

**2Q 2018 Result Update**

**August 27, 2018**

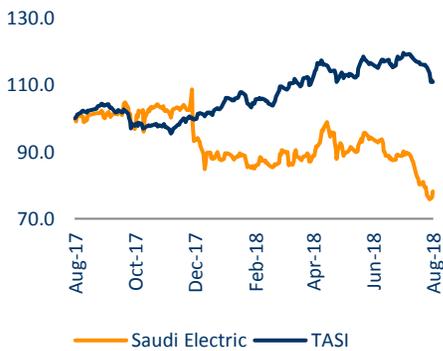
Recommendation	Neutral
Previous Recommendation	Neutral
Current Price (SAR)	18.5
Target Price (SAR)	19.1
Upside/Downside (%)	3.5%

As of August 26th, 2018

**Key Data (Source: Bloomberg)**

Market Cap (SAR bn)	77.0
52 Wk High (SAR)	25.85
52 Wk Low (SAR)	17.66
Total Outstanding shares (in mn)	4,167
Free Float (%)	17.1%

**Saudi Electric vs. TASI (Rebased)**



Price Performance (%)	Absolute	Relative
1m	(12.1%)	(5.7%)
6m	(9.1%)	(13.8%)
12m	(21.9%)	(32.6%)

**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 August 2018

**Higher finance cost weighs on 2Q18 performance**

Saudi Electric reported a net profit of SAR 1.8bn in 2Q18 after booking net losses in last two quarters. However, this was below consensus estimates and 17.3% lower than the SAR 2.2bn net profit reported in 2Q17. Revenue grew 31.5% YoY to SAR 17.5bn, due to higher electricity sales resulting from increase in government and industrial consumption and higher tariffs. This topline growth was registered in spite of the IFRS 15 implementation, which impacted electricity connection fee revenues. Net profitability was impacted by introduction of government fees (which offset the impact of higher tariffs), increase in finance costs, and a decline in other income.

Saudi Electric recently launched the Tayseer program, which offers installment options for residential customers whose monthly power bills fall in the SAR 300-3,000 range. We expect this program to support residential consumption levels, which have been declining after the tariff hike. Saudi Electric enjoys a dominant market position in the domestic market, with recurrent government support to capital structure. However, the company has been unable to reap tangible benefits from the tariff hike, due to the royal mandate to pay an equivalent amount as government fees. Additionally, uncertainty prevails around the company's plans to diversify into solar power generation. Given the countervailing factors, we maintain our 'Neutral' rating on the stock.

- Revenue for 2Q18 increased 31.5% YoY to SAR 17.5bn. This growth was ascribed to 36.4% YoY increase in electricity sales worth SAR 16.6bn as average sale price increased from SAR 0.174 per Kwh in 1H17 to SAR 0.229 per Kwh in 1H18. Decline in residential and commercial electricity consumption was offset by an increase in government and industrial consumption. Electricity connection fees, however, declined 39.8% YoY to SAR 378mn due to the adoption of IFRS 15, which requires the fees to be recognized over the useful lives of the connection equipment.
- Tariffs hike's SAR 4.2bn contribution to revenue growth was offset by government fees of an equivalent amount reported under cost of sales. Thus, gross profit grew only 1.6% YoY to SAR 2.7bn. Cost savings from improvement in thermal efficiency, optimization of fuel mix and lower operations and maintenance expenses (resulting from workforce reduction) were offset by higher depreciation and cost of purchased power. Consequently, gross margin shrank 460bps YoY to 15.6%.
- Operating income declined 3.0% YoY to SAR 2.8bn, as net other income declined from SAR 669mn in 2Q17 to SAR 443mn in 2Q18. This was partially offset by 21.5% YoY reduction in general and administrative expenses of SAR 342mn. Consequently, operating margin declined 578bps YoY to 16.2%.
- Borrowings increased SAR 1.6bn YoY to SAR 15.7bn, thus net finance charges increased 42.7% YoY to 991mn. Saudi Electric undertook SAR 8.7bn capital expenditure in 2Q18 to meet rising demand, improve reliability, and increase customer base.
- Net income declined 17.3% YoY to SAR 1.8bn as a result of lower operating income and increase in finance charges. The company approved a dividend payment of SAR 0.7 per share for financial year 2017.
- Saudi Electric recently launched operations at seven electric transmission stations with a total capacity of 3,613MVA in the Northern Borders Region at a cost of SAR 2.1bn. This forms the base for Saudi Electric's Egypt-Saudi Arabia electricity interconnection project.

**Valuation:** We have revised down our target price to SAR 19.1, in-line with recent share price decline and incorporating weak 2Q18 results, as we expect operating margins to remain under pressure during the remaining quarters of 2018. We maintain Neutral rating on the stock.

(in SAR bn)	Q2'18	1Q'17	% YoY	FY18E	FY17	% YoY
Revenues	17.5	13.3	31.5%	52.5	50.6	3.7%
Gross Profit (Loss)	2.7	2.7	1.6%	7.6	6.6	15.5%
Operating Profit (Loss)	2.8	2.9	-3.0%	7.4	10.0	-26.3%
Net Profit (Loss)	1.8	2.2	-17.3%	4.3	6.9	-37.2%
EPS (LPS) basic (SAR)	0.44	0.54	-17.3%	1.04	1.66	-37.2%
Gross Margin (%)	15.6%	20.2%	-4.6%	14.6%	13.1%	1.5%
Operating Margin (%)	16.2%	22.0%	-5.8%	14.0%	19.8%	-5.7%
Net Profit Margin (%)	10.6%	16.8%	-6.2%	8.3%	13.6%	-5.4%

Source: Company Financials, FALCOM Research

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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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