Saudi Electricity Co.

Utilities| Saudi Electric | 5110

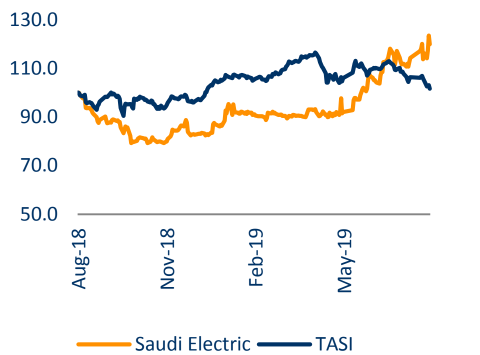
2Q19 Result Update | **September 02, 2019**

Recommendation	**Neutral**
Previous Recommendation	Neutral
Current Price (SAR)	20.7
Target Price (SAR)	19.6
Upside/Downside (%)	(4.9%)

As of September 02nd, 2019

Key Data (Source: Bloomberg)	
Market Cap (SAR bn)	86.1
52-Wk High (SAR)	21.6
52-Wk Low (SAR)	14.3
Total Outstanding shares (in mn)	4,167
Free Float (%)	17.8%

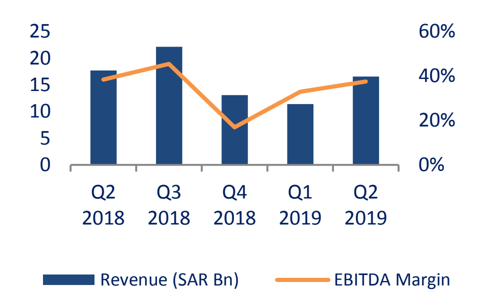
Saudi Electric vs. TASI (Rebased)



Price Performance (%)	**Absolute**	**Relative**
1m	(3.3%)	3.5%
6m	8.8%	(5.8%)
12m	(25.1%)	(32.8%)

Major Shareholders (%)	
Public Investment Fund	74.30%
The Saudi Arabian Oil Company	6.92%

Revenue and EBITDA Margin (%)



Source: Bloomberg, Company Financials, FALCOM Research; Data as of September 02, 2019

Seasonality helps SEC swing to net profit in 2Q19, but posts net loss in 1H19

Saudi Electric Co. (SEC)'s net profit slipped 57.3% YoY to SAR789mn during 2Q19 due to lower electricity sales and higher financing charges over the comparable period. In addition, the sales mix shifted to higher contribution from the lower tariff slabs. Its revenues declined 6.7% YoY during the quarter, but the cost sales continued to be higher, resulting in pressure on its gross profit margin. The company managed to contain its fuel and purchased power costs, driven by an improvement in operational efficiency. However, the company's operating income slumped 31.9% YoY to SAR 1.9bn. On a quarterly basis, its revenues improved 45.0% due to seasonality factors.

Saudi Electric continues to remain the market leader in KSA, with its power generating assets accounting for almost 70% of the total installed generation capacity. Its monopoly extends to the transmission segment as well, where the company connects almost 99% of the kingdom. Although the company is witnessing a rise in overall subscriber numbers, the energy demand growth is expected to flatten in the short term and record modest growth from 2021. The company is working to offset the flattening demand with improved operational efficiency through reducing fuel consumption and boosting thermal efficiency. The investments in the consumption rationalization continue to reduce the burden of capital expenditure on SEC and indicate the success of KSA's reform policy in raising the demand-side consumption efficiency. However, a shift to privatization and reforms in the kingdom's utility sector holds the key to the company's future performance. Thus, considering the countervailing factors, we maintain our "Neutral" rating on the stock.

- Revenues declined 6.7% YoY to SAR16.5bn during 2Q19, reflecting a lower electric power volume, primarily driven by a decline in residential and commercial consumption that accounts for about 60% of the consumption mix. Revenues from the transmission segment slipped on a one-off settlement related to a previous year wheeled energy volume. The company, however, witnessed improvements in revenues from meter reading, maintenance, bill preparation, and electricity connection tariff.
- Cost of sales remained largely in line with the comparable quarter last year. Fuel costs fell 10.4% YoY during 1H19 due to the continued optimization of the fuel mix. Also, the purchased power cost fell 6.6% YoY during the same period.
- Continued improvement in operational efficiency and lower maintenance and general administrative expenses failed to lift the operational profit which fell 31.9% YoY to SAR1.9bn during the quarter. Operating margin stood at 11.7% in 2Q19 compared with 16.0% in 2Q18.
- EBITDA dropped 8.8% YoY to SAR6.2bn and EBITDA margin contracted to 37.4% from 38.3% a year ago.
- SEC's net finance costs increased 14.8% YoY to SAR1.1bn in 2Q19, which exacerbated the slide in the net income that slipped 57.3% YoY to SAR 789mn.
- SEC expects further localization in the power industry over the next few years, following the launch of its Bena (Build and Employ National Abilities) program earlier this year.

Valuation: We maintain our "Neutral" rating on the stock with a target price of SAR 19.6 per share.

	2Q'19	2Q'18	% YoY	FY19E	FY18	% YoY
Revenues (SAR bn)	16.5	17.7	(6.7%)	63.9	64.1	(0.3%)
Gross Profit (SAR bn)	1.8	2.9	(38.0%)	5.1	5.9	(14.5%)
EBITDA (SAR bn)	6.2	6.8	(8.8%)	23.3	22.8	2.3%
Net Profit (SAR bn)	0.8	1.8	(57.3%)	1.1	1.8	(39.2%)
EPS basic (SAR)	0.19	0.44	(57.3%)	0.26	0.43	(39.2%)
Gross Margin (%)	11.0%	16.6%	(5.6%)	7.9%	9.2%	(1.3%)
EBITDA Margin (%)	37.4%	38.3%	(0.9%)	36.5%	35.6%	0.9%
Net Profit Margin (%)	4.8%	10.4%	(5.7%)	1.7%	2.8%	(1.1%)

Source: Company Financials, FALCOM Research

FALCOM Rating Methodology

FALCOM Financial Services uses its own evaluation structure, and its recommendations are based on quantitative and qualitative data collected by the analysts. Moreover, the evaluation system places covered shares under one of the next recommendation areas based on the closing price of the market, the fair value that we set and the possibility of ascent/descent.

Overweight: The Target share price exceeds the current share price by ≥ 10%.

Neutral: The Target share price is either more or less than the current share price by 10%.

Underweight: The Target share price is less than the current share price by ≥ 10%.

To be Revised: No target price had been set for one or more of the following reasons: (1) waiting for more analysis, (2) waiting for detailed financials, (3) waiting for more data to be updated, (4) major change in company`s performance, (5) change in market conditions or (6) any other reason from FALCOM Financial Services.

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