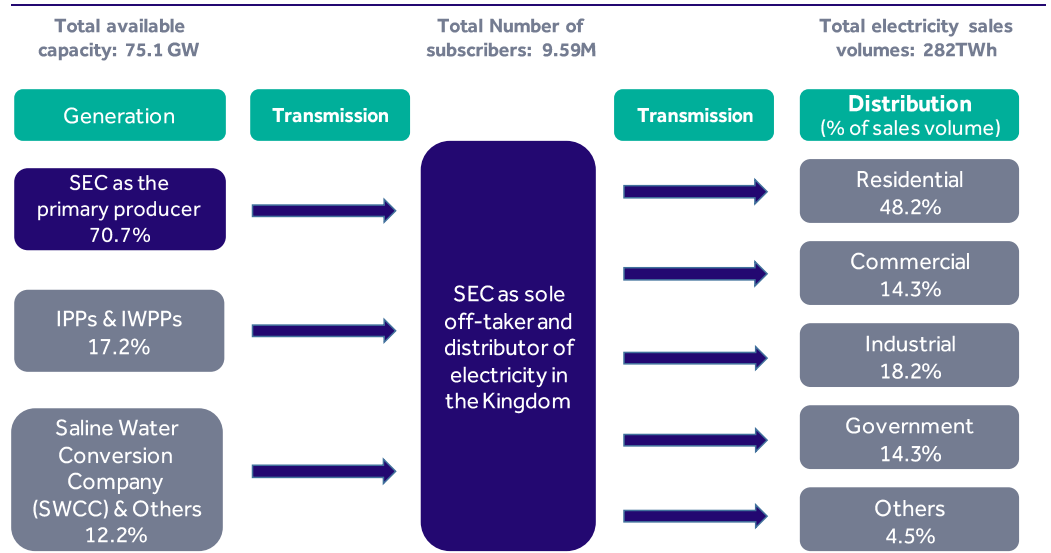
Saudi Electricity Company, the national provider of electricity with monopoly on transmission and distribution services within the Kingdom, has reported disappointing results in 9M 2019. Bottom-line fell sharply by -64% Y/Y during the period to SAR 1.98 billion. We believe the Company's profitability will remain pressured in 2019-2020 as a result of lower sales, higher cost of revenue and financial charges. We initiate our coverage on Saudi Electricity Co, valuing it with a dividend discount model as it is a stable dividend paying utility company, arriving at a target price of SAR 18.00 and a Neutral recommendation.

Several factors have contributed to 9M 2019 results, one of which is the drop in operating revenue by -4% Y/Y to SAR 48.75 billion, mainly driven by lower electricity sales as consumers have been inclined towards rationalization especially after the rise in tariffs. Cost of revenue rose by +2% Y/Y to SAR 43.80 billion during the period, owing to a +12% increase in depreciation, reflecting the growth in the operating asset base, though this was partially offset by a -4% decline in government fees due to continued consumption rationalization.

Other operating income as well as G&A expenses contributed positively to bottom-line as other operating income reached SAR 1.2 billion, up +42% Y/Y, on the back of better dividend income, fines and amortization of government grants revenue, while G&A expenses retreated by -2%. In spite of this relief, operating margin shrunk by 537 bps to 11%. Financial charges weighed with a surge of 23%, leading net profit margin to contract to 4% from 11% last year.

Looking at the Company's cash flows, we find a decrease in net outflow of cash due to investing activities falling from SAR 22.3 billion last year to SAR 13.7 billion, as per the SEC's strategy to rationalize capital expenditure to meet demand, improve reliability and connect new customer. Net cash outflow from financing activities stood at SAR 4.69 billion compared to net inflow of SAR 15.33 billion in 9M 2018.

### Exhibit 1: Overview on SEC's Main Functions



Source: SEC's 1H2019 Presentation

\* As per the financial statements for year ended 31 December 2018.

## Sector Overview

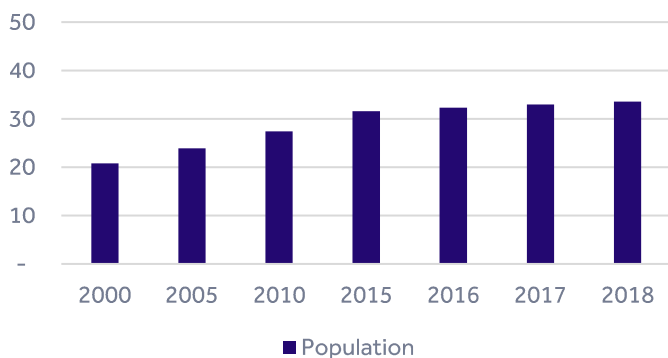
The KSA population has grown by a CAGR of 2.7% since the year 2000 to stand at almost 34 million by 2018-end. According to the World Bank, the population is expected to cross 45 million by 2050.

Table 1: KSA Population and Subscribers

	2012	2013	2014	2015	2016	2017	2018
Population	28,896,842	29,613,068	30,339,797	31,062,072	31,787,580	32,612,846	33,413,660
Number of Subscribers	6,746,646	7,159,368	7,620,128	8,112,539	8,607,000	9,069,513	9,434,489
Energy sales (GWh)	246,610	262,685	281,155	294,612	296,673	298,439	299,188

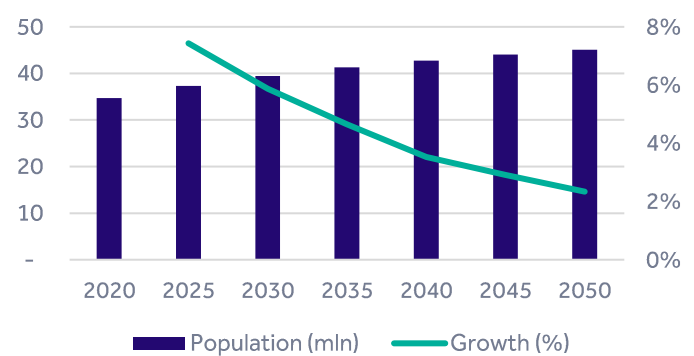
Source: GASTAT

Exhibit 2: Historical KSA Population Growth (mln)



Source: World Bank

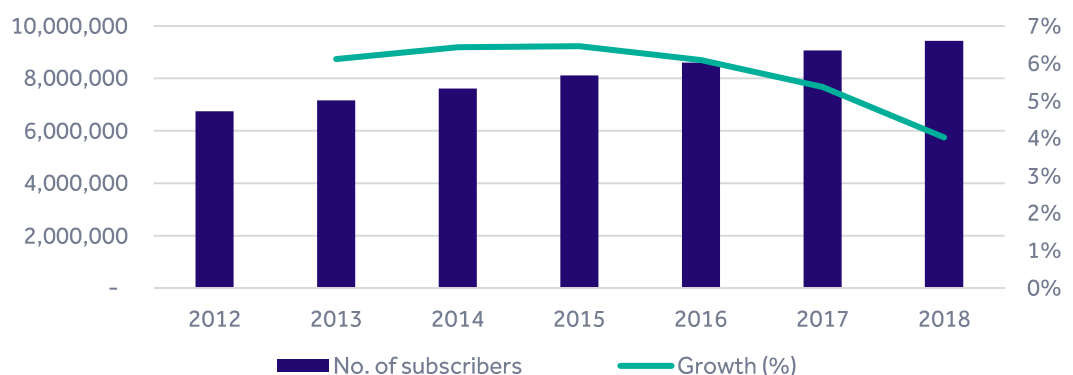
Exhibit 3: KSA Population Forecast (mln)



Source: World Bank

In line with the population growth, the number of subscriber have also risen from 6.8 million in 2012 to almost 9.5 million until 2018-end, as illustrated below.

Exhibit 4: Number of Subscribers in KSA



Source: ECRA

Produced energy has been consistently growing, though at a slower pace in the past three years. Energy sales moved along a similar trend showing lower rates of growth recently. On the other hand, energy usage per subscriber has been dropping since 2015. In fact, energy use per subscriber declined by -14% from 36,900 KWh in 2014 to 31,700 KWh in 2018. This can be attributed to the rise in

electricity tariffs twice, once in January 2016 and next in January 2018, given the government's view of rationalizing local energy consumption.

**Table 2: Electricity prices in KSA (2018)**

Consumption categories (Kwh)	Residential (Halalah/kwh)	Commercial (Halalah/kwh)	Agricultural & Charities (Halalah/kwh)	Governmental (Halalah/kwh)	Industrial (Halalah/kwh)	Private educational facilities, private medical facilities (Halalah/kwh)
1 _ 6000	18	20	16	32	18	18
More than 6000	30	30	20			

Source: SEC's Website

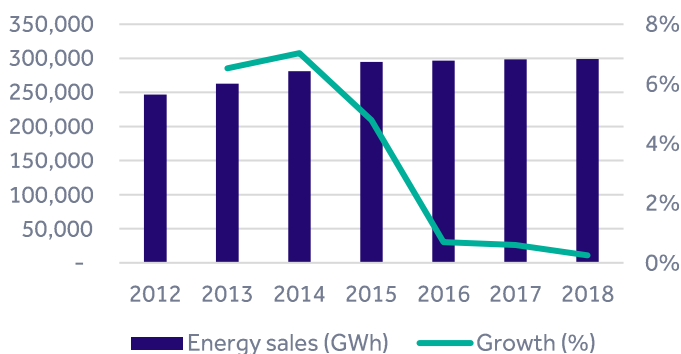
The rationalization trend is likely to continue in 2019-2020, while industrial and governmental sectors will increase their consumption as new projects will launch in the coming years as per Vision 2030. The following table demonstrates electricity demand as a percentage of total produced energy.

**Table 3: Indicators of Electrical Energy and Capacity in Saudi Arabia (GWh)**

	2012	2013	2014	2015	2016	2017	2018
Produced Energy	271,679	284,016	311,807	338,328	345,446	355,080	358,853
Consumed Energy	246,610	262,685	281,155	294,612	296,673	298,439	299,188
% of Demand	91%	92%	90%	87%	86%	84%	83%

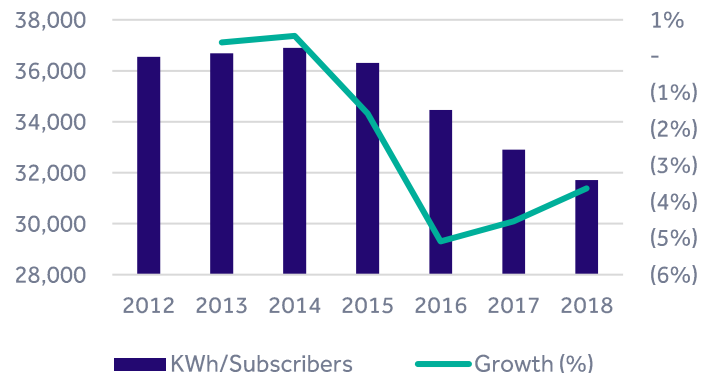
Source: GASTAT

**Exhibit 5: Energy sales (GWh) in KSA**



Source: ECRA

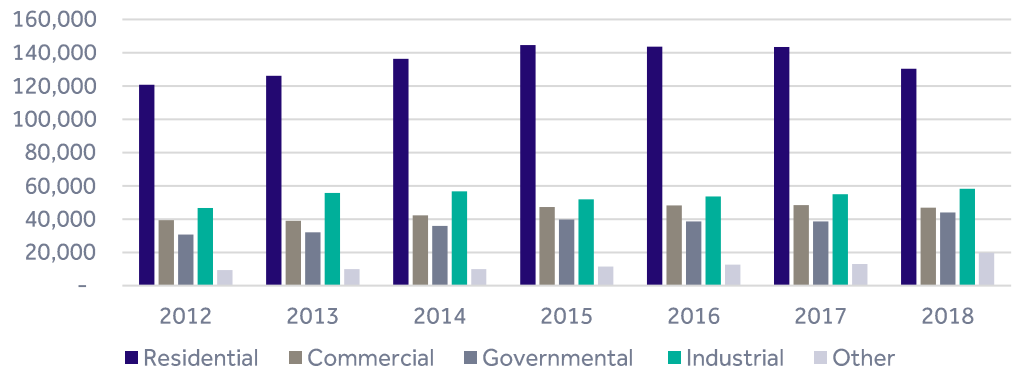
**Exhibit 6: Energy Consumption (KWh/Subscriber) in KSA**



Source: ECRA

The highest consumption of electricity has historically been by the residential sector followed by industrial. However, this is changing now post electricity tariff hikes. Residential consumers accounted for 49% of consumption in 2012 but its share has fallen to 44% in 2018 as illustrated below. We believe there will be a further decline in residential sector consumption as a percentage of total in the years to come.

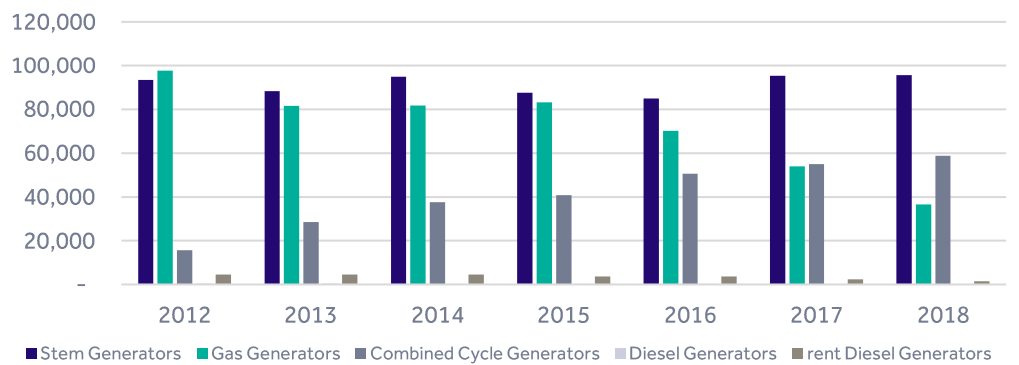
**Exhibit 7: Consumption of Electrical Energy by Sectors in KSA**



Source: GASTAT

Steam generators primarily produce electricity in the Kingdom. However, the proportion of combined cycle generators has been growing while using gas generators has been persistently going down.

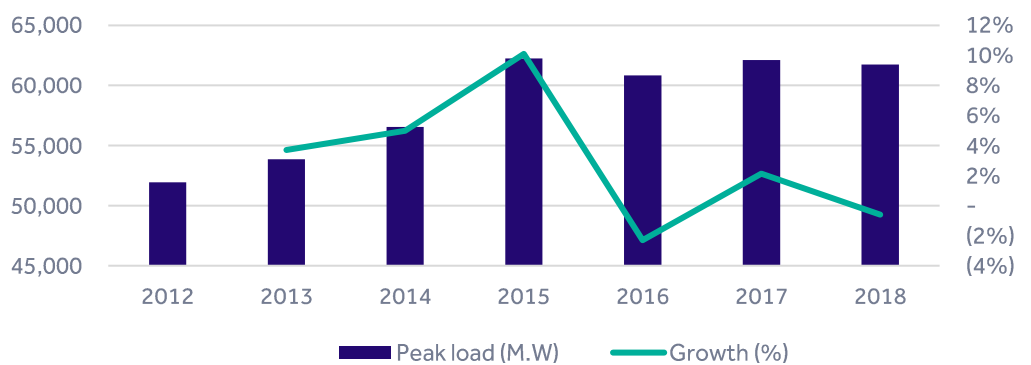
**Exhibit 8: Produced Electrical Energy in KSA**



Source: GASTAT

The peak load demand reached a high of 62,260 MW in 2015 and has fluctuated slightly since. Peak load demand is important, as the producer needs to incur capital expenditure to increase capacity in order to meet peak load demand. Its recent fall to 61,743 implies that there is limited need for additional capital expenditure in the time being.

**Exhibit 9: Peak Load (M.W) Demand in KSA**



Source: GASTAT

## ■ Company Overview

The Saudi Electricity Company (SEC) was founded pursuant to the Royal Decree No. M/16 dated 13 Dec 1999. The Company is the main provider of electric power in the Kingdom, serving governmental, industrial, agricultural, commercial and residential consumers. Its main activities are generation, transmission and distribution of electric power. SEC is 81.2% indirectly owned by the Kingdom of Saudi Arabia (74.3% owned by the Public Investment Fund and 6.92% by Saudi Aramco).

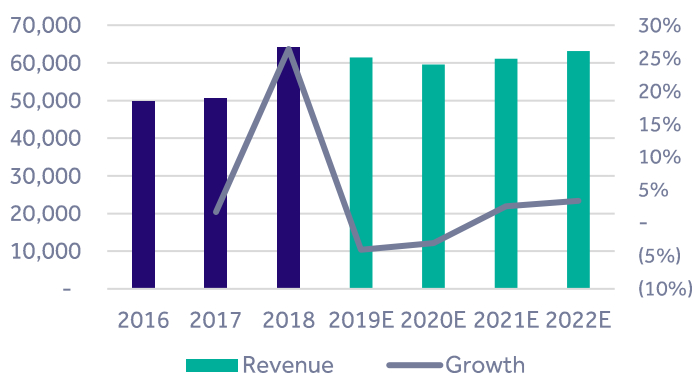
**Table 4: SEC's Fully Owned Subsidiaries and Their Main Activity**

Company	Country	Main Activity
National Grid S.A. Company	Saudi Arabia	Transmission
Saudi Power Procurement	Saudi Arabia	Main Buyer
Saudi Electricity For Projects Development	Saudi Arabia	Project Management
Dawiyat Telecom and information technology	Saudi Arabia	Telecommunication
Dawiyat Telecom Company	Saudi Arabia	Telecommunication
Saudi Electricity Global Sukuk	Cayman Islands	Finance
Saudi Electricity Global Sukuk - 2	Cayman Islands	Finance
Saudi Electricity Global Sukuk - 3	Cayman Islands	Finance
Saudi Electricity Global Sukuk - 4	Cayman Islands	Finance
Electricity Sukuk Company	Saudi Arabia	Finance

Source: SEC's Report

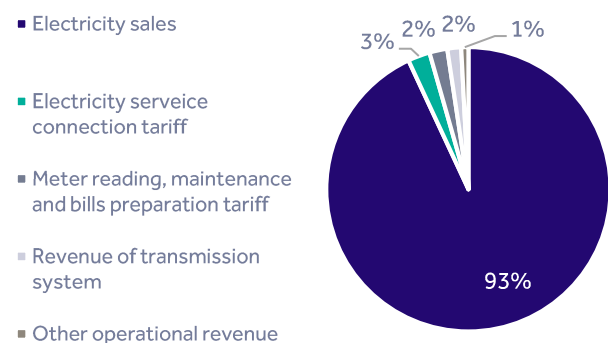
Revenues witnessed a substantial increase in 2018, growing by +26% Y/Y, primarily driven by higher electricity sales due to an increase in tariffs (mainly affecting residential and commercial segments). In addition, there has been higher consumption from governmental and industrial segments that partially offset the consumption rationalization in the residential segment. We anticipate a drop in revenues this year and the next, followed by a recovery in the coming years as we factor in the growing subscribers base and the upcoming projects in the Kingdom.

**Exhibit 10: Revenue through 2016-2022 (SAR mln)**



Source: Riyad Capital, Company Reports

**Exhibit 11: Revenue Breakdown (2018)**



Source: Riyad Capital, Company Reports

The following table shows the geographical distribution of company sales. The Central region has the lion's share of 31%, followed by the western region that rose significantly by +38% Y/Y to be the second highest region in electricity consumption, bumping the eastern region from second in 2017 to third place in 2018.

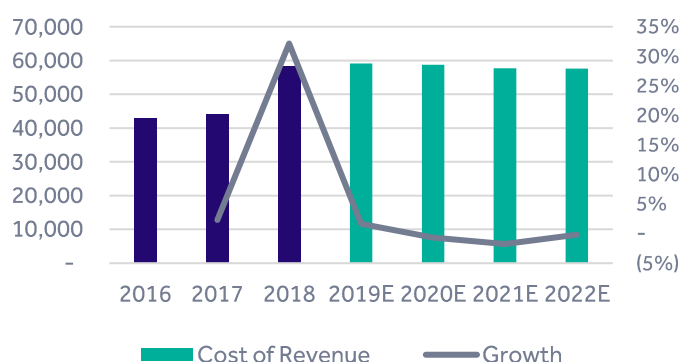
**Table 5: Electricity Sales by Region (SAR mln)**

Year	Item	Region				Total
		Central	Eastern	Western	Southern	
2018	Revenue / Sales	18,752	16,508	18,358	6,005	59,623
2017	Revenue / Sales	14,857	13,334	13,330	3,925	45,446

Source: SEC's Annual Report 2018

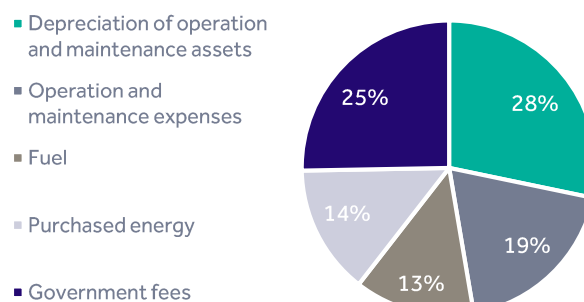
Tariff increase that contributed to augmenting sales was charged as a government fee in cost of revenue, leading them to jump +32% Y/Y in 2018, otherwise, cost of revenue would have decreased Y/Y, continuing SEC's operational efficiency. Fuel costs fell -15% Y/Y indicating improved thermal efficiency and fuel mix driven by lower diesel consumption. Not to mention the effect of lower energy production (2018 191 Twh, 2017: 204 Twh), a drop of 6.5% Y/Y. The Company shifted to using more gas in its generation plants in terms of MMBtu volume during 2018 where it took up to 39% of the fuel mix, followed by heavy fuel oil 29%, crude oil 27%, and diesel 5%. We believe 2019 will see another rise in cost of revenue but we see it easing in the coming years. Financial charges, on the other hand, had been on an uptrend for the past 3 years and expect the trend to continue in 2019 as well.

**Exhibit 12: Cost of Revenue through 2016-2022 (SAR mln)**



Source: Riyad Capital, Company Reports

**Exhibit 13: Cost of Revenue Breakdown (2018)**



Source: Riyad Capital, Company Reports

The Company has had a reduction in electricity demand, which eased its need to increase capital expenditure. However, with the increasing population, expanding residential sector, and growing consumption from the governmental and industrial sectors, we find that SEC will need to continue raising its capital expenditure to grow its capacity to meet future demand and improve reliability. This will lead the Company to seek even more loans in the future.

SEC is working on a restructuring plan overseen by the Ministry of Energy, Industry and Mineral Resources, Electricity & Cogeneration Regulatory Authority, Public Investment Fund and the Ministry of Finance. It aims to develop the electricity market in the Kingdom and increase the competitiveness in the economic operation of the electrical system, which contributes to raising the efficiency of operation, and reduce costs and increase the reliability of the network. If the plan succeeds, it will play a major role in boosting the national economy and comprehensive development plans in the Kingdom.

## Valuation

We valued Saudi Electricity Company using the DDM Approach. The Company is considered a regular dividend paying company with a historically constant DPS of SAR 0.70, which we assume will continue going forward, so we have taken it as an expected terminal DPS. We assumed a risk-free rate of 4.7% and used 0.72 as 2-year weekly beta obtained from Bloomberg. Cost of debt is 4% while long-term growth is assumed at 2%. We obtained a Weighted Average Cost of Capital of 6%; consequently, we arrive at a fair value of SAR 17.83 per share.

### Dividend Discount Model (DDM) Valuation

Assumptions	2019E	2020E	2021E	2022E	Assumptions	
EPS	(0.46)	(0.39)	0.39	1.07	Risk Free Rate	4.7%
DPS	0.70	0.70	0.70	0.70	Beta	0.72
Payout %	(39%)	(46%)	46%	17%	Market return	11%
Present Value DPS		0.66	0.62	0.59	Risk premium	7%
					Cost of equity	9%
Sum PV DPS		1.88			Cost of debt	4%
Expected EPS (T)		1.10			Equity Weight	35%
Expected Payout%		0.64			Debt Weight	65%
Expected DPS (T)		0.70	Terminal Growth	2%	<b>WACC</b>	<b>6%</b>
Terminal Price		18.94				
Discounted Terminal value		15.95				
<b>Target Price (SAR)</b>		<b>17.83</b>				

Source: Riyad Capital

We initiate coverage on Saudi Electricity Company (SEC) with a target price of SAR 18.00 and a Neutral Recommendation.

## Appendix

### Financials and Forecasts

	2018	2019E	2020E	2021E	2022E
<b>Income Statement (SAR mln)</b>					
Revenue	64,064	61,457	59,574	61,094	63,132
Gross Profit	5,920	2,351	863	3,414	5,565
EBITDA	22,952	21,242	20,739	23,578	27,056
EBIT	6,016	3,035	2,064	5,290	8,153
Net Income	1,757	(1,899)	(1,646)	1,632	4,474
EPS	0.42	(0.46)	(0.39)	0.39	1.07
DPS	0.70	0.70	0.70	0.70	0.70
<b>Balance sheet (SAR mln)</b>					
<b>Assets:</b>					
Total Current Assets	43,603	52,256	53,647	54,559	55,688
Total Non-Current Assets	420,953	422,658	428,385	436,198	445,254
Total Assets	464,556	474,913	482,032	490,757	500,942
<b>Liabilities:</b>					
Total Current Liabilities	160,776	167,938	171,173	181,241	179,744
Total Non-Current Liabilities	230,102	235,881	242,295	239,998	247,955
Total Liabilities	390,878	403,819	413,468	421,239	427,699
<b>Equity:</b>					
Total Equity	73,678	71,094	68,565	69,518	73,243
Total Equity and Liabilities	464,556	474,913	482,032	490,757	500,942
<b>Key Ratios</b>					
Gross Margin	9%	4%	1%	6%	9%
EBIT Margin	9%	5%	3%	9%	13%
EBITDA Margin	36%	35%	35%	39%	43%
Net Margin	3%	(3%)	(3%)	3%	7%
EV/EBITDA	20.7x	23.0x	24.x	21.5x	18.9x
EV/Sales	7.4x	8.0x	8.4x	8.3x	8.1x

Source: Riyad Capital, Company Reports



## ■ Stock Rating

Buy	Neutral	Sell	Not Rated
Expected Total Return Greater than +15%	Expected Total Return between -15% and +15%	Expected Total Return less than -15%	Under Review/ Restricted

\* The expected percentage returns are indicative, stock recommendations also incorporate relevant qualitative factors  
For any feedback on our reports, please contact [research@riyadcapital.com](mailto:research@riyadcapital.com)

## Disclaimer

Riyad Capital is a Saudi Closed Joint Stock Company with Paid up capital of SR 200 million, licensed by the Saudi Arabian Capital Market Authority NO.07070-37. Commercial Registration No: 1010239234. Head Office: Granada Business Park 2414 Al-Shohda Dist. – Unit No 69, Riyadh 13241 - 7279 Saudi Arabia. Ph: 920012299.

The information in this report was compiled in good faith from various public sources believed to be reliable. Whilst all reasonable care has been taken to ensure that the facts stated in this report are accurate and that the forecasts, opinions and expectations contained herein are fair and reasonable. Riyad Capital makes no representations or warranties whatsoever as to the accuracy of the data and information provided and, in particular, Riyad Capital does not represent that the information in this report is complete or free from any error. This report is not, and is not to be construed as, an offer to sell or solicitation of an offer to buy any financial securities. Accordingly, no reliance should be placed on the accuracy, fairness or completeness of the information contained in this report. Riyad Capital accepts no liability whatsoever for any loss arising from any use of this report or its contents, and neither Riyad Capital nor any of its respective directors, officers or employees, shall be in any way responsible for the contents hereof. Riyad Capital or its employees or any of its affiliates or clients may have a financial interest in securities or other assets referred to in this report. Opinions, forecasts or projections contained in this report represent Riyad Capital's current opinions or judgment as at the date of this report only and are therefore subject to change without notice. There can be no assurance that future results or events will be consistent with any such opinions, forecasts or projections which represent only one possible outcome. Further, such opinions, forecasts or projections are subject to certain risks, uncertainties and assumptions that have not been verified and future actual results or events could differ materially. The value of, or income from, any investments referred to in this report may fluctuate and/or be affected by changes. Past performance is not necessarily an indicative of future performance. Accordingly, investors may receive back less than originally invested amount. This report provides information of a general nature and does not address the circumstances, objectives, and risk tolerance of any particular investor. Therefore, it is not intended to provide personal investment advice and does not take into account the reader's financial situation or any specific investment objectives or particular needs which the reader may have. Before making an investment decision the reader should seek advice from an independent financial, legal, tax and/or other required advisers due to the investment in such kind of securities may not be suitable for all recipients. This research report might not be reproduced, nor distributed in whole or in part, and all information, opinions, forecasts and projections contained in it are protected by the copyright rules and regulations.