

ISSUER COMMENT

6 May 2024

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Saudi Electricity Company

Increase in the WACC rate is credit positive, but partly offset by higher profit margin on the shareholder instrument

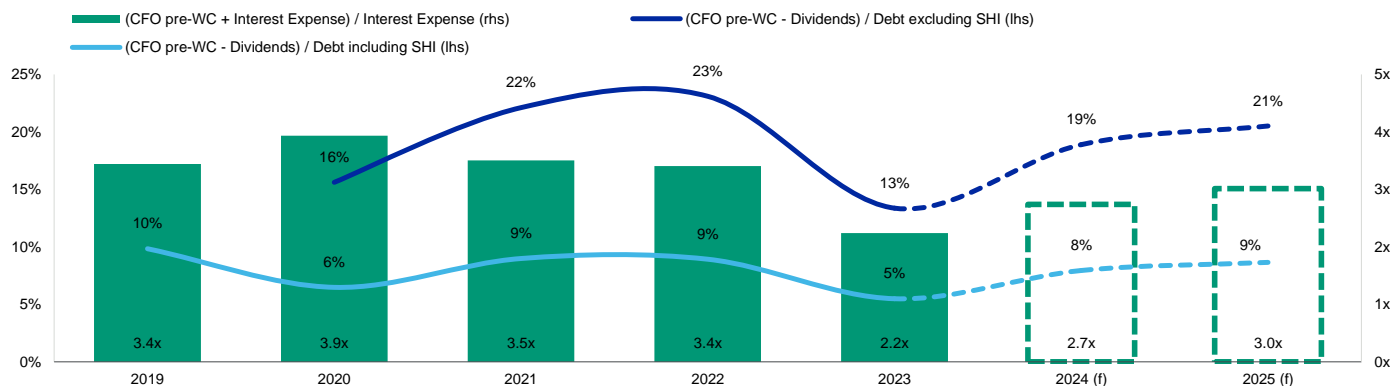
On 29 April, [Saudi Electricity Company](#) (SEC, A1 positive) [announced](#) that it had received a letter from HRH Prince Abdulaziz bin Salman, [Saudi Arabia's](#) (A1 positive) Minister of Energy and chairman of the ministerial committee for restructuring the kingdom's electricity sector and SEC, approving an increase in the regulated weighted average cost of capital (WACC) on SEC's regulated asset base (RAB) to 6.65% from 6% during the current price control period (PCR2, 2024-26). At the same time, the annual profit margin on the shareholder instrument (SHI) during the same period has increased to 5.15% from 4.5%.

We view the upward revisions as positive given the higher interest rate environment, with the newly established regulatory framework working as expected and in a transparent manner. Following the increase in WACC, we also expect SEC to generate higher regulated revenue, though this will be partly offset by the higher servicing cost on the SHI. We expect both WACC and the annual profit margin on the SHI to move in tandem and maintain a 1.5% margin differential across PCR2.

The increase in the WACC rate during PCR2 is credit positive for SEC. As the company executes on its sizable pipeline of transmission and distribution projects in Saudi Arabia, we estimate that its RAB will grow to around SAR250 billion in 2025 from around SAR210 billion in 2023, increasing its regulated revenue. In the short term, however, the impact on its credit metrics (Exhibit 1) will be partly offset by the increase in the SAR168 billion SHI's annual profit margin, with our expectation that the SHI's periodic distribution will increase under PCR2 to SAR8.6 billion from SAR7.7 billion. We also expect that SEC will continue to benefit from strong demand for electricity in Saudi Arabia over the next 12-18 months, driven by an increase in customer connections and higher volumes of electricity sold. We estimate that SEC's revenue will grow to around SAR85 billion by 2025 from around SAR75 billion in 2023.

Exhibit 1

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

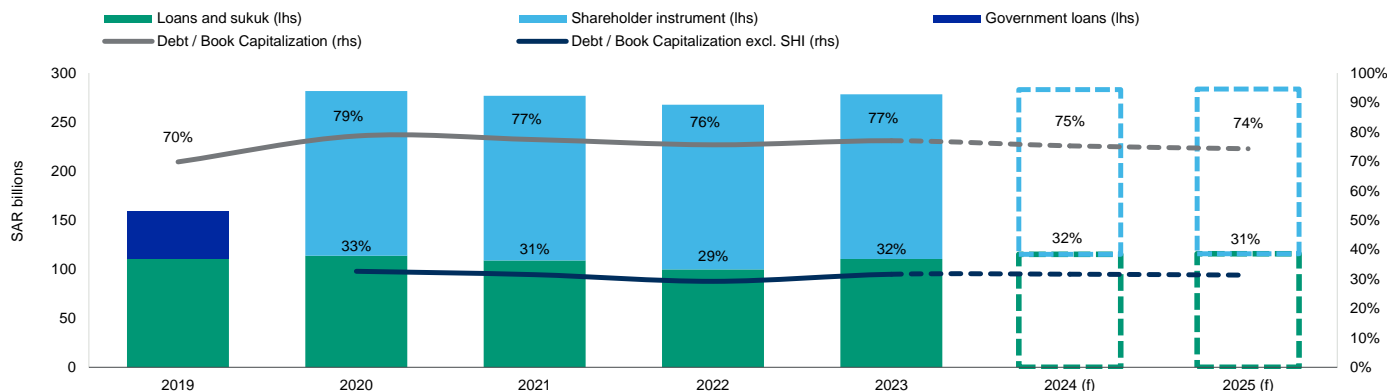


All ratios are calculated using Moody's estimates and standard adjustments. Moody's Forecasts (f) are Moody's opinion and do not represent the views of the issuer. Periods are financial year-end unless indicated. We classify SEC's SHI as debt under our adjustments. Sources: Moody's Financial Metrics™ and Moody's Ratings forecasts

This is the first price revision under the regulatory framework established in 2021 following significant reforms to the kingdom's electricity sector. The framework allows SEC to recover its operational costs and earn a fair rate of return on its transmission, distribution and retail business under a RAB model with control periods of three years. The WACC is calculated based on SEC's post-tax cost of equity and pre-tax cost of debt. On the other hand, the SHI provides a degree of financial flexibility (Exhibit 2) to SEC not captured in our ratios but recognized in our standalone assessment. The perpetual instrument pays cash coupons that can be postponed at the company's discretion under certain circumstances. The SHI agreement between SEC and the Ministry of Finance can be amended if both parties agree.

Exhibit 2

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



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