



# KENYA POWER

## COMPANY UPDATE

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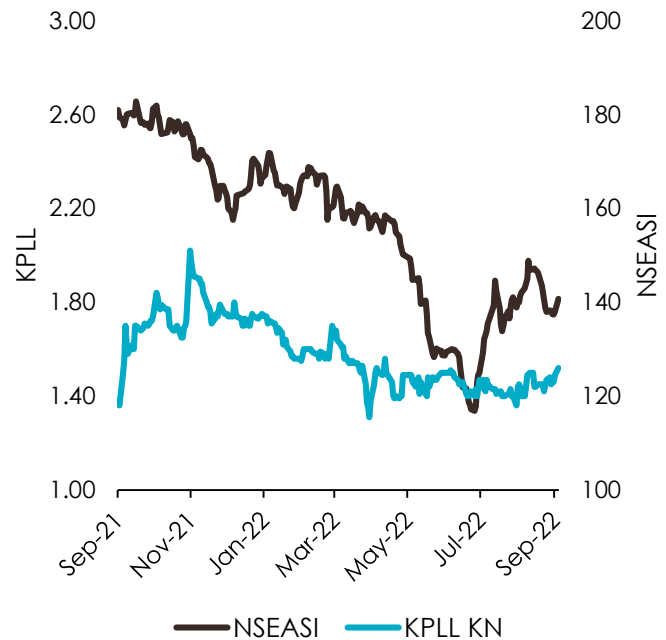
Kenya Power's performance at the Nairobi Securities Exchange has come under considerable pressure. Its price has largely trailed the NSE 20 index. The performance has been predicated on reports of possible impropriety at the company. The company is seeking to restructure its operations and implement critical reforms. If successful, this will mark a turning point for its fortunes.

### Share Data

Bloomberg Ticker	<b>KPLL KN</b>
Reuters ticker	<b>KPLC.NR</b>
Current Price (KES)	<b>1.77</b>
Target Price (KES)	<b>2.00</b>
Upside	<b>13%</b>
Rating	<b>ACCUMULATE</b>
52WK High (KES)	<b>2.08</b>
52WK Low (KES)	<b>1.30</b>
Market Cap (Bn)	<b>3.65</b>
Shares outstanding (Bn)	<b>1.95</b>
Dividend yield (%)	<b>0.00</b>
EPS	<b>0.76</b>
P/E	<b>2.00</b>

Source: Company financials, NCBA IB Research

### Kenya Power one-year return



Source: NSE, NCBA IB Research

### INVESTMENT CASE

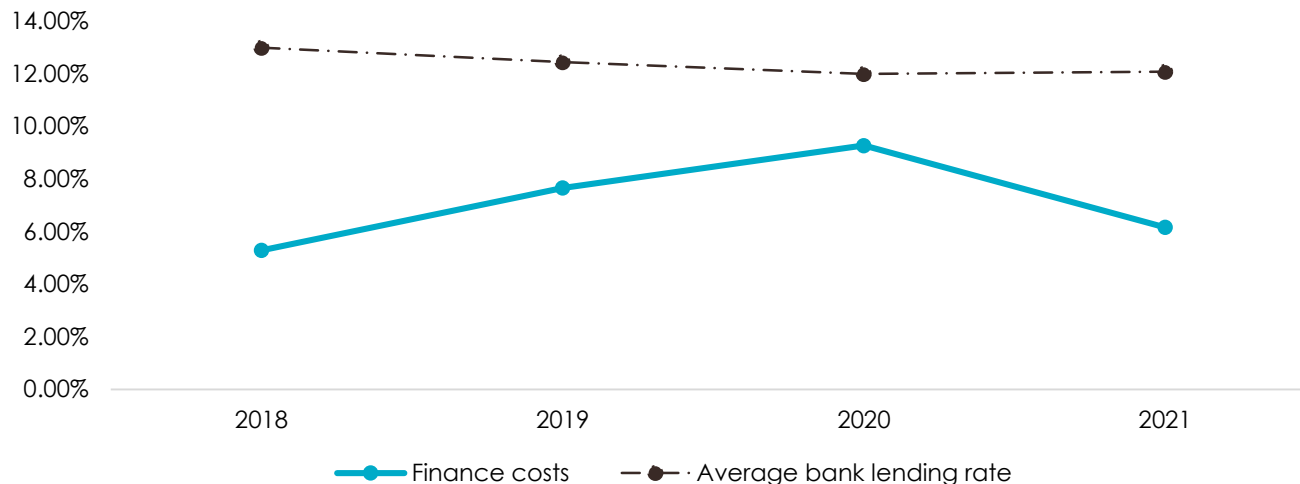
In this update, we have revised our recommendation to ACCUMULATE with a target price of KES 2.00, implying a 13% upside relative to the volume weighted average price of KES 1.77 recorded on 14<sup>th</sup> October 2022. Our [publication](#) of November 2021 had a SELL recommendation with a target price of KES 1.14.

We settle on a strong case for investment following sustainable revenue growth backed by increased electricity consumption. Increased demand for electricity continues to be driven by expansion in economic activity. We opine that successful implementation of the proposed reforms will lead to improved margins driven by operational excellence.

## TAILWINDS

**Leveraging the government:** Government of Kenya has acted as a guarantor which has enabled the company access credit from global lenders at fairly competitive rates, thus taming finance costs.

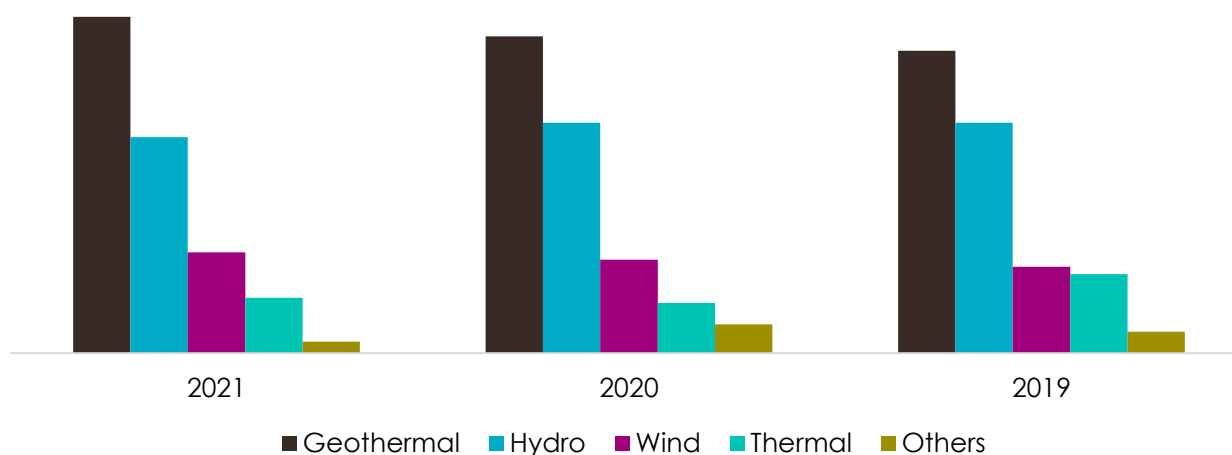
**Kenya Power's finance costs vis-à-vis commercial bank lending rates**



Source: Company financials, NCBA IB Research

**Reliable geothermal power:** Overdependence on hydro power generation has in the past resulted in supply disruptions during periods of drought, with costly thermal sources being used to boost output. Installed geothermal capacity is currently the largest source of electricity. The rise in geothermal power generation is expected to minimize volatility in supply of electricity.

**Generation mix**



Source: Company financials, NCBA IB Research

**Rise in electricity demand:** Energy is a key input to any production process. As the economy grows, increased production capacity by industries leads to a surge in electricity demand. Peak demand reached 1,999MW in the FY2021 surpassing the pre-Covid peak of 1926MW (February 2020). Demand is expected to maintain an upward trajectory, supported by the ongoing investment in the national grid transmission network.

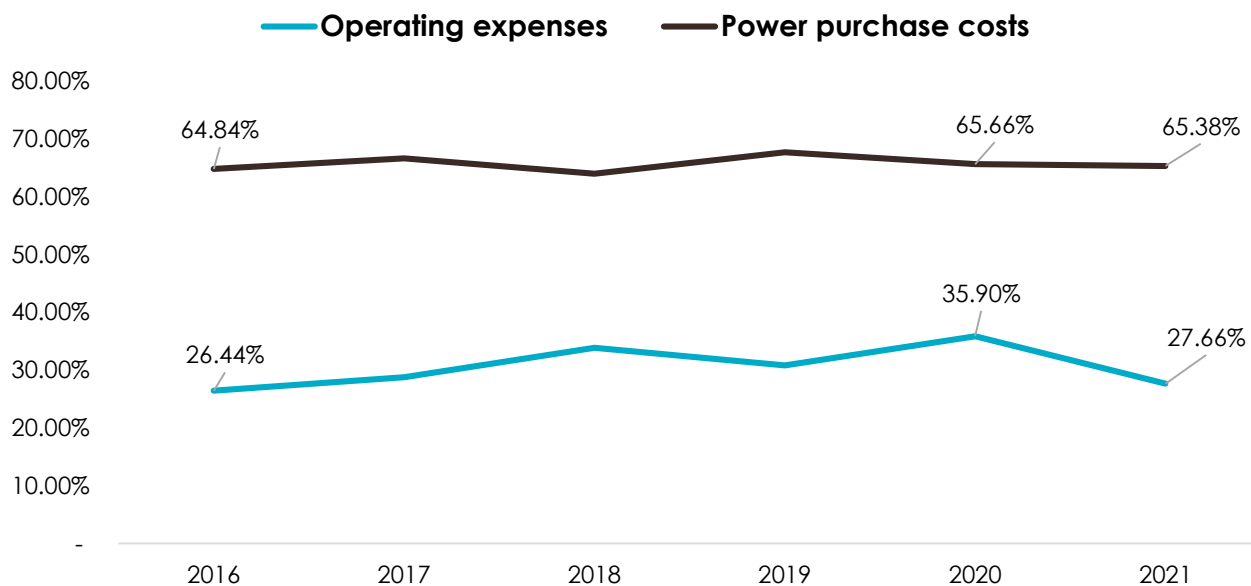
## HEADWINDS

**Cash flow difficulties:** Inconsistent cash flows have in the last five years, been a major risk to the business. The current ratio has also repeatedly been below the required regulatory threshold of 19.9%. Improved efficiency in revenue collection is critical in improving the liquidity position of the company. We expect these challenges to persist in the short term.

**Fuel costs.** Thermal power generators run on fuel which is costly. This cost is passed through to the consumer resulting in high tariffs.

**Reputational risk:** Negative publicity regarding the operations of the company has contributed to depressed pricing of the stock at the bourse. If this persists, then the stock's performance is likely to be remain muted.

**Power purchase costs.** Power purchase costs rose by 7.7% to KES 94.22Bn in FY2022. The effective unit cost of power purchased from IPP's was as high as 119 per KWh while the same was sold at an average of KES 15.66 per Kwh.



Source: Company financials, NCBA IB Research

**A push to lower power costs:** The government is keen on delivering on its promise for cheaper power. Lower tariffs to consumers' points to lower profit margins. Moreover, the Energy Regulatory Commission, had recommended scraping the forex element in power bills. This move would expose the company to greater foreign exchange risk. With Kenya Power already facing working capital challenges, sustainability of power cost reduction is in question. The company announced a 15 per cent reduction of power costs effective January 2022. The decision was however reversed in September 2022.

## ECONOMIC OUTLOOK AND ELECTRICITY GROWTH

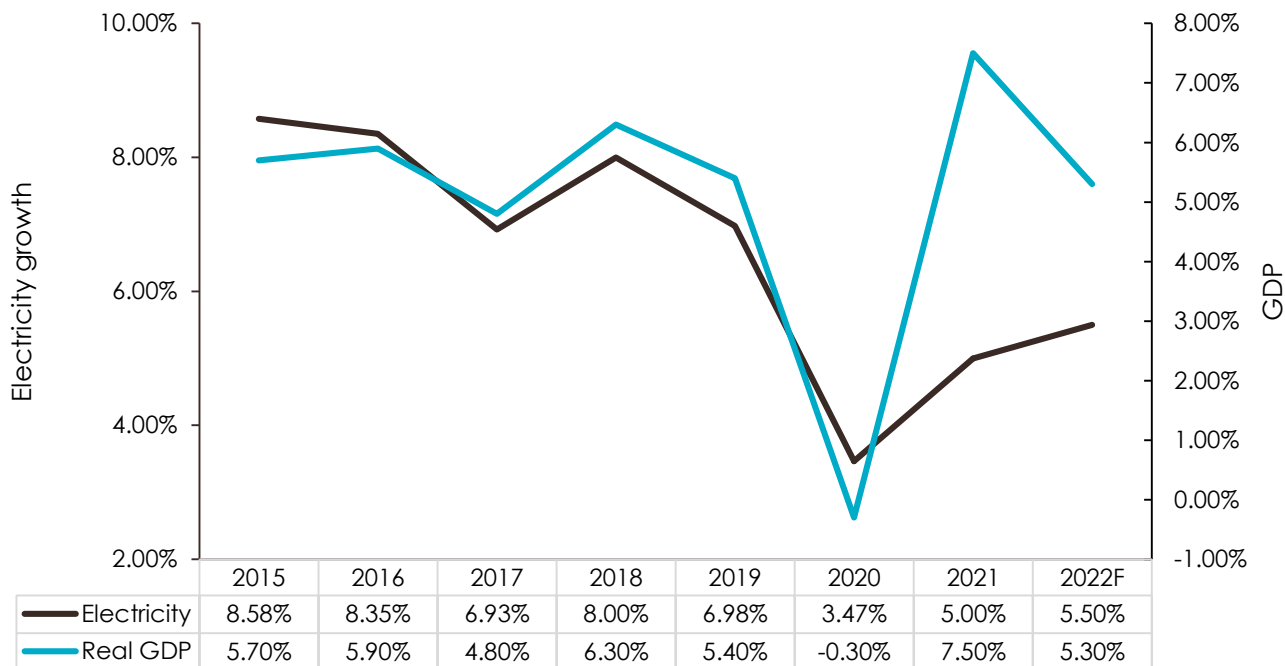
The economic outlook of 2022 and 2023 is overwhelmingly tilted to the downside amid soaring inflation, lingering effects of the COVID-19 pandemic and mounting geopolitical threats. Inflation escalated to 9.2% in September 2022. We expect inflation to remain elevated and entrenched owing to high commodity prices.

The implications of high inflation on Kenya Power are however limited. This is because the company has a pass-through mechanism for inflation adjustment which translates to higher electricity bills for consumers.

Electricity consumption has a direct correlation with economic growth. An efficient and cost effective energy sector is the driving force for growth of any economy. The country has continued to scale up electricity production mainly from renewable sources.

The electrification rate is at 70.00% with the rural rate being 60% which is above the sub-Saharan Africa rate of 50%. The bridge to 100% connection presents an opportunity for Kenya Power to increase electricity sales through increased connectivity. It is important to note that increased connectivity does not necessarily mean that there will be high consumption of electricity.

A holistic approach would be needed to ensure that provision of access to electricity is coupled with measures to catalyze consumption and rural development.



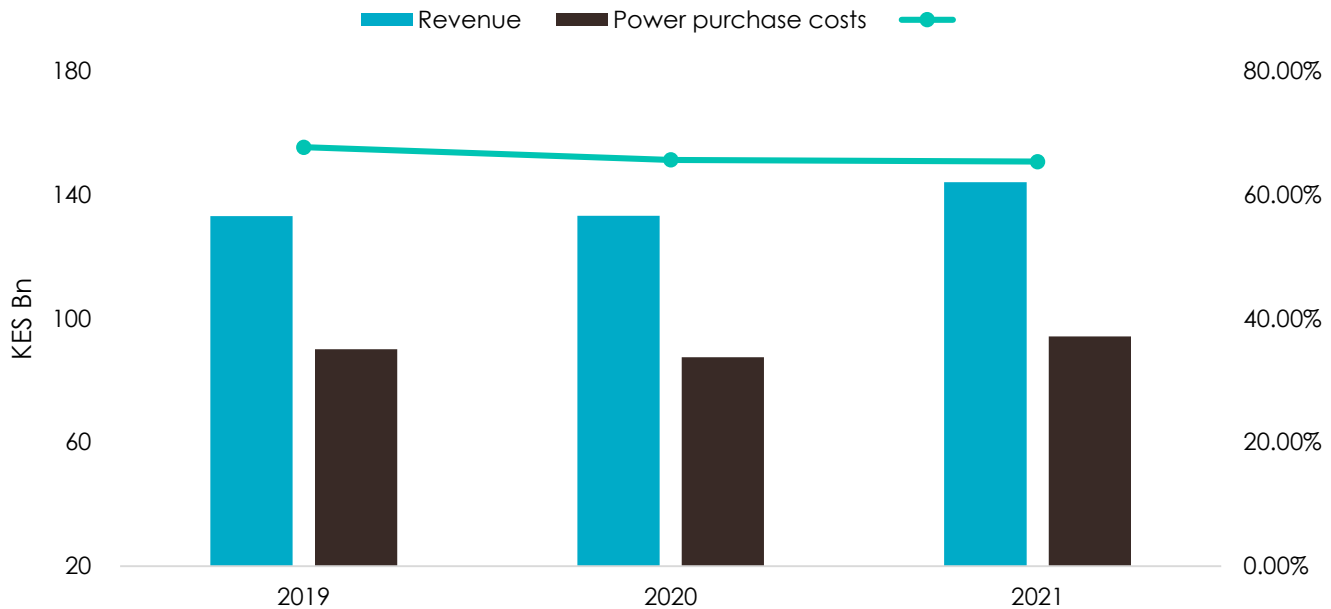
Source: KNBS, NCBA IB Research

## PROPOSED REFORMS FOR KENYA POWER

### Power Purchase Agreements (PPA's)

The government is keen on delivering on its promise of cheaper power in the country and eliminating the risk posed by power procured from IPPs.

The cost of power purchased by Kenya Power for onward transmission to consumers is only one component of the company's total costs, but it is the largest one, accounting for 66% of total revenue.



Source: Company financials, NCBA IB Research

The FY21 financial results reflect costs of sales of KES 94.2Bn, a 7.7% increase from FY20. This includes KES 49.2Bn which relates to capacity charges accordant with power purchase agreements with Independent Power Producers (IPPs). These charges account for a whopping 52% of the total cost of sales. Considering that these charges are fixed, they have the potential to adversely affect the company's performance.

IPP projects have been characterized by lengthy lead times. Implementation of energy projects can take up to ten years as is the case in the Kipeto Wind Project. The prolonged implementation impacts the cost of energy, as the PPA signed over ten years ago ends up being implemented at higher tariffs compared to global prevailing rates. Relatedly, Kenya Power PPA's average twenty to thirty years which further expose the company to forex risk.

IPP's also expose the company to foreign exchange risk due to the fact that most power purchase agreements are denominated in foreign currencies whereas Kenya Power's revenue is reported in local currency, raising foreign exchange liabilities. The proposal made is to have future PPA's denominated in local currency. It has been suggested that existing PPA's undergo amendments to include provisions for termination of contracts if their effectiveness is not achieved owing to long stop dates by the developer. Recommendations provide that project implementation should take up to five years from feasibility approval, preparations, and construction.



Procurement of new PPA's is envisaged to be done through a renewable energy auction mechanism. Unlike negotiated power purchase agreements, auctions have the potential to enable price discovery, reduce windfall profits to IPPs, and deliver lower electricity prices to consumers.

Source/Power producer	Power purchase costs (Mn)	Units purchased (GWh)	Purchase Cost per unit
KenGen	41,142.19	8,443	4.87
OrPower 4 Inc.	17,337.24	1,559	11.12
Lake Turkana Wind Power	11,895.50	981	12.13
Rabai Power Limited	2,948.80	266	11.09
Triumph Power Generating Company Limited	2,621.27	22	119.15
Tsavo Power Company Limited	2,478.62	183	13.54
Thika Power Limited	2,394.76	93	25.75
Gulf Power Limited	2,207.28	21	105.11
Iberafrica Power (E.A.) Company Limited	2,095.16	192	10.91
Uganda Electricity Transmission Company Limited	1,765.09	45	39.22
Garissa Solar Power Plant	1,137.97	88	12.93
Regen-Terem	515.18	86	1.76
Gura	223.63	22	10.17
Ethiopia Electricity Power Company	118.22	14	8.44
Mumias Sugar Company	108.91	5	21.78
Power Technology Solutions Limited	97.83	11	8.89
Chania Power Limited	19.22	2	9.61
Strathmore University	14.47	1	14.47
Imenti Tea Factory	10.53	1	10.53
Biojoule Kenya Limited	4.10	-	-
Tanzania Electric Supply Company Limited	3.6	-	-

Source: Company financials, NCBA IB Research

### System losses

The national grid is one of the main challenges in reducing system losses for Kenya Power - its limited number of transmission lines and deficiencies lead to frequent power outages as well as technical and non-technical losses.

Over the past five years, the power distribution network has expanded considerably in tandem with the rapid pace of new electricity connections. The extended network and growth in customer numbers has led to a consequent increase in system losses. These losses contribute to high power charges to consumers given that the industry regulator allows the company to charge up to 19.9% of the power losses to the consumer.

Ongoing system upgrades, Advanced Metering Infrastructure (AMI) will help reduce system losses to the global benchmark of 15.0%. Reduced system losses would have immediate positive impact on sales, revenue and business sustainability.

### System losses (%)



Source; Company financials, NCBA IB Research

### Revenue diversification

Kenya Power plans to diversify its revenues and capitalize on growing data usage in the country. The company has been issued with a Network Facility Provider License, and has developed a telecommunications business unit, "U-Telco" for its fibre optic business.

Kenya Power intends to ride on the existing extensive power transmission and distribution network across the country in order to lay fibre optic cable.

The new strategy is promising, given Kenya Power's extensive transmission network. However, competition is stiff with the existing players; Wananchi, Safaricom, and Jamii accounting for 80% of the market share, signaling a pricing war in the telecommunication sector where operators already view data as the frontier for growth.

The competitive edge lies in Kenya Power offering its customers a package that will allow them to buy internet and electricity as a bundle.

### Least Cost Power Development plan (LCPDP)

The energy sector still experiences inefficiencies in the power companies, high use of costly emergency power, low economies of scale in generation and limited regional integration. There have been however, steady improvements in productivity and generation capacity.

As a result of the unbundling of the energy sector, i.e., generation, distribution, and regulation, the coordination of the energy sector projects and players is a critical component of the sector's effectiveness.

The installed capacity in the country is currently 2,870MW. The available capacity, however, is between 2,100-2,300MW and could drop below 2,000MW in a sustained drought. Demand is about 2,000MW meaning the system currently has no frugal reserve margin.

The Least Cost Power Development Plan involves identifying generation plants needed to meet soaring demand and estimating indicative tariffs from the planned generation and transmission network. LCPDP is critical in ensuring that electricity generated matches the demand.



The Least Cost Power Development Plan proposes a total committed capacity of 2,838MW which includes 50 generation projects with PPA's at various stages of development. This generation sequence indicates the projects under pipeline are sufficient to meet projected demand.

As part of the Least-Cost-Power supply options, the Kenya-Ethiopia import agreement is meant to cushion soaring demand experienced by the country. Kenya imports a minimum of 150MW and recommendations provided are to scale up to 200MW to allow for development of local capacity in the short-medium term. Kenya Power is expected to take the leading role in LCPDP implementation of proposed projects.

The East Africa Power pool (EAPP) is also being set up, with the assistance of the World Bank and Africa Development Bank. The EAPP will comprise of power utilities from 11 countries; Kenya, Uganda, Ethiopia, Rwanda, Burundi, Tanzania, Sudan, Egypt, Libya, Djibouti and Democratic Republic of Congo.

These proposed changes are designed to create hybrid bilateral contracts and short term trading platforms which include power delivery auctions. This will be a major turning point for the sector, to allow member countries invigorate their supply-demand imbalances.

## CLIMATE CHANGE

In 2022, the World Bank forecast that energy would rebound by 2.6%, as global GDP growth returns. The world remains in the immense space of climate change with efforts to slow the impact of global warming. Carbon taxes and the removal of fossil fuel subsidies, along with possible addition of levies on electricity bills, could add to the cost of electricity and fuels.

Thermal power generation needs to substantially reduce in order to control carbon emissions which have considerable effects on the environment. Indicatively, generation from renewable sources in Kenya accounts for approximately 90%. Given the environmental landscape, the power generation potential is still relatively untapped when compared to other developing countries. Geothermal energy currently accounts for about 50% of Kenya's total installed generation capacity while unexploited geothermal resources are estimated to be between 7,000MW to 10,000MW in the Rift Valley escarpment alone.

Kenya is racing to catch up with the rest of the world in the shift to clean mobility in efforts to reduce environmental pollution from fossil fuels. Kenya Power will set the ground for e-mobility in constructing electric charging systems for motorists.

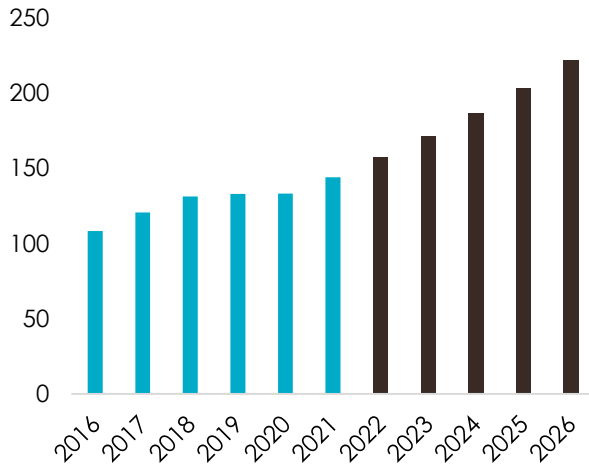
## Valuation summary

Valuation Methodology	Implied Price	Weighting	Weighted Value
DCF Approach	1.30	70%	0.91
EV/EBITDA	5.51	10%	0.55
P/E Approach	4.21	10%	0.42
P/B Approach	1.15	10%	0.11
<b>Fair Value</b>		<b>100%</b>	<b>2.00</b>
<b>Current Price (at 14.10.2022)</b>			<b>1.77</b>
Upside/(Downside)			12.9%

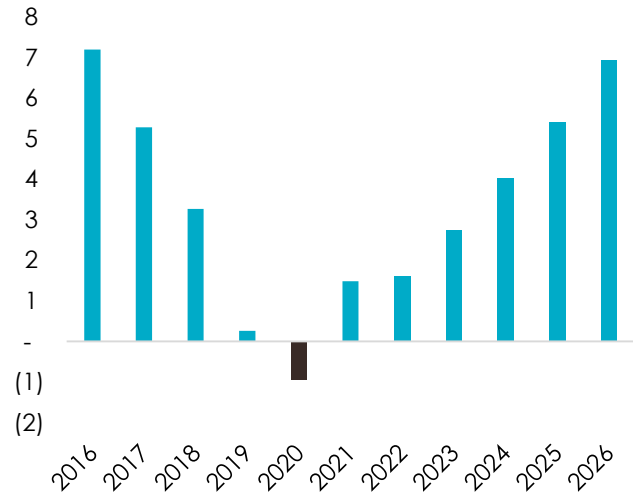
Source: NCBA IB Research

Financial Performance Highlights

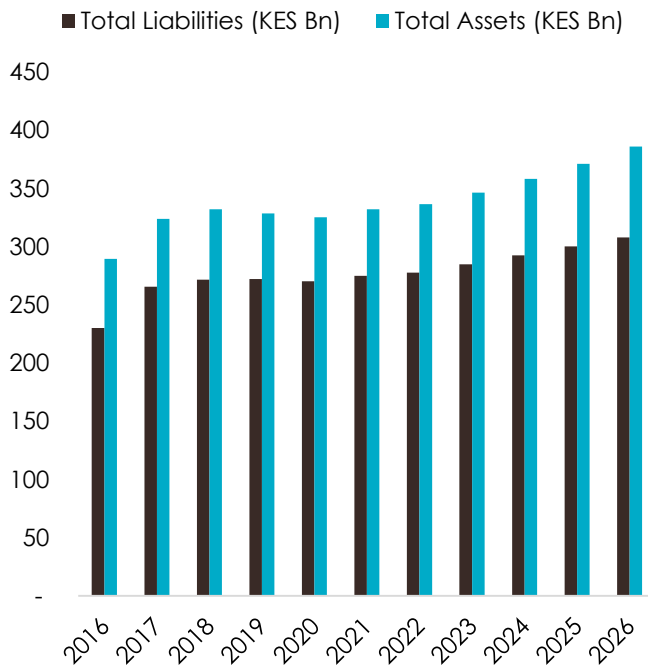
Total Revenue (KES Bn)



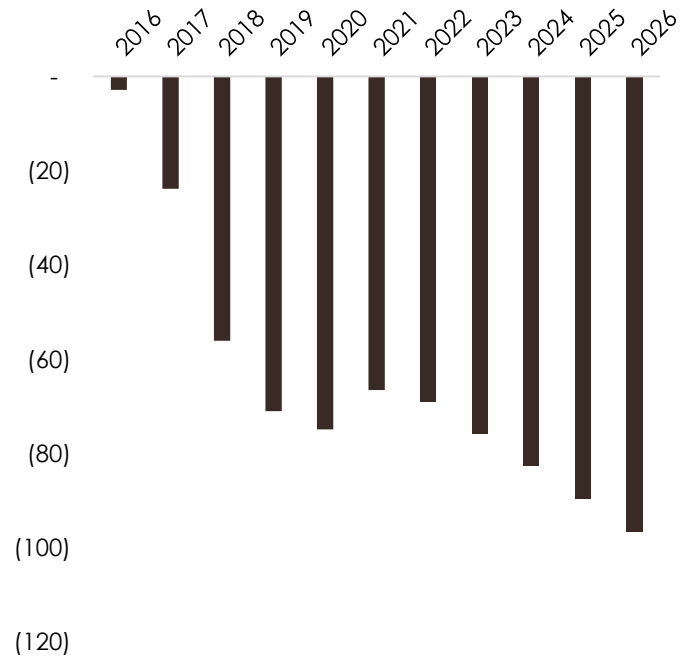
Profitability (KES Bn)



Balance Sheet (KES Bn)



Working Capital (KES Bn)



Source: Company financials, NCBA IB Research

## Financial performance

## Kenya Power condensed Income Statement KES 'MM

	FY17	FY18	FY19	FY20	FY21
Electricity sales post-paid	91,952	95,435	95,753	98,355	105,349
Electricity sales pre-paid	-	-	16,676	17,818	20,578
Foreign exchange adjustment	6,683	9,322	860	924	6,333
Fuel cost charge	22,108	26,622	19,852	16,162	11,860
<b>Total Revenue</b>	<b>120,742</b>	<b>131,379</b>	<b>133,141</b>	<b>133,259</b>	<b>144,120</b>
Power purchase costs	(80,477)	(84,100)	(90,152)	(87,499)	(94,220)
<b>Gross Profit</b>	<b>40,265</b>	<b>47,278</b>	<b>42,989</b>	<b>45,759</b>	<b>49,900</b>
Net operating expenses	(34,745)	(44,541)	(41,043)	(47,834)	(39,861)
<b>Operating Income</b>	<b>5,520</b>	<b>2,738</b>	<b>1,945</b>	<b>(2,075)</b>	<b>10,039</b>
Other income	8,130	9,178	8,586	7,387	7,046
<b>Operating profit</b>	<b>13,651</b>	<b>11,916</b>	<b>10,531</b>	<b>5,312</b>	<b>17,085</b>
Finance income (Net)	(5,994)	(6,948)	(10,197)	(12,354)	(8,887)
Profit before tax (PBT)	7,657	4,968	334	(7,042)	8,198
Income tax (charge)/credit	(2,376)	(1,700)	(72)	6,103	(6,708)
<b>Profit after tax (PAT)</b>	<b>5,280</b>	<b>3,269</b>	<b>262</b>	<b>(939)</b>	<b>1,490</b>
EPS	2.71	1.67	0.13	(0.48)	0.76
DPS	0.50	0.00	0.00	0.00	0.00

## Kenya Power condensed Balance sheet KES 'MM

	FY17	FY18	FY19	FY20	FY21
<b>ASSETS</b>					
Property, plant and equipment	262,348	273,377	277,067	276,860	277,305
Other non-current assets	7,595	8,658	6,717	5,781	5,290
Inventories	9,626	9,745	9,835	4,831	5,896
Trade receivables	40,794	35,220	30,111	33,815	37,683
Other current assets	655	492	481	539	510
Cash and cash balances	2,942	4,777	4,284	3,442	5,547
<b>Total assets</b>	<b>323,960</b>	<b>332,269</b>	<b>328,495</b>	<b>325,267</b>	<b>332,230</b>
<b>EQUITY AND LIABILITIES</b>					
Total Equity	58,398	60,622	56,231	54,897	57,174
Non-current Borrowings	111,075	96,929	92,615	94,957	91,043
Other non-current liabilities	76,681	68,471	63,968	57,938	67,899
Current trade Payables	57,545	71,259	81,196	88,503	91,522
Current Borrowings	9,918	15,788	18,768	15,004	15,947
Other current liabilities	10,343	19,200	15,716	13,969	8,645
<b>Total Equity and Liabilities</b>	<b>323,960</b>	<b>332,269</b>	<b>328,495</b>	<b>325,267</b>	<b>332,230</b>

Source: NCBA IB Research Estimates, Company Financials

## Financial Forecasts

Statement of Comprehensive Income		FY22F	FY23F	FY24F	FY25F	FY26F
Electricity sales	Kes '000'	157,090,369	171,228,503	186,639,068	203,436,584	221,745,877
<b>Total Revenue</b>	<b>Kes '000'</b>	<b>157,090,369</b>	<b>171,228,503</b>	<b>186,639,068</b>	<b>203,436,584</b>	<b>221,745,877</b>
Cost Of sales	Kes '000'	(103,224,082)	(112,514,249)	(122,640,532)	(133,678,179)	(145,709,216)
<b>Gross Profit</b>	<b>Kes '000'</b>	<b>53,866,288</b>	<b>58,714,254</b>	<b>63,998,536</b>	<b>69,758,405</b>	<b>76,036,661</b>
Other income	Kes '000'	9,818,148	10,701,781	11,664,942	12,714,787	13,859,117
<b>Gross Profit and Other Income</b>	<b>Kes '000'</b>	<b>63,684,436</b>	<b>69,416,035</b>	<b>75,663,478</b>	<b>82,473,191</b>	<b>89,895,778</b>
Network management	Kes '000'	(13,132,755)	(14,314,703)	(15,603,026)	(17,007,298)	(18,537,955)
Commercial services	Kes '000'	(9,048,405)	(9,862,762)	(10,750,410)	(11,717,947)	(12,772,562)
Administration	Kes '000'	(24,867,405)	(27,105,472)	(29,544,964)	(32,204,011)	(35,102,372)
Expected credit losses on financial assets	Kes '000'	(1,979,339)	(2,157,479)	(2,351,652)	(2,563,301)	(2,793,998)
Total Operating Expenses	Kes '000'	(49,027,904)	(53,440,416)	(58,250,053)	(63,492,558)	(69,206,888)
<b>Operating Profit</b>	<b>Kes '000'</b>	<b>14,656,531</b>	<b>15,975,619</b>	<b>17,413,425</b>	<b>18,980,633</b>	<b>20,688,890</b>
Net Finance costs	Kes '000'	(11,893,060)	(11,231,546)	(10,487,344)	(9,650,117)	(8,708,235)
<b>Profit before income tax</b>	<b>Kes '000'</b>	<b>2,763,472</b>	<b>4,744,073</b>	<b>6,926,081</b>	<b>9,330,517</b>	<b>11,980,655</b>
Income tax (expense)/ credit	Kes '000'	(1,160,658)	(1,992,511)	(2,908,954)	(3,918,817)	(5,031,875)
<b>Total Net Profit After Tax</b>	<b>Kes '000'</b>	<b>1,602,814</b>	<b>2,751,562</b>	<b>4,017,127</b>	<b>5,411,700</b>	<b>6,948,780</b>

Statement of Financial Position		FY22F	FY23F	FY24F	FY25F	FY26F
Total Non-current Assets	Kes '000'	288,250,172	294,620,337	301,840,517	309,987,973	319,146,918
Total Current Assets	Kes '000'	48,220,328	51,696,696	56,303,539	61,324,998	66,798,388
<b>Total Assets</b>	<b>Kes '000'</b>	<b>336,470,500</b>	<b>346,317,033</b>	<b>358,144,056</b>	<b>371,312,971</b>	<b>385,945,306</b>
<b>Total equity</b>	<b>Kes '000'</b>	<b>58,776,755</b>	<b>61,528,317</b>	<b>65,545,444</b>	<b>70,957,144</b>	<b>77,905,923</b>
Total non-current liabilities	Kes '000'	160,542,943	157,389,101	153,743,036	149,534,402	144,683,265
Total Current Liabilities	Kes '000'	117,150,802	127,399,615	138,855,576	150,821,425	163,356,118
<b>Total Liabilities</b>	<b>Kes '000'</b>	<b>277,693,745</b>	<b>284,788,716</b>	<b>292,598,612</b>	<b>300,355,827</b>	<b>308,039,383</b>
<b>Total Equity and Liabilities</b>	<b>Kes '000'</b>	<b>336,470,500</b>	<b>346,317,033</b>	<b>358,144,056</b>	<b>371,312,971</b>	<b>385,945,306</b>

Statement of Cash flows		FY22F	FY23F	FY24F	FY25F	FY26F
Cash from operations	Kes '000'	26,209,880	30,249,788	31,727,500	33,300,461	34,972,619
Net cash used in investing activities	Kes '000'	(19,620,061)	(21,363,292)	(23,263,415)	(25,334,549)	(27,592,085)
Net cash used in financing activities	Kes '000'	(11,893,060)	(11,231,546)	(10,487,344)	(9,650,117)	(8,708,235)
<b>Net increase in cash and cash equivalents</b>	<b>Kes '000'</b>	<b>(5,303,241)</b>	<b>(2,345,051)</b>	<b>(2,023,259)</b>	<b>(1,684,204)</b>	<b>(1,327,701)</b>

Source: Company financials, NCBA IB Research Estimates

## About NCBA Investment Bank

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## Certification

The following analyst(s) who prepared this research report: Victoria Mututu hereby certifies(y) that: (i) all of the views and opinions expressed in this research report accurately reflect the research analyst's(s') personal views about the subject investment(s) and companies (y) and (ii) no part of the analyst's(s') compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed by the analyst(s) in this research report.

## Rating Definitions

**BUY** – Total expected 12-month return (incl. dividends) greater than 20%  
**ACCUMULATE** - Total expected 12-month return (incl. dividends) between 10% - 20%  
**HOLD** – Total expected 12-month return (incl. dividends) between 0% -10%  
**SELL** – Total expected 12-month return (incl. dividends) less than 0%

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