

KenGen's performance at the Nairobi Securities Exchange has come under considerable pressure in what we perceive is attributable to the firm's linear relationship with Kenya Power. With Kenya Power being the single buyer of power generated by KenGen, challenges within Kenya power have spilled over to KenGen.

The sustained sell-off in the equities market has seen KenGen record a **24.3% loss** year-to-date.

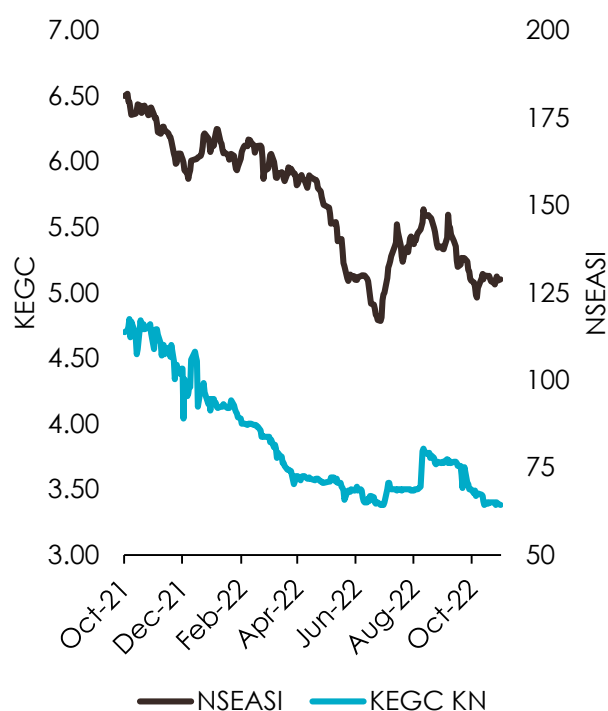
In this update, we maintain our **BUY** recommendation with a revised target price of **KES 4.45**, implying a 30% upside relative to the volume weighted average price of KES 3.40 recorded on 28th October 2022 exclusive of dividend yield. Our publication of August 2021 had a BUY recommendation with a target price of KES 5.37.

We expect the company to declared a dividend for the financial year ended June 2022 following consistent revenue growth and additional income driven from geothermal projects in Ethiopia.

The share is currently trading at a price to earnings (P/E) and price to book (P/B) multiple of 18.83x and 0.11x, respectively. On a normalized basis however, the P/E multiple of 2.91x against the current market P/E multiple of 6.9x, presents a buying opportunity which reiterates our guidance.

Share Data

Bloomberg Ticker	KEGC KN
Reuters ticker	KEGN.NR
Current Price(KES)	3.40
Target Price(KES)	4.45
Upside	30%
Rating	BUY
52WK High (KES)	4.00
52WK Low (KES)	3.35
Market Cap (Bn)	22.41
Shares outstanding (Bn)	6.59
Dividend yield (%)	0.00
EPS (normalized)	1.17
P/E (normalized)	2.91

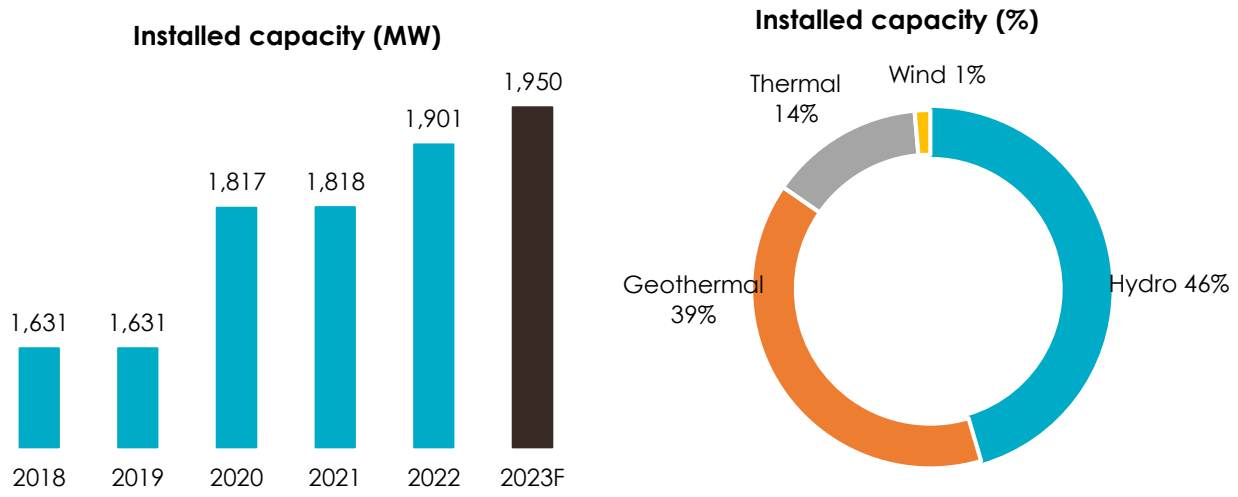


Source: Company financials, NCBA IB Research

KEY UPSIDES

Market dominance: KenGen is the largest power producer in Kenya, contributing over 65% of the power generated in the country.

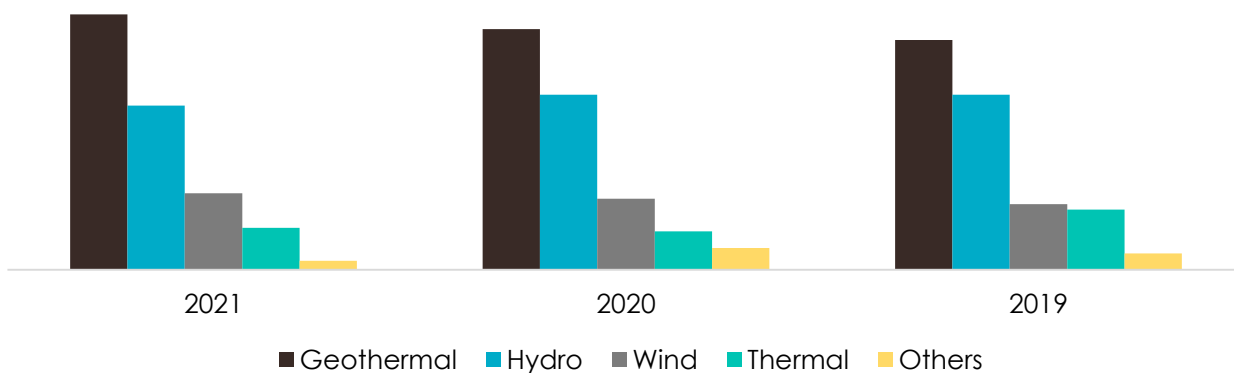
Capacity Increase: KenGen's effective installed capacity has grown at a CAGR of 2.8% from 1,631MW in 2018 and is estimated to reach 2500MW by 2025. The operationalization of the 83.3MW Olkaria 1 unit 6 commenced in January 2022 bringing the total installed capacity to 1,900MW. With the growing capacity, we expect to see an uptick in electricity sales.



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.

Geothermal generation has steadily been growing and now accounts for 39% of installed capacity. From a revenue perspective, it did account for 42%, 44% and 47% for FY2019, FY2020 and FY2021 respectively giving credence to investments made in increasing geothermal capacity. Steam revenue is also expected to rise with the increase in geothermal capacity.

Generation mix



Source: Company financials, NCBA IB Research

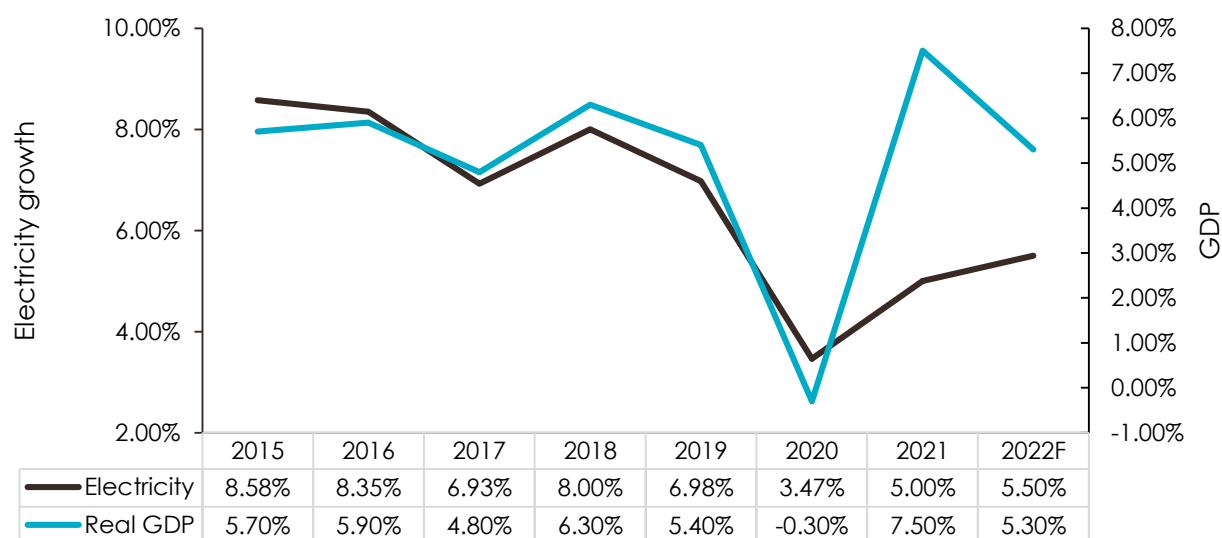
Economic outlook and electricity demand: The economic outlook of 2022 and 2023 is overwhelmingly tilted to the downside amid soaring inflation, lingering effects of the COVID-19 pandemic and mounting geopolitical threats. Inflation escalated to 9.6% in October 2022. We expect inflation to remain elevated and entrenched owing to high commodity and fuel prices.

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.

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 KenGen to increase electricity sales through increased production.

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

Revenue diversification paying off: The diversification venture that includes drilling of wells and geothermal exploration in Ethiopia contributed additional revenue of KES1.78Bn in FY2021 compared to 0.44Bn reported in the previous year. This diversification is expected to continue contributing to sustainable revenue growth. The diversification strategy will also entrench the firm's presence in the region.

Going Green: 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%. 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.

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.

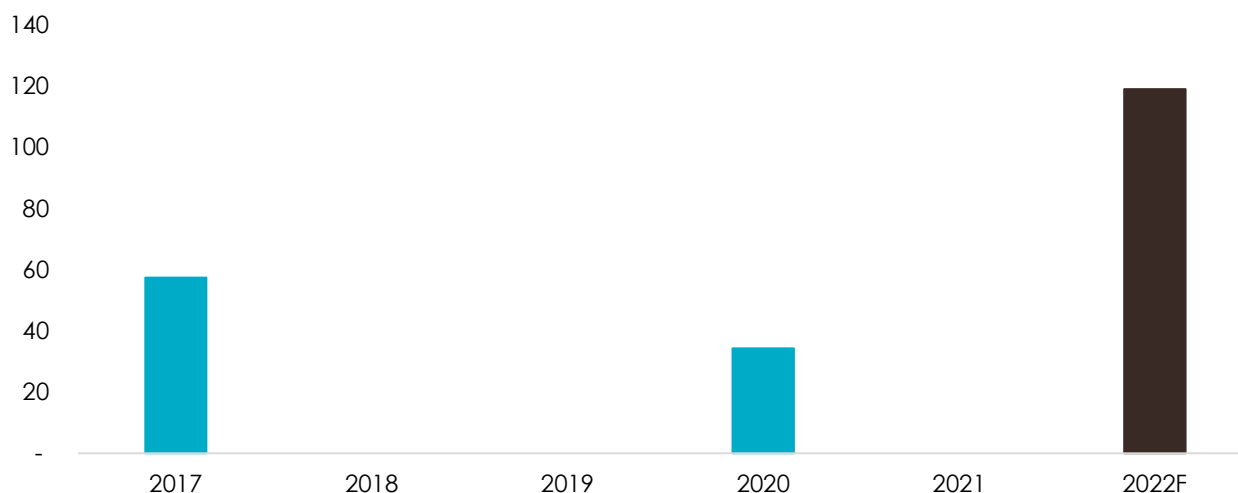
Carbon Credits: The United Nation Framework Convention on Climate Change (UNFCCC) signed the Kyoto Protocol which encourages countries and business entities to engage in mitigation of the impacts of climate change in their processes.

KenGen's investment in green energy sources is paying off with the company earning additional income from the sale of carbon credits. KenGen has 6 registered CDM projects and intends to register three more in the next financial year.

Project	tCO2e Certified Emissions Reductions (CERs)
Olkaria IV	2,025,813
Kiambere	160,160
Tana	57,458
Ngong	23,868
Olkaria II	309,495
Olkaria I AU 4&5	2,040,515
Total	4,617,309

In the Clean Development Mechanism (CDM) framework, the carbon credits earned have a monetary value thereby increasing the companies' income. KenGen has earned additional income from carbon credits as shown below;

Carbon credits (KES 'Mn)



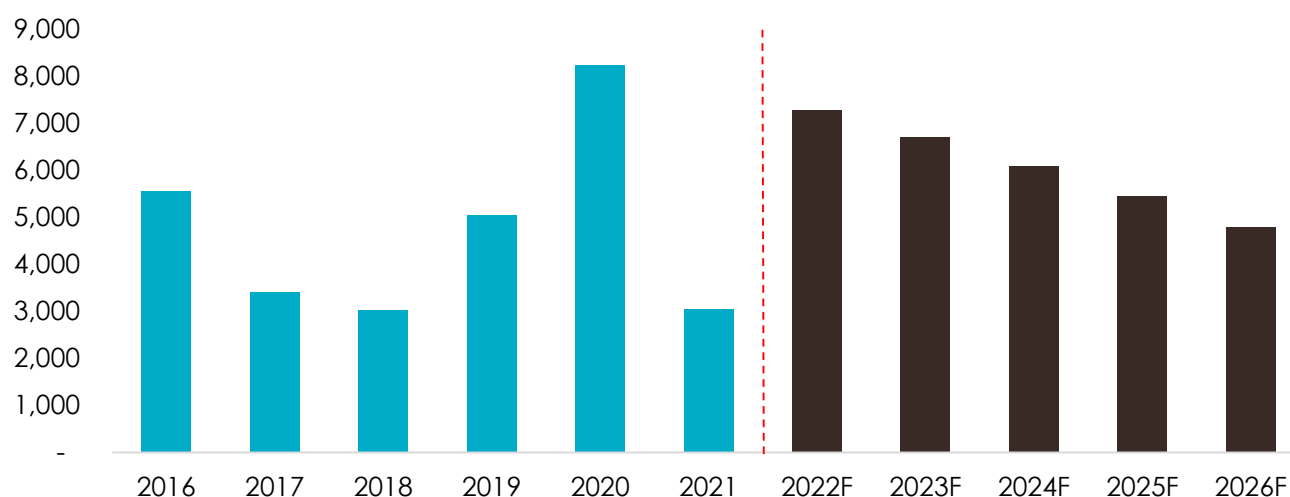
Source: company reports, NCBA IB Research

As a way of enhancing its portfolio of climate change mitigation projects, KenGen intends to incorporate additional geothermal, wind and solar projects which will further reduce carbon emissions annually, thus reducing the negative impact on the environment.

KEY DOWNSIDES

Forex implications: The Kenya shilling has maintained gradual depreciation against the US dollar compared to previous years. KenGen's debt is majorly denominated in US dollar and Japanese Yen. This will translate to foreign exchange loss for the company thus increase finance costs.

Finance costs KES 'Mn



Source: Company financials, NCBA IB Research

Hydro-power generation: Hydro-electric power generation accounts for approximately 46% (825.7MW) of KenGen's power generation. Energy mix has significantly shifted with hydro contributing 29% of the total power generated. Amidst low rainfall concerns, the country is enduring its worst drought in 40 years, according to the government and the United Nations. KenGen will likely report low hydro electricity sales. Hydro power is cheaper to generate and we are therefore likely to see increased costs associated with thermal power generation which is used to plug in the deficit when hydro generation is low.

Fuel costs: The Russo-Ukrainian war has negatively affected the energy industry with rising fuel prices. Fuel prices have risen by an average of 38% on YTD. This will translate to high fuel costs associated with power generation plants. The implications will however be limited because the company has a pass through mechanism where the fuel costs are passed on to the final power consumer through higher electricity bills.

Kenya Power woes: Kenya power is the single buyer of the power produced by KenGen. The risks of the single buyer model persist even as Kenya Power struggles to undertake reforms.

VALUATION

Ahead of KenGen's FY2022 earnings release, and given some of the key business announcements by the company since our last publication, we have reviewed our forecasts and subsequently our valuation of the stock.

We estimate an improvement of +5.14% in total revenue driven by expected marginal growth in electricity revenue (+3.99% y/y).

From our estimates and assumptions, we see a significant upside potential post FY2022 and maintain our BUY recommendation at a target price of KES 4.45.

The target price implies an upside of 30.8% to the current trading price of KES 3.40 as of 28th October 2022.

Valuation Methodology	Implied Price	Weighting	Weighted Value
DCF Approach	7.66	33%	2.55
P/E Approach	2.97	33%	0.99
P/B Approach	2.71	33%	0.90
Fair Value		100%	4.45
Current Price (at 14.10.2022)			3.40
Upside/(Downside)			30.8%

Source: NCBA IB Research estimates

Peer comparison: Middle East and Africa

Company	Location & Core business		Mkt Cap (USD Mn)	EV/EBITDA	P/E	P/B	ROE	Dividend Yield
Dhofar Generating Company	M.E	G	27.71	10.02	5.32	0.21	4.65%	-
Jordanian Electric Power	M.E	G	284.44	8.23	5.47	1.44	28.96%	4.50%
KenGen	Africa	G	178.48	5.57	16.76	0.10	0.58%	9.12%
Musandam Power Company	M.E	G	61.06	10.18	9.12	1.90	21.28%	9.70%
Omnican Ltd	Africa	G	24.84	2.39		0.19	-8.60%	-
Phoenix Power Company	M.E	G	167.15	5.62	3.15	0.29	9.29%	9.43%
Smn Power Holding Saog	M.E	G	17.63	3.19	0.75	0.10	13.92%	-
Irbid District Electricity	M.E	D	123.02	5.20	8.68	4.61	61.72%	5.48%
Kenya Power	Africa	D	28.09	2.45	2.27	0.06	2.66%	-
Lyonnaise Des Eaux	M.E	D	155.43	9.84	16.48	0.94	5.79%	3.73%
Copperbelt Energy Corp Plc	Africa	G & D	400.65	2.72	6.36	0.86	16.22%	12.49%
Umeme Ltd	Africa	G & D	85.83	1.74	2.09	0.36	16.40%	27.05%
Average			129.53	5.60	6.95	0.92	14.41%	10.19%

G: Generation D: Distribution M.E: Middle East

Source: Bloomberg, NCBA IB Research estimates

Historical Financial performance (KES' 000)

Statement Of Comprehensive Income	2016	2017	2018	2019	2020	2021
Electricity revenue Actuals	28,933,568	29,006,622	29,285,691	29,796,983	33,783,190	35,010,719
Steam revenue Actuals	6,856,018	5,189,072	6,222,057	5,871,921	5,549,684	5,227,392
Fuel Charge Actuals	-	9,069,403	9,622,740	10,111,516	4,155,499	3,674,626
Water Charge Actuals	-	166,822	159,172	185,226	181,774	204,408
Revenue from Branch Actuals	-	-	-	-	440,344	1,783,694
Total Revenue Actuals	35,789,586	43,431,919	45,289,660	45,965,646	44,110,491	45,900,839
Fuel costs Actuals	-	(8,812,614)	(9,246,855)	(10,006,336)	(4,106,504)	(3,955,710)
Water costs Actuals	-	(166,822)	(159,172)	(185,226)	(181,786)	(204,408)
Cost Of sales Actuals	-	(8,979,436)	(9,406,027)	(10,191,562)	(4,288,290)	(4,160,118)
Gross Profit Actuals	35,789,586	34,452,483	35,883,633	35,774,084	39,822,201	41,740,721
Other income Actuals	2,210,050	896,416	(775,177)	3,798,007	6,855,496	1,619,569
Gross Profit and Other Income Actuals	37,999,636	35,348,899	35,108,456	39,572,091	46,677,697	43,360,290
Depreciation and amortization Actuals	(10,223,370)	(9,244,422)	(10,147,886)	(10,360,330)	(12,029,561)	(11,520,128)
Employee expenses Actuals	(4,389,290)	(5,754,748)	(6,132,305)	(6,800,376)	(7,082,496)	(7,685,411)
Steam costs Actuals	(3,167,173)	(2,795,798)	(3,549,428)	(3,357,126)	(3,160,582)	(3,028,982)
Plant operation and maintenance expenses Actuals	-	(1,554,480)	(1,669,068)	(1,512,278)	(1,503,237)	(1,880,704)
Other expenses Actuals	(4,558,578)	(2,454,146)	(2,168,131)	(2,257,402)	(2,298,971)	(3,309,859)
Total Operating Expenses Actuals	(22,338,411)	(21,803,594)	(23,666,818)	(24,287,512)	(26,074,847)	(27,425,084)
Operating Profit Actuals	15,661,225	13,545,305	11,441,638	15,284,579	20,602,850	15,935,206
Finance income Actuals	556,108	1,242,157	3,341,383	1,423,062	1,431,118	1,879,747
Finance costs Actuals	(5,563,209)	(3,417,442)	(3,037,554)	(5,053,924)	(8,244,181)	(3,053,208)
Net Finance costs Actuals	(5,007,101)	(2,175,285)	303,829	(3,630,862)	(6,813,063)	(1,173,461)
Profit before income tax Actuals	10,654,124	11,370,020	11,745,467	11,653,717	13,789,787	14,761,745
Income tax (expense)/ credit Actuals	(4,520,552)	(2,476,793)	(3,854,834)	(3,769,382)	4,587,306	(13,573,338)
Total Net Profit After Tax	6,133,572	8,893,227	7,890,633	7,884,335	18,377,093	1,188,407

Statement Of Financial Position	2016	2017	2018	2019	2020	2021
Total Non-current Assets Actuals	344,821,946	347,090,213	347,940,938	367,793,076	378,888,857	381,838,967
Total Current Assets Actuals	21,916,420	29,639,369	31,412,067	33,629,173	34,038,073	43,819,196
Total Assets Actuals	366,738,366	376,729,582	379,353,005	401,422,249	412,926,930	425,658,163
Total equity Actuals	172,385,381	182,835,913	190,103,625	194,964,536	211,318,388	210,323,369
Total non-current liabilities Actuals	176,162,926	173,800,472	168,369,902	180,860,247	184,552,489	194,939,148
Total Current Liabilities Actuals	18,190,059	20,093,197	20,879,478	25,597,466	17,056,053	20,395,646
Total Liabilities Actuals	194,352,985	193,893,669	189,249,380	206,457,713	201,608,542	215,334,794
Total Equity and Liabilities Actuals	366,738,366	376,729,582	379,353,005	401,422,249	412,926,930	425,658,163

Source: NCBA IB Research Estimates, Company Financials

Financial forecasts (KES '000)

Statement Of Comprehensive Income	2022F	2023F	2024F	2025F	2026F
Electricity revenue Actuals	36,411,148	37,867,594	39,382,297	40,957,589	42,595,893
Steam revenue Actuals	5,709,268	5,937,639	6,175,144	6,422,150	6,679,036
Fuel Charge Actuals	4,150,871	4,316,906	4,489,582	4,669,165	4,855,932
Water Charge Actuals	203,902	212,059	220,541	229,363	238,537
Revenue from Branch Actuals	1,783,694	1,783,694	1,783,694	1,783,694	1,783,694
Total Revenue Actuals	48,258,883	50,117,891	52,051,258	54,061,961	56,153,092
Fuel costs Actuals	(4,140,079)	(4,305,682)	(4,477,909)	(4,657,025)	(4,843,306)
Water costs Actuals	(203,902)	(212,059)	(220,541)	(229,363)	(238,537)
Cost of sales Actuals	(4,343,981)	(4,517,740)	(4,698,450)	(4,886,388)	(5,081,843)
Gross Profit Actuals	43,914,902	45,600,150	47,352,809	49,175,573	51,071,248
Other income Actuals	1,703,539	1,769,162	1,837,409	1,908,387	1,982,204
Gross Profit and Other Income Actuals	45,618,441	47,369,312	49,190,218	51,083,960	53,053,452
Depreciation and amortization Actuals	(11,871,183)	(12,327,872)	(12,802,155)	(13,294,733)	(13,806,339)
Employee expenses Actuals	(7,914,457)	(8,219,334)	(8,536,406)	(8,866,162)	(9,209,107)
Steam costs Actuals	(3,132,104)	(3,257,389)	(3,387,684)	(3,523,191)	(3,664,119)
Plant operation and maintenance expenses Actuals	(1,809,708)	(1,879,421)	(1,951,922)	(2,027,324)	(2,105,741)
Other expenses Actuals	(3,257,475)	(3,382,958)	(3,513,460)	(3,649,182)	(3,790,334)
Total Operating Expenses Actuals	(27,984,926)	(29,066,974)	(30,191,627)	(31,360,592)	(32,575,640)
Operating Profit Actuals	17,633,514	18,302,338	18,998,591	19,723,368	20,477,812
Finance income Actuals	2,179,701	2,527,518	2,930,837	3,398,515	3,940,820
Finance costs Actuals	(7,278,775)	(6,700,079)	(6,092,448)	(5,454,436)	(4,784,523)
Net Finance costs Actuals	(5,099,074)	(4,172,561)	(3,161,611)	(2,055,921)	(843,703)
Profit before income tax Actuals	12,534,440	14,129,778	15,836,980	17,667,447	19,634,109
Income tax (expense)/ credit Actuals	(5,515,154)	(6,217,102)	(6,968,271)	(7,773,677)	(8,639,008)
Total Net Profit After Tax	7,019,286	7,912,675	8,868,709	9,893,770	10,995,101

Statement Of Financial Position	2022F	2023F	2024F	2025F	2026F
Total Non-current Assets	383,662,746	385,557,608	387,527,071	389,574,793	391,704,582
Total Current Assets	58,375,706	62,658,314	66,995,755	71,429,005	76,004,514
Total Assets	442,038,453	448,215,922	454,522,826	461,003,798	467,709,096
Total equity	217,342,655	225,255,331	234,124,039	244,017,810	255,012,911
Total non-current liabilities	204,242,717	202,458,962	199,831,200	196,334,702	191,943,094
Total Current Liabilities	20,453,081	20,501,630	20,567,586	20,651,286	20,753,091
Total Liabilities	224,695,797	222,960,591	220,398,786	216,985,989	212,696,185
Total Equity and Liabilities	442,038,453	448,215,922	454,522,826	461,003,798	467,709,096

Source: Company financials, NCBA IB Research Estimates

About NCBA Investment Bank

NCBA Investment Bank is a subsidiary of NCBA Group. The services offered by the brokerage department include equities trading for listed securities, fixed income trading for both corporate and government bonds, Over the Counter (OTC) equity transactions as well as execution of equities transactions across the East African countries. Additionally, NCBA Investment Bank backs these activities with solid advice from the research team to enable investors meet their return objectives. NCBA Investment Bank deploys simple and convenient client driven technologies, robust risk management, highly competent and experienced staff and has the backing of robust research capabilities to differentiate itself from other players in the market.

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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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