الشركة السعودية للكهرباء
Saudi Electricity Company
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Electricity Sector Regulatory Framework

Investor Presentation

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Introduction

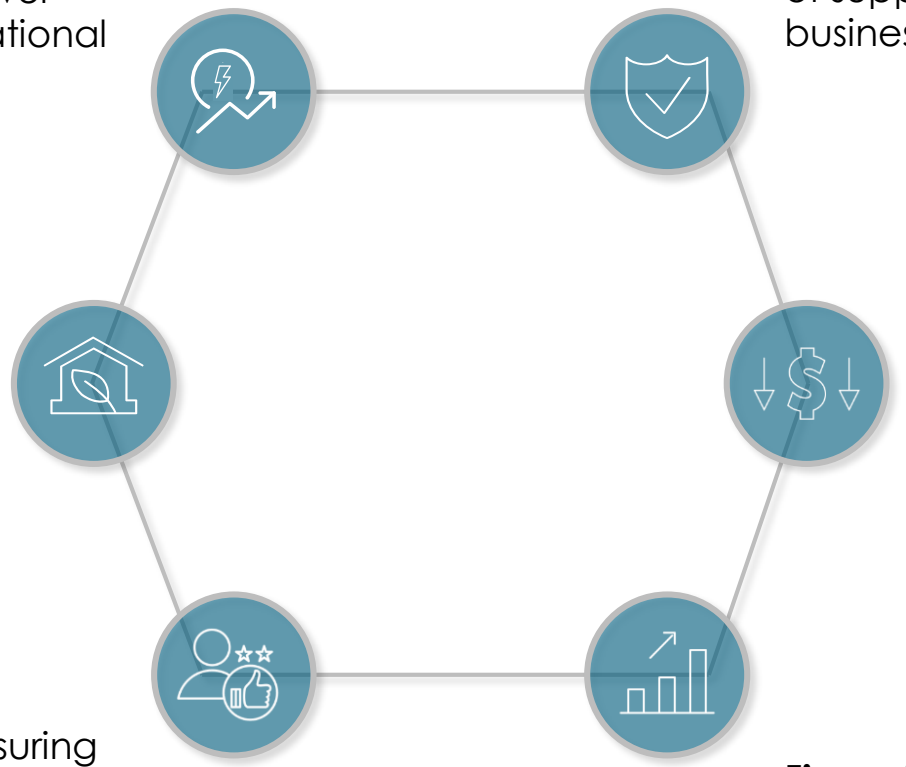
Key stakeholders in the Kingdom of Saudi Arabia have been working together for a number of years to develop holistic reforms to the electricity sector with the aim of ensuring the sustainability and efficiency of the electricity sector in the Kingdom in line with the objectives of Vision 2030

1. A new **transparent RAB-based regulatory framework** has been developed by the regulator (ECRA) without any negative impact on consumers and with sufficient flexibility to adapt to new circumstances
2. The **Balancing Account** will allow SEC and its investors to have full **financial visibility**
3. The conversion of legacy net financial obligations into a **non-dilutive equity-like financial instrument held by the MOF** will simplify SEC's capital structure and **improve its capitalisation and leverage**
4. **Enhancing SEC's financial strength and operational capability** have been **at the center of the sector reform**
5. The holistic reforms **reinforce the commitment of government support to SEC through clear mechanisms**

Reforms contribute to the achievement of sector pillars

Increased Localization through alignment between power demand growth and national economy growth

Safety, Security and Reliability of supply to all households, businesses and government



Environmental Stewardship enabling the realization of the Kingdom's commitments

Efficiency reflecting in a competitive cost-to-serve

Customer Centricity ensuring value added services and high customer satisfaction

Financial Sustainability allowing sector players to be profitable

Summary of actions

Existing government liabilities

- Conversion of SEC legacy obligations (government payables and soft loans) to an **equity-like Financial Instrument**

Regulatory framework

- **RAB based regulatory framework** balances the interest of key stakeholders and allows for SEC to generate commercial returns

Balancing account

- The balancing account to cover the difference between required and actual revenues:

  Balancing account payment =

  required revenue – revenue from approved tariffs

Government fee

- **Cancellation of Government fee**

Key elements of the Regulatory Framework

Regulatory Framework

- Revenue for SEC determined on a global standard Regulatory Asset Base methodology starting 01 Jan, 2021.
- Balancing fund to cover difference of SEC's required revenue and actual revenue.
- Framework to enable SEC to be financially sustainable and meet its:
  - Operational expenses
  - Financial obligations to stakeholders
  - Equity returns to all the shareholders
- First regulatory period to enable capability to improve future regulatory framework

Performance related compensation based on RAB

Maximum revenue is set through allowed OpEx, depreciation and return on regulated asset base

Examples of implementing countries

Regulatory framework summary

Regulated Asset Base

- Delineating **regulated asset base** components upon which utilities are allowed to earn a return

WACC

6%[2]

- Defining a fair **cost of capital** (WACC) that reflects the company's cost to finance debt and equity

Required Revenue (RR_t) = **Return on RAB[1] (RoI_t)** + **Depreciation of RAB (Dep_t)** + **Allowed Opex (AO_t)** + **Pass-Through Costs (PTC_t)** + **Revenue Correction (RC_t)** + **Bad debt**

Regulatory review process



Notes:
1. Return on RAB = RAB x WACC
2. For the regulatory period 2021-2023

Balancing account overview

Balancing account = required revenues − actual revenues

These are the notional revenue requirements to ensure financial sustainability of SEC

These are the actual revenues of SEC from applied tariffs

- Balancing account based on **required revenue formula**
  - Forward looking model based on fair returns on investments
  - Established & transparent formula stimulating economical behaviour and enabling long term planning
  - Incentivisation of performance improvement
- Balancing account, that started operating in 2019, will continue in 2020 **enabling SEC to meet all its financial obligations including fuel & dividend payments to all shareholders**
- A new mechanism will be implemented to **ensure timely payment of public sector electricity consumption**

Customer centricity focus



Enhances reliability

- SEC incentivized and remunerated to spend capex to maintain service reliability



Improves service quality

- Regulatory framework to set opex metrics to enable SEC to provide benchmark service quality



Incentivizes Efficiency

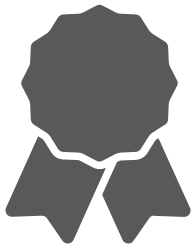
- ECRA will monitor various parameters of SEC's opex, capex, etc.

Summary of Equity Like Financial Instrument



SAR 167.92 bn

SEC’s historical net liabilities owed to the KSA Government



Equity-like

Accounting treatment expected

Key Characteristics

- **Status:** Unsecured and deeply subordinated (junior to all senior payments and obligations; ranks ahead of common equity only).
- **Maturity:** Perpetual in respect of which there is no fixed redemption date.
- **Profit rate:** Set at 4.5% for 3 year period ending Dec 31 2023; to be reset with reference to the regulatory WACC less margin of 1.5% in line with the regulatory period.
- **Payments of profit rate:** The profit rate is payable if a distribution of dividends to common shareholders is declared by SEC.
- **Mandatory redemption event:** To be redeemed in proportion of any share buy back by SEC.

Financial impact on SEC

Policy decisions	Financial impact
RAB-based regulatory framework	Revenue visibility and adequate ROCE
Balancing account	Tariff deficit transferred to MOF, Δ Revenues
Government fee cancellation	Δ Net Revenues
Public Sector electricity consumption bill	Δ Net working capital
Cash settlement of fuel payments to Saudi Aramco	∇ Net working capital
Legacy receivables netted against payables	∇ Assets and liabilities
Conversion of government payables to equity-like financial instrument	Δ Equity
Conversion of soft loans to equity-like financial instrument	∇ Debt, Δ Equity
Payment of dividends to other shareholders	= Dividends (no impact expected)

Next steps

2020: Transition period

1. Settlement of all government receivables and payables pertaining to 2020, partly offset by Government fees
2. Balancing fund for 2020 to cover returns for SEC on a Revenue cap basis to meet its financial obligations

2021 onwards: Implement and improve

1. Proposed regulatory framework to come in effect from 1st January 2021
2. Balancing account to cover difference of SEC's required revenue and actual revenue
3. Framework to enable SEC to be financially sustainable and meet its:
   - Operational expenses
   - Financial obligations to stakeholders