FALCOM فالكم

Saudi Electricity Co.

Utilities| Saudi Electric | 5110

INTELLIGENT INVESTMENT IDEAS

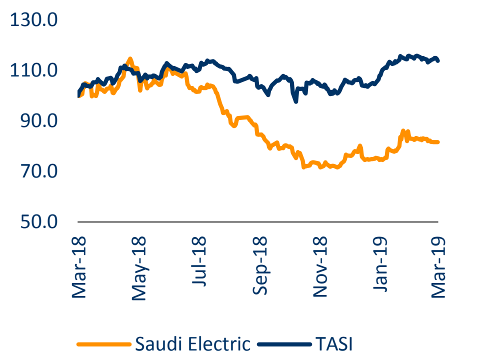
FY18 Result Update **March 12, 2019**

Recommendation	**Neutral**
Previous Recommendation	Neutral
Current Price (SAR)	16.3
Target Price (SAR)	17.7
Upside/Downside (%)	8.5%

As of March 12th, 2019

Key Data (Source: Bloomberg)	
Market Cap (SAR bn)	68.0
52 Wk High (SAR)	23.4
52 Wk Low (SAR)	14.3
Total Outstanding shares (in mn)	4,167
Free Float (%)	17.0%

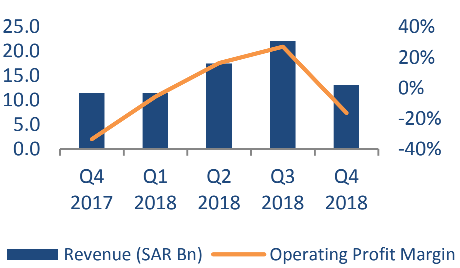
Saudi Electric vs. TASI (Rebased)



Price Performance (%)	**Absolute**	**Relative**
1m	(1.7%)	(0.1%)
6m	(3.5%)	(13.8%)
12m	(18.5%)	(32.2%)

Major Shareholders (%)	
Public Investment Fund	74.3%
The Saudi Arabian Oil Company	6.92%

Revenue and Operating Profit Margin



Source: Bloomberg, Company Financials, FALCOM Research; Data as of 12th March 2019

FY18 net income much below expectations

Saudi Electric Co. (SEC) reported a 74.2% YoY decline in net profit in FY18, below consensus estimate. Revenues grew 26.4% YoY, led by an increase in electricity sales due to higher government and industrial consumption coupled with a rise in tariffs. The increase in tariffs contributed SAR 14.7bn to the top line during the quarter; the same amount, however, was deducted as government fees as part of operating costs. Besides, the gains in the top line were also limited by a surge in net finance expenses, a drop in net other income, and non-recurring write-off of municipality fees as well as adaptation of IFRS 15.

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.

- Revenues for the year grew 26.4% to SAR 64.1bn on 31.2% YoY increase in electricity sales to SAR 59.6bn as a result of a tariff increase and higher consumption by government and industrial bodies. Electricity connection fees, however, declined 37.9% YoY to SAR 1.6bn following the adoption of IFRS 15. Revenues for 4Q18 increased 13.6% YoY but declined 41.4% QoQ to SAR 13.0bn due to seasonal effect. Tariff increase differential contributed SAR 3bn and SAR 14.7bn to electricity sales in 4Q18 and FY18, respectively.
- Cost of sales increased 32.2% to SAR 58.2bn following the inclusion of government fees totaling SAR 14.7bn; this offset the benefits from higher tariffs. Gross profit declined 11.7% to SAR 5.9bn. Gross margin narrowed to 9.2% in FY18 from 13.2% in FY17. Fuel costs declined, reflecting improvement in thermal efficiency and fuel mix driven by lower diesel consumption. In 4Q18, gross losses increased 125% to SAR 2.4bn.
- Consequently, operating income for the year declined 39.6% YoY to SAR 6.0bn, while operating margins fell to 9.4% in FY18 from 19.7% in FY17 in the absence of any non-recurring revenues and lower gross profits. Operating income and margin dropped despite an improvement in operational efficiency reflected in SG&A costs declining to SAR 889mn in FY18 from SAR 1.0bn an year earlier.
- Depreciation increased 7.5%, reflecting growth in depreciable operating asset base: projects worth SAR 44.1bn were completed and became operational during 2018. The company invested SAR 29.5bn in capital projects during 2018 (2017: SAR 43.3 billion).
- Net finance costs increased to SAR 4.1bn from SAR 2.8bn during the year driven by increase in term loans and other interest bearing liabilities. Net income declined 74.2% YoY to SAR 1.8bn as a result of higher finance charges; lower other income; application of IFRS 15; and other one-off items. Net margin for the year slipped to 2.8% in FY18 from 13.6% in FY17.
- SEC recently announced that the construction of an electricity substation in Jeddah, entailing an investment of SAR 180mn was complete. The project has been set up to ensure stability of the national electricity grid in main regions across Jeddah.
- SEC entered a syndicated Murabaha facility agreement valued at SAR 15.2bn with several banks for seven years for general corporate purpose.

Valuation: We revised our target price slightly upwards to SAR 17.7, in the light of increased sales from completed projects and improving operational efficiencies. We maintain a "Neutral" rating on the stock.

	4Q'18	4Q'17	% YoY	FY19E	FY18	% YoY
Revenues (SAR bn)	13.0	11.5	13.6%	67.0	64.1	4.6%
Gross Profit (SAR bn)	(2.4)	(1.0)	148.4%	7.6	5.9	28.2%
EBITDA (SAR bn)	(2.1)	(3.8)	(44.5%)	8.1	6.0	33.5%
Net Profit (SAR bn)	(3.8)	(5.5)	(31.7%)	4.0	1.8	124.9%
EPS basic (SAR)	(0.91)	(1.33)	(31.7%)	0.96	0.43	124.9%
Gross Margin (%)	(18.2%)	(8.3%)	(9.9%)	11.3%	9.2%	2.1%
Operating Margin (%)	(16.4%)	(33.5%)	17.1%	12.0%	9.4%	2.6%
Net Profit Margin (%)	(28.9%)	(48.1%)	19.2%	6.0%	2.8%	3.2%

Source: Company Financials, FALCOM Research

nFALCOM 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.

FALCOM Financial Services

Contact us on the below phone numbers:
Customer Services: 8004298888
Brokerage Services: 920004711

Fax or Email us at the below number:
Fax: +966 11 2032546
Email: addingvalue@falcom.com.sa

Mail us at the following address:
P.O. Box 884
Riyadh 11421
Kingdom of Saudi Arabia

Disclaimer and Risks Warning:

The information in this report was compiled from various public sources believed to be reliable and whilst all reasonable care has been taken to ensure that the facts stated in this report are accurate and that the forecasts, opinions, future prices and expectations contained herein are fair and reasonable, FALCOM makes no representations or warranties whatsoever as to the accuracy of the data and information provided and, in particular, FALCOM does not represent that the information or expected future prices 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 or the expected prices contained in this report. FALCOM accepts no liability whatsoever for any loss arising from any use of this report or its contents, and FALCOM shall not be in any way responsible for the contents hereof. Opinions, forecasts or price projections contained in this report represent FALCOM'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, prices or events will match any such opinions, forecasts or prices projections which represent only one possible outcome and these price estimates may not occur in the future whatsoever. Further, such opinions, forecasts or price projections are subject to certain risks, uncertainties and assumptions that have not been verified and future actual results or events could differ materially. Any value or price, 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, the person who obtain a copy of this report should understand that this report is not intended to provide personal investment advice and does not take into account his/her financial situation or any specific investment objectives or particular needs which he/she may have. Before making an investment decision the investors should seek advice from an independent financial, investment 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 price estimates contained; are protected by the intellectual property laws, copyright and publishing rules and regulations applied in the Kingdom of Saudi Arabia.

All rights reserved.

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.