

CREDIT OPINION

28 March 2023

Update

Send Your Feedback

RATINGS

Saudi Electricity Company

| | |
|------------------|-----------------------------|
| Domicile | Riyadh, Saudi Arabia |
| Long Term Rating | A1 |
| Type | LT Issuer Rating - Fgn Curr |
| Outlook | Positive |

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

Contacts

Paul Feghaly +971.4.237.9531
Analyst
paul.feghaly@moodys.com

Ahmed Al-hubaishi +971.4.237.9508
Associate Analyst
ahmed.al-hubaishi@moodys.com

Rehan Akbar, CFA +971.4.237.9565
Senior Vice President
rehan.akbar@moodys.com

Saudi Electricity Company

Update following A1 ratings affirmation, change of outlook to positive

Summary

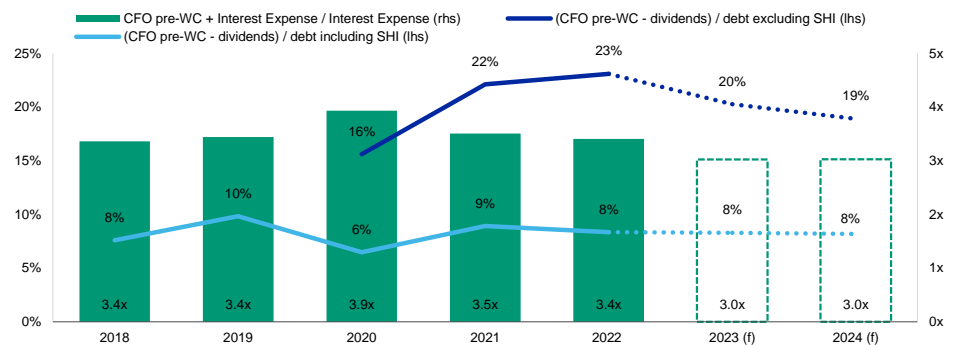
On March 23 2023, we affirmed [Saudi Electricity Company's](#) (SEC or the Company) A1 ratings, and changed its outlook to positive from stable.

The affirmation of the A1 issuer rating and change of outlook to positive from stable mirrors the action taken on the the [Government of Saudi Arabia](#) (A1 Positive) rating and the [Public Investment Fund](#) (PIF, A1 Positive) rating and also reflects the significant credit linkages between SEC and its parent company the PIF, as well as its ultimate holder, the Government of Saudi Arabia. SEC is Saudi Arabia's main electricity utility company with all of its assets located in the country and it also benefits from supportive government policies.

SEC's A1 ratings incorporate a standalone assessment that has the characteristics of a strong Baa profile and multiple notches of uplift, reflecting SEC's continued strategic importance to the PIF, and therefore the Government of Saudi Arabia. It is supported by the low business risk profile of its integrated electricity activities and its dominant market position in Saudi Arabia and continued ongoing support from the government including fuel and other forms of subsidies. Since 1 January 2021, SEC operates under a new regulated asset base framework that is transparent and supportive. SEC's A1 ratings, also reflect a growing debt load as substantial investments are incurred to meet the growing demand for electricity in Saudi Arabia.

Exhibit 1

Large financial servicing costs will continue to weigh on SEC's credit ratios



All ratios are calculated using Moody's estimates and standard adjustments. Moody's Forecasts (f) are Moody's opinion and do not represent the views of the issuer. Periods are Financial Year-End unless indicated. We classify the company's shareholder instrument (SHI) as debt under our adjustments.

Source: Moody's Investors Service

Credit strengths

- » Dominant market position in Saudi Arabia
- » Transparent and supportive new regulatory framework
- » Track record of ongoing government support

Credit challenges

- » Limited track record under the new regulatory framework
- » Shareholder instrument increases debt servicing costs
- » Growing debt load as a result of substantial investments needs

Rating outlook

The positive outlook on SEC's ratings reflects the company's low business risk profile and considers the significant credit linkages between SEC and PIF and the government.

Factors that could lead to an upgrade

SEC's ratings could be upgraded if the PIF's or the Saudi Arabia's sovereign rating were to be upgraded. This would also require no material deterioration in the company's operating and financial performance and a good track record under the new regulatory regime.

Factors that could lead to a downgrade

SEC's ratings could be downgraded if PIF's or the Government of Saudi Arabia's ratings were to be downgraded. The rating could also be downgraded because of a reduction in Moody's assumption of parental support; or if SEC's credit profile weakens such that:

- » $(\text{CFO pre-WC} + \text{interest})/\text{interest}$ is sustained below 3.0x
- » $(\text{CFO pre-WC} - \text{dividends})/\text{debt}$, excluding the shareholder instrument from debt, is sustained below 15%

Key indicators

Exhibit 2

| | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 (f) | 2024 (f) |
|---|-------|-------|-------|-------|-------|----------|----------|
| (CFO Pre-W/C + Interest Expense) / Interest Expense | 3.4x | 3.4x | 3.9x | 3.5x | 3.4x | 3.0x | 3.0x |
| (CFO Pre-W/C) / Debt | 7.9% | 10.3% | 6.7% | 10.0% | 10.0% | 9.3% | 9.2% |
| (CFO Pre-W/C - Dividends) / Debt | 7.6% | 9.8% | 6.5% | 9.0% | 8.9% | 8.3% | 8.2% |
| Debt / Book Capitalization | 72.6% | 69.8% | 78.6% | 77.4% | 75.6% | 75.9% | 76.0% |

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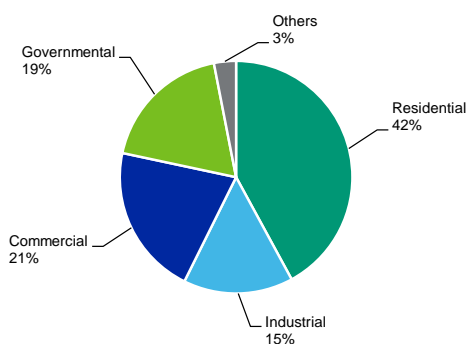
Source: Moody's Investors Service

Profile

SEC is the dominant vertically integrated electricity utility in Saudi Arabia, where it served over 10.9 million customers as of 31 December 2022. The company owns 41 major plants with a generation capacity of 54.5 Gigawatts (GW) and has interest in joint ventures with generation capacity of a further 16.5 GW, representing the vast majority of Saudi Arabia's generation capacity. The Saudi government indirectly owns 81.2% of SEC, including 74.3% directly through PIF and 6.9% through [Saudi Arabian Oil Company](#) (Saudi Aramco, A1 positive). The remaining 18.8% is listed on the Saudi Stock Exchange. The company reported consolidated revenues of SAR72.1 billion (\$19.2 billion) during 2022 and SAR479.5 billion in assets (\$127.9 billion) as of 31 December 2022.

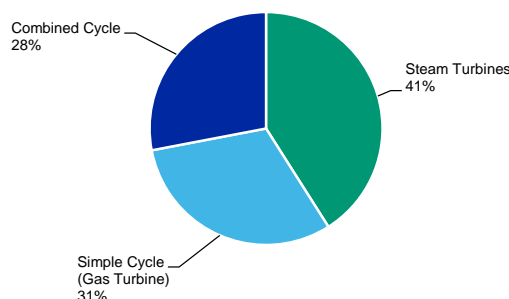
This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody.com> for the most updated credit rating action information and rating history.

Exhibit 3
Revenue breakdown by type of customer



As of 31 December 2022
Source: Company data

Exhibit 4
Installed electricity generation capacity directly owned by SEC



As of 31 December 2022
Source: Company data

Detailed credit considerations

Dominant market position in Saudi Arabia's power sector

SEC plays a strategically important role as the dominant provider of electricity in Saudi Arabia. This is especially true given the country's desert climate that leaves it highly reliant on energy-intensive water desalination and air conditioning. As of 31 December 2022, SEC's direct share of the total electricity generation capacity in Saudi Arabia stood at around 65%. In addition SEC also held interest in joint ventures with generation capacity in Saudi Arabia of around 16.5 GW. The company also benefits from monopolistic positions in the transmission and distribution of electricity.

The planned unbundling and privatization of the electricity sector are part of the government's plan to promote competition in Saudi Arabia and are enshrined in the Electricity Law. Their materialization could affect SEC's credit profile. We expect SEC to maintain its dominant position as a transmitter and distributor of electricity for the foreseeable future, given the government's prudent approach on reforms in the power sector.

During 2022, SEC completed the carve out of [Saudi Power Procurement Company](#) (SPPC, A1 positive), the sole electricity principal buyer in Saudi Arabia. The carve out ultimately improves the competitive environment for Independent Power Producers (IPPs). This is part of the various reforms that the electricity sector is currently undergoing in Saudi Arabia. SPPC is not supposed to generate any profit under its regulatory framework, and the license specifically prohibits the company from making investments and engaging in any activities outside its core licensed business.

The carve out of SPPC is neutral to SEC as it will sell the power that it generates to SPPC under the energy conversion agreements (ECAs) and will buy the power that it transmits and distributes to end customers from SPPC under the bulk supply agreement (BSA). Consequently, SEC has contracted to supply its entire electricity power production to SPPC for the remaining periods of the entire productive life of its generation plants.

New regulatory framework is transparent and supportive

SEC started operating under a new regulatory framework on 1 January 2021. The framework allows SEC to recover its operational costs and earn a fair rate of return of 6.0% on its investments under a regulated asset base model with control periods of three years. This will lead to more stable and predictable cash flows for most of the company's operations. However, we recognize the need for an operating track record under the new regulatory framework, such as the timeliness of payments by the government and the outcome of the upcoming negotiation with the regulator on the rate of return to be set for the next price control period (PCR) starting in 2024.

Demand for electricity remains strong in Saudi Arabia despite the rationalization of energy consumption through various initiatives

The demand for electricity in Saudi Arabia continue to grow with SEC recording a 3.9% increase in the number of new customers compared to 2021 as well as an increase of 2.2% in the volume of total energy sold in 2022 when compared to prior year. However

the growth in consumption volumes has softened since 2016 despite a sustained increase in customers served. This is the result of two substantial tariff increases in 2016 and 2018 that were aimed at rationalizing the consumption behaviour of customers and reducing government subsidies. Electricity tariffs are determined by an independent regulator, with any proposed changes in residential tariffs requiring the approval of the Council of Ministers. While the government aims to continue decreasing non-oil subsidies, electricity tariffs are unlikely to continue to increase at a significant pace in the future.

Auxiliary support provisions set to continue

The substantial tariff reforms in 2016 and 2018 have significantly improved SEC's standalone revenue generation. Direct government subsidies through the balancing fund represented 4.3% of SEC's revenue during 2022. However, the company will continue to benefit from a number of indirect subsidy mechanisms. For instance, SEC benefits from the subsidized fuel prices prevailing in Saudi Arabia for feedstock. In addition, subsidies through the 'citizen account' scheme indirectly help eligible Saudi citizens pay their electricity bill.

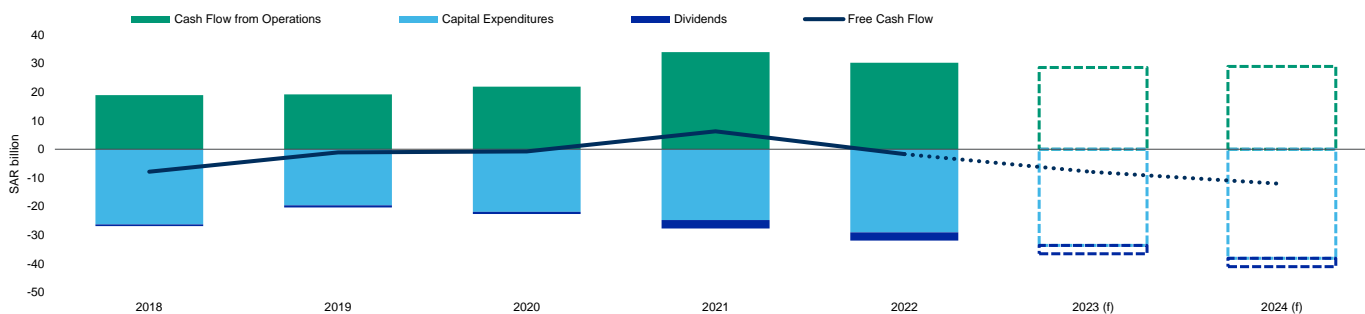
Large investment needs will constrain free cash flow generation

SEC is set to generate significant operating cash flows under the new regulatory framework. Cash flow from operations will reach around SAR36 billion in 2023 before the periodic distribution under the shareholder instrument. However, the SAR7.7 billion periodic payment and increased capital spending under the new regulatory framework will lead to significant negative free cash flow over the foreseeable future.

The long-term energy plans of the government and the growing demand for electricity in Saudi Arabia will continue to call for significant investments. Between 2018 and 2022 the company reported an average of SAR26 billion a year of capital investments, representing around 38% of the revenue generated over that same period, and largely in excess of its internal cash generation. While the successive tariff increases in 2016 and 2018 led to a rationalization of electricity demand and a reduction in peak capacity investments, the new regulatory framework is likely to encourage additional capital spending, including towards network efficiency. Capital investments could reach around SAR36 billion per year, over the next two years, and are expected to represent around 48% of SEC's revenue.

Exhibit 5

Large capital investments will lead to sustained negative free cash flow



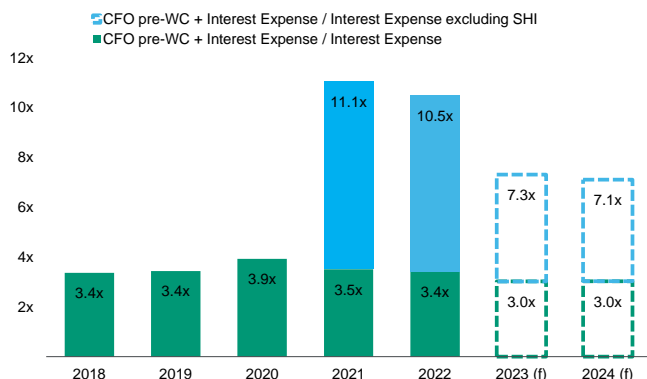
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Source: Moody's Investors Service

Shareholder instrument and increasing debt burden put negative pressure on credit ratios

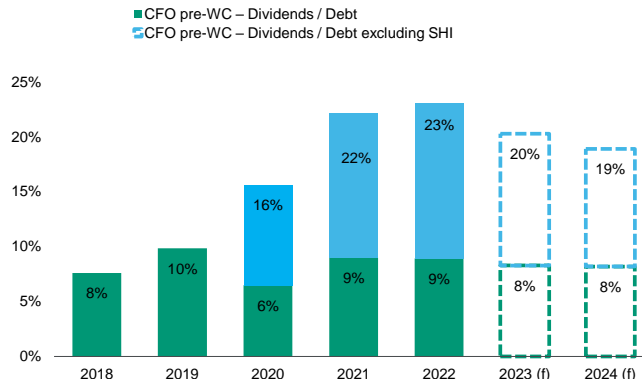
The SAR7.7 billion periodic distribution under the shareholder instrument and gradually increasing interest payments will weigh on the company's coverage ratios. $(CFO \text{ Pre-W/C} + \text{Interest Expense}) / \text{Interest Expense}$ will reach 3.0x in 2023, compared to 7.3x when excluding the periodic distribution from the calculation. Similarly, $(CFO \text{ Pre-W/C} - \text{Dividends}) / \text{Debt}$ will reach 8% in 2023, compared to 20% when excluding the periodic distribution from CFO and the shareholder instrument from debt.

Exhibit 6
Periodic distributions under the shareholder instrument significantly decreases interest coverage



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 Source: Moody's Investors Service

Exhibit 7
The inclusion of the shareholder instrument in debt significantly decreases debt coverage

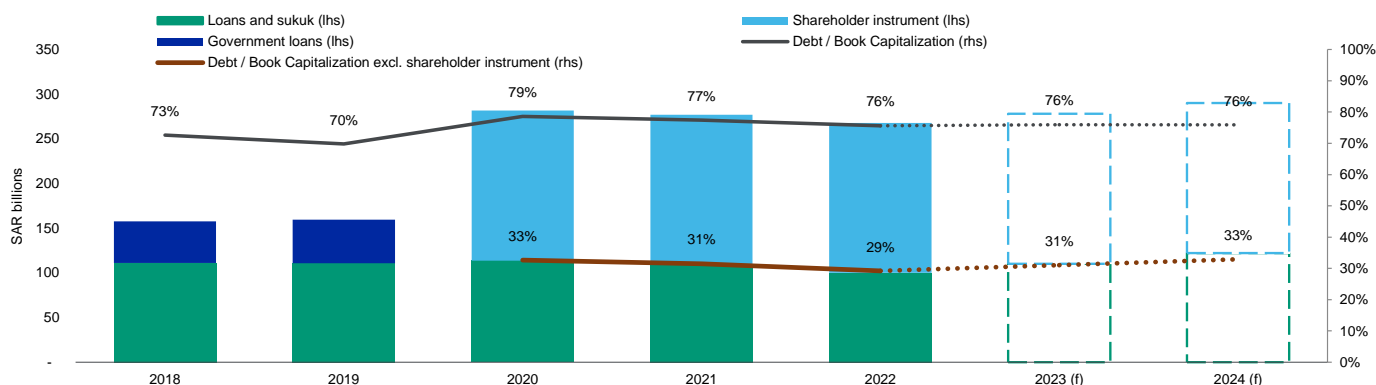


All ratios are calculated using Moody's estimates and standard adjustments. Moody's Forecasts (f) are Moody's opinion and do not represent the views of the issuer. Periods are Financial Year-End unless indicated. We classify the company's shareholder instrument (SHI) as debt under our adjustments.
 Source: Moody's Investors Service

SEC will rely on substantial debt issuances to finance its vast investment program which will gradually increase its debt load. We estimate that the company will require around SAR23 billion of additional capital in the next two years. The company's debt-to-capitalisation ratio will reach 76% for 2023 after Moody's adjustments, which reclassify the company's SAR168 billion shareholder instrument as a debt (see note below). Excluding the instrument from the calculation, the debt-to-capitalization ratio would be materially lower, at around 31% in 2023.

We classify the company's SAR168 billion (\$44.8 billion) shareholder instrument as a debt instrument under our [Hybrid Equity Credit methodology](#), published in September 2018. The methodology calls for the debt treatment of shareholder loans issued by investment grade corporate issuers. The instrument provides a degree of financial flexibility to the company that is not captured in our ratios but that is recognized in our standalone assessment of SEC. The perpetual instrument pays cash coupons which can be postponed at the option of the company under certain circumstances. The instrument is also subordinated to any existing and future senior debt. The agreement between SEC and the Ministry of Finance may be amended if agreed by the parties.

Exhibit 8
SEC's debt includes a shareholder instrument that offers a degree of financial flexibility



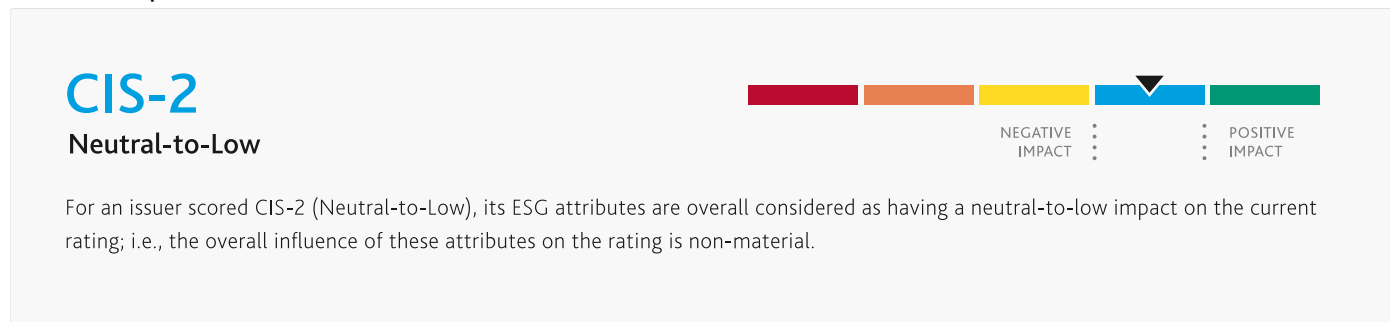
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 Source: Moody's Investors Service

ESG considerations

Saudi Electricity Company's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 9

ESG Credit Impact Score



Source: Moody's Investors Service

Saudi Electricity Company's (SEC) ESG Credit Impact Score is (**CIS-2**), where its ESG attributes are overall considered as having a neutral-to-low impact on the current rating. SEC's **CIS-2** reflects moderately negative environmental risks, and neutral to low social and governance risks.

Exhibit 10

ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

SEC's moderate environmental risk (**E-3** issuer profile score) is driven by its exposure to physical climate risk, because of the geographical concentration of its assets in Saudi Arabia. Risks in the areas of carbon transition, water management, waste and pollution, and natural capital are neutral to low.

Social

Exposure to social risks is neutral to low (**S-2** issuer profile score) reflecting neutral to low risk to demographics and societal trends, health and safety, responsible production, customer relations and human capital.

Governance

Governance does not pose specific risks (**G-2** issuer profile). This is primarily supported by neutral to low risks related to financial strategy and risk management, reflecting SEC's disciplined financial strategy and risk management, strong balance sheet and solid liquidity management. SEC is exposed to moderately negative risks related to its ownership concentration (81.2% indirect ownership by the government of Saudi Arabia). Risks in the areas of management credibility and track record, organizational structure and compliance and reporting are neutral to low.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Liquidity analysis

We consider SEC's liquidity profile as adequate and anticipate an acceleration in the company's capital expenditures under the new regulatory framework which will require external funding. In a stress scenario, the company could use the flexibility around the payment of periodic distributions under the shareholder instrument and capital spending to manage its liquidity needs.

As of 31 December 2022, primary sources of liquidity include planned operating cash flows of around SAR29 billion for the next 12 months (after SAR7.7 billion profit payments on the SHI), SAR20 billion available under committed credit facilities and a cash balance of SAR3.2 billion which are insufficient to cover SAR19 billion of short-term debt as of 31 December 2022, expected dividends of around SAR2.9 billion and expected capital expenditures of around SAR35 billion for the next 12 months. We expect SEC to fund the shortfall with debt or delay certain capital expenditure.

Rating methodology and scorecard factors

The principal methodology used in rating SEC was [Regulated Electric and Gas Utilities](#) published in June 2017. Our SEC's standalone assessment is stronger than the forward-looking scorecard-indicated outcome of Baa3, this reflecting our view that the company's financial ratios do not incorporate the financial flexibility provided by the shareholder instrument.

Exhibit 11

Regulated Electric and Gas Utilities Industry

| | Current FY 12/31/2022 | | Moody's 12-18 Month Forward View | |
|---|--------------------------|-------|-------------------------------------|-------|
| | Measure | Score | Measure | Score |
| Factor 1 : Regulatory Framework (25%) | | | | |
| a) Legislative and Judicial Underpinnings of the Regulatory Framework | Baa | Baa | Baa | Baa |
| b) Consistency and Predictability of Regulation | A | A | A | A |
| Factor 2 : Ability to Recover Costs and Earn Returns (25%) | | | | |
| a) Timeliness of Recovery of Operating and Capital Costs | Baa | Baa | Baa | Baa |
| b) Sufficiency of Rates and Returns | Ba | Ba | Ba | Ba |
| Factor 3 : Diversification (10%) | | | | |
| a) Market Position | Baa | Baa | Baa | Baa |
| b) Generation and Fuel Diversity | Aaa | Aaa | Aaa | Aaa |
| Factor 4 : Financial Strength (40%) | | | | |
| a) CFO pre-WC + Interest / Interest (3 Year Avg) | 3.6x | Baa | 3.2x | Baa |
| b) CFO pre-WC / Debt (3 Year Avg) | 8.9% | Ba | 10% | Ba |
| c) CFO pre-WC – Dividends / Debt (3 Year Avg) | 8.1% | Ba | 9% | Ba |
| d) Debt / Capitalization (3 Year Avg) | 77.2% | Caa | 78% | Caa |
| Rating: | | | | |
| a) Scorecard-Indicated Outcome | | Baa3 | | Baa3 |
| b) Actual Rating Assigned | | | | A1 |

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Source: Moody's Investors Service

Appendix

Exhibit 12

Peer comparison

| | Saudi Electricity Company | | | Abu Dhabi National Energy Company | | | Dubai Electricity & Water Authority PJSC | | |
|---|---------------------------|------|------|-----------------------------------|------|------|--|-------|-------|
| | A1 Positive | | | Aa3 Stable | | | Baa2 Stable | | |
| | 2020 | 2021 | 2022 | 2020 | 2021 | 2022 | 2019 | 2020 | 2021 |
| (CFO Pre-W/C + Interest) / Interest Expense | 3.9x | 3.5x | 3.4x | 7.8x | 7.2x | 7.8x | 12.4x | 13.2x | 10.5x |
| (CFO Pre-W/C) / Debt | 7% | 10% | 10% | 12% | 25% | 27% | 54% | 47% | 36% |
| (CFO Pre-W/C - Dividends) / Debt | 6% | 9% | 9% | 9% | 20% | 17% | 28% | 39% | 29% |
| Debt / Book Capitalization | 79% | 77% | 76% | 52% | 47% | 44% | 17% | 18% | 23% |
| (CFO Pre-W/C + Interest) / Interest Exp. (3 Year Avg) | 3.6x | 3.6x | 3.6x | 3.4x | 5.2x | 7.6x | 13.6x | 13.2x | 11.7x |
| (CFO Pre-W/C) / Debt (3 Year Avg) | 8% | 9% | 9% | 10% | 15% | 21% | 66% | 47% | 41% |
| (CFO Pre-W/C - Dividends) / Debt (3 Year Avg) | 8% | 8% | 8% | 8% | 12% | 15% | 50% | 39% | 33% |
| Debt / Book Capitalization (3 Year Avg) | 74% | 76% | 77% | 69% | 57% | 48% | 15% | 18% | 21% |

All ratios are calculated using Moody's estimates and standard adjustments. Periods are Financial Year-End unless indicated. We classify the company's shareholder instrument (SHI) as debt under our adjustments.

Source: Moody's Investors Service

Exhibit 13

Moody's-adjusted debt breakdown

| In SAR millions | 2018 | 2019 | 2020 | 2021 | 2022 |
|-------------------------------|----------------|----------------|----------------|----------------|----------------|
| As Reported Debt | 157,579 | 159,890 | 113,838 | 108,950 | 99,934 |
| Pension Adjustments | 3,870 | 4,567 | 5,261 | 6,006 | 5,782 |
| Operating Lease Adjustments | 26,674 | 0 | 0 | 0 | 0 |
| Hybrid Securities Adjustments | 0 | 0 | 167,921 | 167,921 | 167,921 |
| Non-Standard Adjustments | 513 | 525 | 0 | 0 | 0 |
| Moody's adjusted debt | 188,635 | 164,982 | 287,019 | 282,877 | 273,637 |

All figures are calculated using Moody's estimates and standard adjustments. Periods are Financial Year-End unless indicated. We classify the company's shareholder instrument (SHI) as debt under our adjustments.

Source: Moody's Investors Service

Ratings

Exhibit 14

| Category | Moody's Rating |
|---|----------------|
| SAUDI ELECTRICITY COMPANY | |
| Outlook | Positive |
| Issuer Rating | A1 |
| SAUDI ELECTRICITY GLOBAL SUKUK COMPANY 3 | |
| Outlook | Positive |
| Bkd Senior Unsecured | A1 |
| SAUDI ELECTRICITY GLOBAL SUKUK COMPANY 2 | |
| Outlook | Positive |
| Bkd Senior Unsecured | A1 |
| SAUDI ELECTRICITY GLOBAL SUKUK COMPANY 4 | |
| Outlook | Positive |
| Bkd Senior Unsecured | A1 |
| SAUDI ELECTRICITY GLOBAL SUKUK COMPANY 5 | |
| Outlook | Positive |
| Bkd Senior Unsecured | A1 |

Source: Moody's Investors Service

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