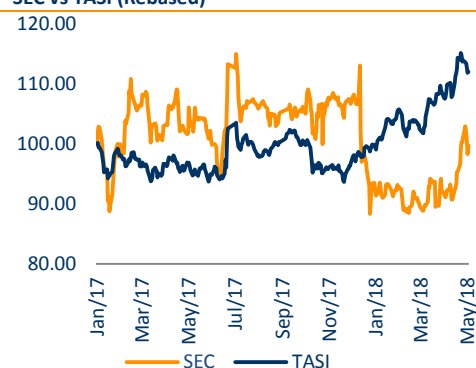


Initiation Coverage
May 10, 2018

Recommendation	Neutral
Current Price (SAR)	21.2
Target Price (SAR)	22.2
Upside/Downside (%)	4.5%

As of May 09, 2018
Key Data (Source: Bloomberg)

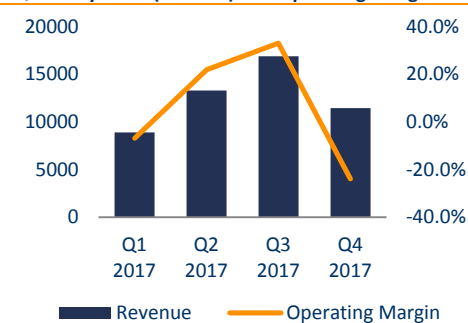
Market Cap (SAR bn)	88.45
52 Wk High (SAR)	26.05
52 Wk Low (SAR)	19.76
Total Outstanding shares (in mn)	4,166.6
Free Float (%)	17.08%

SEC vs TASI (Rebased)


Price Performance (%)	Absolute	Relative
1m	9.5%	5.5%
6m	-7.1%	-23.6%
12m	-4.2%	-20.6%

Major Shareholders (%)

Public Investment Fund	74.3%
Aramco(Saudi Arabian Oil Company)	6.9%

Quarterly Sales (SAR mn) and Operating Margin


Source: Bloomberg, Company Financials, FALCOM Research; Data as of 09th May, 2018

Saudi Electricity Company (SEC) reported a 52% Y/Y increase in net profits, driven by one-off municipality fees of SAR6,120mn, coupled with the non-recurring charge of SAR2,829mn related to human resource productivity improvement program. In 4Q17, SEC reported revenue of SAR 11,476mn (+7.7 Y/Y, -32.2% Q/Q), gross loss of SAR965mn (-50.8% Y/Y, -117.4% Q/Q). The company reported a net loss of SAR 5,521mn for Q4 2017, compared to a net loss of SAR 2,343mn in Q4 2016.

SEC enjoys a dominant market position in the domestic market, as an integrated electricity provider with strong credit rating underpinned by its favourable procurement cost structure and recurrent government support to capital structure. Conversely, the stock has been operating below global peer levels in terms of ROE and financial leverage. In our view, any tangible support to SEC's revenue from the regulatory policy to increase tariffs is highly unlikely. Moreover, the uncertainty prevails around SEC's plans to diversify into solar power generation, if we consider the government's plans to divest 100% of SEC's generation capacity by 2020. Given the countervailing factors, we recommend a neutral rating with a target price of SAR 22.2.

Below par ROE and financial leverage

SEC provided electricity on a government regulated subsidized rate. Despite favourable arrangements for the input fuel supply, lower revenues have suppressed the company's ROE which is much lower in comparison to its global peers. In 2017, ROE jumped up to 9.6% due to one-time gain of waived municipality levy worth SAR 6.1bn. Also the Saudi government ensures that funds are made available to the SEC on comfortable terms which in turn distorts the company's financial leverage. Hence, the proposed divestment of SEC's generation assets may help SEC with loan repayment and SEC can move towards becoming self-sufficient entity with internally generated FCF and sustainable debt levels.

Revised electricity tariff benefits to be passed to the government, consumption may be affected

Saudi Arabia's electricity regulator implemented a threefold increase in the tariffs from January 2018 to encourage more efficient utilization of electricity. However, SEC is required to pay the difference from the revised tariff as a fee to the government leading to no substantial effect on the realisable revenues or the Some changes in the electricity consumption pattern may be noted.

Uncertainly looms over diversification in solar energy and its impact on company's prospects

On 27th March 2018, Saudi Arabia's Public Investment Fund (PIF) extended its partnership with the SoftBank Vision Fund to create the world's largest solar power generation project with 200 GW capacity through 2030 with an estimated cost of US\$ 200 bn. The MoU entails the formation of a new power generation company. Saudi Arabia's National Transformation Program formalised a policy proposal to unbundle 100% of SEC's generation assets to four newly incorporated GenCos by 2020. However, the project remains in the early phases, and it is not yet guaranteed it will be built

Favourable cost structure with strong government support

The company enjoys a non-cash fuel procurement cost arrangement with Saudi Aramco wherein accrued Aramco payables are gradually transferred to a government account. In addition, the company has taken other steps to realise significant savings from cheaper fuel mix and the replacement of expensive diesel fired plant with the new thermal efficient combined cycle gas fired units. With planned capex focussing on further reduction in fuel costs and improving the national grid interconnectivity, the company may move towards a more refined cost structure.

Valuation: We valued Saudi Electric Company the DCF Approach to arrive at a fair value of SAR 22.2per share. We considered WACC at 6.0%, with a terminal growth rate of 2.0%.

	2017	2018E	2019E	2020E	2021E
Revenues (SAR bn)	50,615	52,509	54,299	55,923	57,616
Operating Profit (SAR bn)	5,180	6,266	6,535	6,876	7,392
EPS (SAR)	1.7	1.1	1.2	1.3	1.5
Operating Margin (%)	10.2%	11.9%	12.0%	12.3%	12.8%
D/E (x)	2.0	1.9	1.8	1.7	1.4
RoE (%)	9.6%	6.0%	6.0%	6.3%	6.7%
P/E (x)	12.7x	19.4x	18.0x	16.4x	14.4x
Price/BV (x)	1.2x	1.2x	1.2x	1.1x	1.0x
EV/EBITDA (x)	11.1x	10.6x	10.0x	9.2x	8.3x

Source: Company Financials, FALCOM Research

Initiation Coverage

May 10, 2018

Valuation Summary

Explanation of valuation methodology and assumptions

We valued Saudi Electricity Company using the DCF Approach to arrive at a fair value of SAR 22.2 per share. We considered WACC at 6.0% with a terminal growth rate of 2.0%. In relative terms, SEC is trading at 1yr forward P/E of 19.4x, at a premium of 56.8% to its sector peers and 27.6% to the Tadawul All Share Index.

SAR Mn	FY 2017	FY 2018E	FY 2019E	FY 2020E	FY 2021E
EBIT	5,180	6,266	6,535	6,876	7,392
Taxes	(5)	(141)	(151)	(166)	(190)
Depreciation, amortization and impairment	15,769	15,742	16,554	17,256	17,835
Changes in working capital	10,730	3,522	2,864	2,966	3,497
Net capital expenditure	(95,495)	(31,505)	(27,149)	(22,369)	(17,285)
Free Cash Flow to firm	(63,822)	(6,117)	(1,348)	4,563	11,250
<i>Discount Factor</i>		1.0	0.9	0.9	0.8
PV of free cash flow to firm		(5,891)	(1,225)	3,911	9,097
Net Present Value (A)					5,892
PV Terminal Value (B)					231,978
Assumed Terminal Growth Rate					2.0%
Discount Rate					6.0%
Enterprise Value (A+B)	237,871	WACC Assumptions			
Total Cash	1,058	Risk free rate	3.0%		
Total Debt	146,511	Market returns	8.1%		
Minority Interest	-	Beta	0.9x		
Equity Value in SAR mn	92,418	Cost of equity	10.5%		
Number of shares in mn	4,167	Post tax cost of debt	3.8%		
Target Price in SAR per share	22.2	Weight of equity in capital structure	33.0%		
CMP in SAR as on May 9th, 2018	21.2	Weight of debt in capital structure	67.0%		
Upside/(Downside) to current market price	4.5%	WACC	6.0%		

Source: Company Financials, FALCOM Research Estimates

Risks

Upside Risks:

- Positive changes in the electricity tariff reform may prove to be the stepping stone towards restructuring of the utility sector and the company may realize increased revenues going forward.
- Favorable cost structure, continued government support and further savings in maintenance and operational costs may lead to better returns.

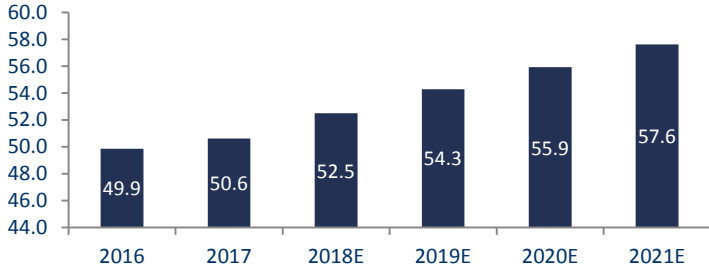
Downside Risks

- Lack of visibility on fuel costs, power tariffs and resolution of key balance sheet items including payables and receivables.
- Uncertainty over the timeline for the unbundling of the generation assets could push back the realization of divestment returns and the company's plans to become a self-sustaining entity.

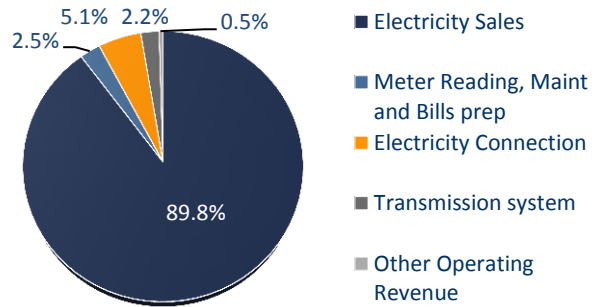


Key Charts

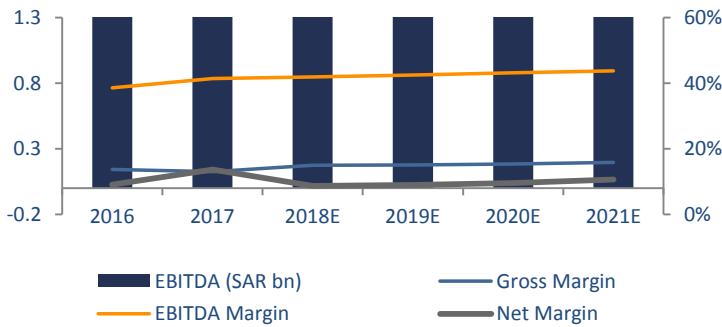
Revenue (SAR bn)



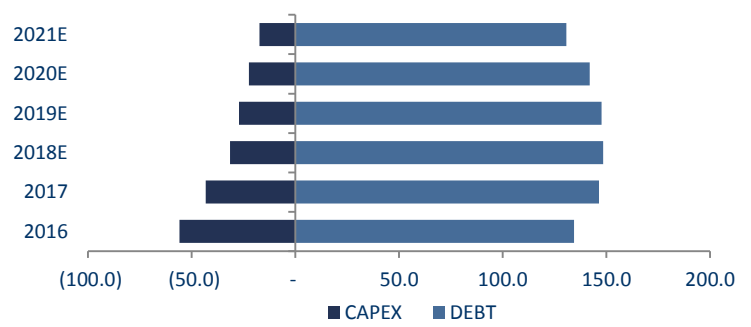
Revenue Split (2017)



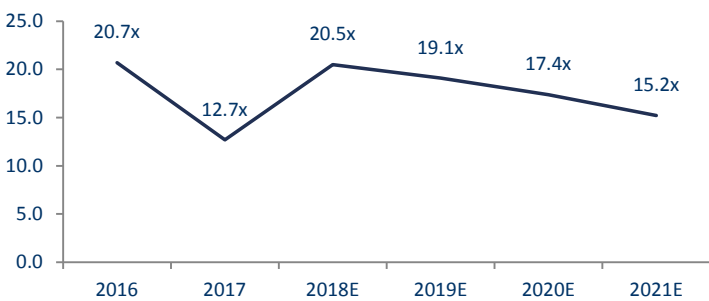
EBITDA & Margins



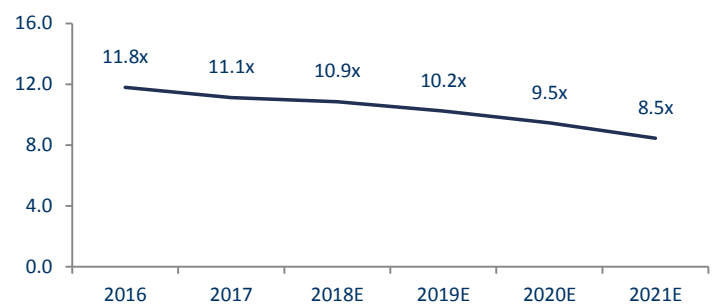
CAPEX and Debt (SAR bn)



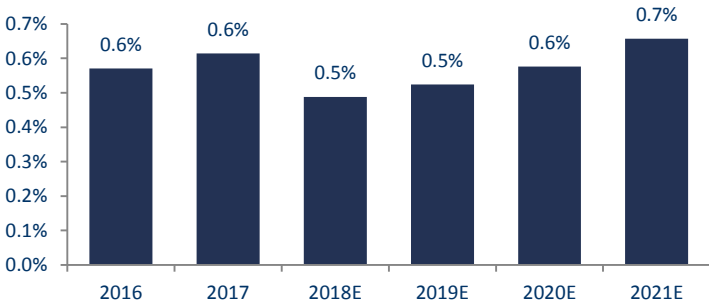
Price to Earnings



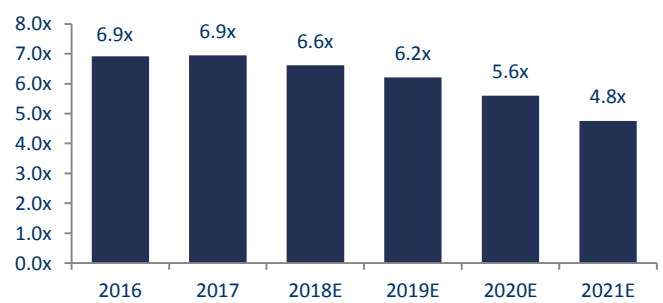
EV/EBITDA



Dividend Yield



Net Debt/EBITDA



Source: FALCOM Research Estimates

Initiation Coverage

May 10, 2018

Summary Financials

P&L (SAR mn)	2017	2018E	2019E	2020E
Revenue	50,615	52,509	54,299	55,923
Gross Profit	6,620	7,875	8,208	8,604
EBITDA	20,948	22,007	23,089	24,132
EBIT	5,180	6,266	6,535	6,876
Associates				
Net Interest	(2,752)	(2,790)	(2,773)	(2,667)
Other	4,716	1,217	1,277	1,332
PBT	7,144	4,693	5,039	5,541
Zakat and deferred taxes	(235)	(141)	(151)	(166)
Net Income	6,908	4,552	4,887	5,374
EPS	1.7	1.1	1.2	1.3
DPS	0.1	0.1	0.1	0.1

BS (SAR mn)	2017	2018E	2019E	2020E
Cash	1,058	3,036	4,332	7,003
Current Assets	38,628	39,391	40,225	42,219
Fixed Assets	404,290	420,124	430,797	435,998
Intangibles	372	380	382	378
Total Assets	445,760	462,274	473,698	480,809
Current Liabilities	151,718	155,507	158,095	160,009
Short Term Debt	17,142	18,624	18,810	18,434
Long Term Debt	129,368	129,900	128,826	123,559
Shareholders Equities	72,309	76,407	80,805	85,642
Total Liabilities & Shareholders' Equity	445,760	462,274	473,698	480,809

CF (SAR mn)	2017	2018E	2019E	2020E
Operating Cash Flow	22,884	31,180	29,727	30,924
Working Capital Changes	10,730	3,522	2,864	2,966
Cash Flow from Operating Activities	33,614	34,702	32,590	33,890
Capex	(43,219)	(31,583)	(27,230)	(22,452)
Cash Flow from Investing Activities	(43,234)	(31,492)	(27,144)	(22,372)
Changes in Debt	18,750	2,014	(889)	(5,643)
Dividends	(539)	(455)	(489)	(537)
Cash Flow from Financing Activities	9,632	(1,232)	(4,151)	(8,848)

Source: Bloomberg, Company Financials, FALCOM Research

Growth	2017	2018E	2019E	2020E
Revenue Growth	1.5%	3.7%	3.4%	3.0%
EBITDA Growth	8.7%	5.1%	4.9%	4.5%
Operating profit Growth	-10.6%	21.0%	4.3%	5.2%
PBT Growth	57.1%	-34.3%	7.4%	10.0%
Net Income Growth	52.0%	-34.1%	7.4%	10.0%

Ratios (%)	2017	2018E	2019E	2020E
Gross Margin	13.1%	15.0%	15.1%	15.4%
EBITDA Margin	41.4%	41.9%	42.5%	43.2%
EBIT Margin	10.2%	11.9%	12.0%	12.3%
Net Margin	13.6%	8.7%	9.0%	9.6%
ROE	9.6%	6.0%	6.0%	6.3%
ROCE	1.8%	2.0%	2.1%	2.1%
ROA	1.5%	1.7%	1.7%	1.8%
Debt/Equity	2.0	1.9	1.8	1.7
Net Debt/EBITDA	6.9	6.6	6.2	5.6
FCF Yield	-72.8%	-6.6%	-1.4%	4.9%
Dividend Yield	0.6%	0.5%	0.5%	0.6%

Valuation	2017	2018E	2019E	2020E
PE	12.7x	19.4x	18.0x	16.4x
PB	1.2x	1.2x	1.2x	1.1x
EV/EBITDA	11.1x	10.6x	10.0x	9.2x
EV/EBIT	45.0x	38.1x	36.2x	33.2x
EV/Sales	4.6x	4.5x	4.4x	4.1x

Peer Valuations	12M Fwd PE	12m Fwd EV/EBITDA
Abu Dhabi National Energy Co.	4.8x	8.3x
Dana Gas	NA	7.0x
Qatar Electricity & Water Co.	13.9x	16.0x
Energias Do Brasil SA	10.8x	6.0x
Energias De Portugal	14.9x	8.8x
Saudi Electricity Co.	19.4x	10.6x
Sector Median	12.4x	8.3x
TASI	15.2x	11.6x

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 $\geq 10\%$.

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 $\geq 10\%$.

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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