Saudi Electricity Co.

Utilities| Saudi Electric | 5110

3Q 2018 Result Update

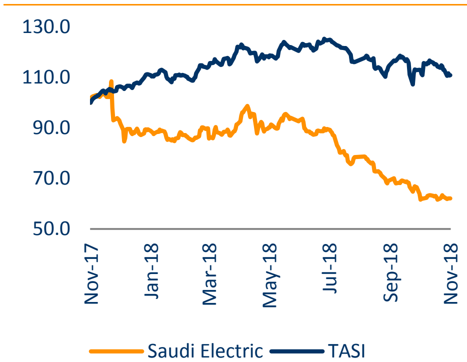
November 26, 2018

Recommendation	**Neutral**
Previous Recommendation	Neutral
Current Price (SAR)	14.5
Target Price (SAR)	14.8
Upside/Downside (%)	2.0%

As of November 26th, 2018

Key Data (Source: Bloomberg)	
Market Cap (SAR bn)	60.4
52 Wk High (SAR)	25.85
52 Wk Low (SAR)	14.34
Total Outstanding shares (in mn)	4,167
Free Float (%)	17.2%

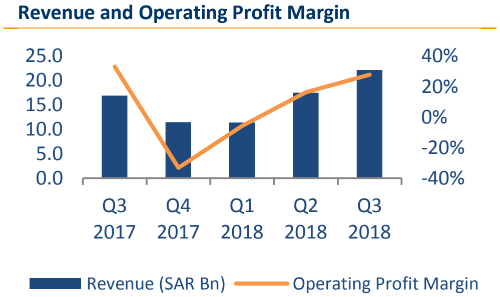
Saudi Electric vs. TASI (Rebased)



Price Performance (%)	**Absolute**	**Relative**
1m	(2.8%)	(0.9%)
6m	(31.2%)	(25.1%)
12m	(37.9%)	(48.8%)

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

Revenue and Operating Profit Margin



Source: Bloomberg, Company Financials, FALCOM Research; Data as of 26th November 2018

Net margins under pressure due to higher finance and zakat expenses

Saudi Electric reported decline of 6.4% YoY in net profit to SAR 4.9bn in 3Q18, and missed the consensus estimates. Revenue growth was led by an increase in electricity sales as a result of higher government and industrial consumption coupled with a rise in tariffs. The increase in tariffs contributed SAR5.2bn to the top line during the quarter. However, the revenue growth was offset by rising cost of sales, a surge in net finance expenses, a drop in net other income, and higher taxes. In contrast on a quarterly basis, net income increased 166.7%, driven by higher revenues and lower SG&A expenses.

Saudi Electric benefitted from the revised tariffs rate in 2018, which boosted the topline. However, high energy costs and government fees continue to pressure operating margins. Although the company enjoys government support in the form of free government loans and waived off dividend rights, the lack of reform in the Kingdom's utility sector limits the stock's upside potential. Hence, we maintain our "Neutral" rating on the stock.

- Revenue for the quarter increased 30.3% YoY and 26.5% QoQ to SAR 22.1bn. Growth was ascribed to a 33.1% YoY and 26.7% QoQ increase in electricity sales to SAR 21.0bn as a result of a tariff increase and higher consumption by government and industrial bodies. The total electricity consumption for 9M18 stood at 226.6Twh. Electricity connection fees, however, declined 48.5% YoY and 5.6% QoQ to SAR 357mn following the adoption of IFRS 15. Higher revenues of transmission system (+63.9% YoY) and higher sales from tariffs charged for meter reading, maintenance and bills preparation (+4.5% YoY) also supported the annual growth in the topline.
- Government fees of SAR 4.9bn increased cost of sales by 40.3% YoY partially offsetting revenue growth from higher tariffs. Gross profit grew 10.1% YoY to SAR 6.2bn, reflecting improvement in thermal efficiency, optimization in the fuel mix as a result of lower usage of diesel and crude oil, and decline in operational and maintenance expenses. Gross profit increased 125.8% QoQ as higher revenues more than offset an 8.1% rise in cost of sales.
- Operating income advanced 6.7% YoY and 110.9% QoQ to SAR 6.0bn, supported by higher revenues in spite of a reduction in net other income to SAR 80mn in 3Q18 from SAR 266mn in 3Q17 and SAR 443mn in 2Q18. The operating margin came in at 27.0% in 3Q18 (3Q17: 33.0%, 2Q18: 16.2%).
- Net finance costs increased SAR 710mn YoY to SAR 1.0bn as borrowings grew during the quarter. During September 2018, SEC issued a global sukuk amounting to SAR 7.5bn equivalent to US$2bn. Sequentially, net finance costs rose 6.0% from SAR 991mn in 2Q18. Additionally, SEC undertook capital expenditure of SAR6.3bn in 3Q18, in line with the company's efforts to meet growing demand, expand the customer base, and improve reliability.
- Net income declined 6.4% YoY to SAR 4.9bn as a result of higher finance charges; lower other income, and an increase in zakat expenses. Net income, however, grew sequentially, driven by a higher top line and lower operating and non-operating expenses, which more than offset a fall in other net income and increase in finance charges.
- SEC recently announced the issuance of a cabinet resolution which requires inclusion of Saudi Aramco's shares among beneficiaries in any future dividends.

Valuation: We revised down our target price to SAR 14.8, in line with the recent share price decline, as we expect margins to remain under pressure in 2018. We maintain a "Neutral" rating on the stock.

	3Q'18	3Q'17	% YoY	FY18E	FY17	% YoY
Revenues (SAR bn)	22.1	17.0	30.3%	62.5	50.6	23.6%
Gross Profit (SAR bn)	6.2	5.6	10.1%	8.5	6.6	29.0%
EBITDA (SAR bn)	6.0	5.6	6.7%	7.9	10.0	-21.4%
Net Profit (SAR bn)	4.9	5.3	-6.4%	4.8	6.9	-30.4%
EPS basic (SAR)	1.18	1.26	-6.4%	1.15	1.66	-30.4%
Gross Margin (%)	27.9%	33.0%	-5.1%	13.6%	13.1%	0.6%
Operating Margin (%)	27.0%	33.0%	-6.0%	12.6%	19.8%	-7.2%
Net Profit Margin (%)	22.3%	31.0%	-8.7%	7.7%	13.6%	-6.0%

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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Disclaimer and Risks Warning:

FALCOM acquired the Saudi Capital Market Authority license number (37-06020) on 27/05/2006, and commenced providing its services to the investors in the Saudi Stock Exchange on 19/02/2007 with CR Number 1010226584 Issued on 04/12/1427H.