FY21 Energy Sector Earnings Update

Kenya Power and Lighting Company (KPLC)

- KPLC has reported KES.1.5Bn in **Profit after Tax** FY21, compared to a KES.939Mn loss FY20 driven mainly by a 16.7% decline in transmission, distribution and administration costs from KES.47.8Bn to KES.39.9Bn.
- **Earnings Per Share (EPS)** consequently increased to KES.0.76 from a loss of KES.0.48 over the same period in 2020.
- **Total revenue** recorded an 8.2% jump from KES.133.3Bn in 2020 to KES.144.1Bn due to the aforementioned expansion in their customer base and heightened revenue protection activities in light of their increased field presence.
- Further, all customer segments recorded growth, with Commercial and Industrial growing by 4.8%, Small Commercial by 5.1%, domestic customers by 4.9% and street lighting by 10.2%.
- This led to an 8.4% increase in **electricity revenue** (excluding foreign exchange surcharge and fuel recovery) as a result of KES.9.8Bn growth in electricity sales to KES.125.9Bn.
- **Unit sales** grew by 5% to 8,571GWh largely driven by the connection of 716,206 new customers and a rebound of the economy from the effects of the Covid-19 pandemic.
- **Operating costs** dropped by KES.7.9Bn from KES.47.8Bn to KES.39.9Bn which management attributes to lower provisions as a result of enhanced revenue collection, prudent cost management and resource optimization initiatives.
- **Finance costs** declined by KES.3.4Bn to KES.9.1Bn following the partial conversion of overdrafts and continued repayment of commercial loans.
- Management further stated that unrealized foreign exchange losses reduced due to prudent planning of foreign exchange transactions.
- Overall **system efficiency** stood at 76.1% in June 2021 due to a reduction in system losses from 25.2% to 22.7%.
- The net effect of the foregoing measures was an increase in **cash flow from operations** by 37.8% from KES.23.6Bn to KES.32.5Bn.
- **Total assets** grew marginally by 2.1% to KES.332.2Bn, mainly attributable to a 16.4% growth in current assets.
- **Current Liabilities** dropped negligibly by 1.2% from KES.117.5Bn to KES.116.1Bn which when coupled with the increase in current assets, served to reduce the firm's negative net working capital position from KES.74.9Bn to KES.66.5Bn.
- **Dividend -** No dividend was declared.

FY22 Outlook

- KPLC's jump back to profitability is a welcome surprise for shareholders and will boost the utility firm's share price in the short-term.
- While the growth in the utility's top line growth is commendable, the 8,571GWh sold to customers is still below the 10,399GWh bought by the company in FY21.
- Key to the firm's recovery will be a reduction in the amount of electricity purchased seeing as supply is way above demand, a factor contributing to system losses of 22.7%.
- The ongoing negotiations between Kenya Power and Independent Power Producers (IPP's) that aims to renegotiate the firm's Power Purchase Agreements (PPA's) will be key in stabilizing the firm for the long term.
- The presidential task force mandated to find a way to reduce the high cost of electricity saw PPA's (which are heavily skewed to IPP's due to take-or-pay clauses) as being key to cost reduction for both the utility and consumers.
- The negotiations are still ongoing but given the Government's influence as well as the upcoming election year, KPLC is likely to see costs associated with electricity purchases reduce.
- Also of worthy note is the firm's reduction in operating expenses (OPEX) which in FY20 stood at KES.47.8Bn thereby effectively swallowing up its gross profit of KES.45.8Bn.

- The sustainability of this cost reduction is unlikely given its continued grid expansion program, however, it is a step in the right direction.
- While KPLC's negative net working capital position is still significant, majority of current liabilities comprise of trade payables that (while interest bearing) the utility firm can forego payment at least in the short run due to Government ownership of its key supplier, KenGen.
- The company is also pushing for 2 more years of debt suspension on loans amounting to KES.53.3Bn which, if successful, will help to ease cash flow constraints.
- All these factors combine to point to a long term recovery of the company if sustained and successful, a factor which the firm's share price will reflect in the coming days.

KenGen

- KenGen reported KES.14.8Bn in **Pre-tax profit** for FY21, compared to KES.13.8Bn in the previous year.
- However, the energy producer's **Profit After tax** dropped to KES.1.2Bn (FY20: KES.18.4Bn) due to a deferred tax liability that drove up its income tax expense to KES.13.6Bn.
- **Earnings per Share** (EPS) dropped to KES.0.18 per share compared to KES.2.79 over the same period in 2020.
- **Revenue** increased 4.1% from KES.44.1Bn to KES.45.9Bn which management attributed to increased revenues from geothermal, hydro generation and diversification venture at Tulu Moye in Ethiopia.
- **Unit sales** grew by 2.5% from 8,237GWh to 8,443GWh due to recovery of the economy from the Covid-19 pandemic and the full operationalization of the 172MW Olkaria V geothermal plant.
- The full operationalization of the plant also led to a 12% displacement of thermal generation, thereby reducing fuel costs by 3.7%.
- The ongoing geothermal drilling services in Tulu Moye contributed KES.1.7Bn to revenues compared to KES.440Mn a year earlier, representing a 305% year-on-year (YoY) increase.
- **Operating expenses (OPEX)** increased by 18% from KES.10.9Bn to KES.12.9Bn mainly attributable to cost of drilling operations in Ethiopia, operation and maintenance costs of power plants and Corporate Social Investment (CSI) such as the construction of the Naivasha Level 5 County Referral Hospital.
- **Finance income** increased by 31% from KES.1.4Bn to KES.1.9Bn attributable to interest on delayed payment of receivables.
- Finance income was also boosted from interest income associated with investing funds arising from deferred payment of on-lent loans under moratorium and Debt Service Suspension Initiative (DSSI).
- **Finance costs** decreased by 63% from KES.8.2Bn to KES.3.1Bn attributable to a stable Kenya Shilling which lowered foreign exchange losses on foreign currency denominated borrowings to KES.702Mn compared to KES.6Bn the previous year.
- Given that the corporate tax rate was reduced from 30% to 25% in 2020 but reversed to 30% in 2021, a tax expense of KES.8.7Bn on deferred tax resulted, compared to a tax credit of KES.8.1Bn in the previous year.
- This occurrence contributed significantly to the company's high tax expense of KES.13.6Bn.
- **Total Assets** grew by 3.1% to KES.425.7Bn, mainly attributable to a 28.7% growth in current assets from KES.34Bn to KES.43.8Bn.
- The company's **cash flow from operations** shot up from KES.17.9Bn to KES.27.4Bn representing a 53.1% YoY growth.
- **Dividend -** KenGen maintained its dividend at KES.0.30 per share.

FY22 Outlook

- The power producer continues to boast stellar operational results and is in a firm financial position, despite the drop in PAT.
- If KenGen's tax expense was normalized, the company would announce higher bottom line profits on a YoY basis.
- We do not expect a similar tax impact in the coming year, therefore, when we consider the producers strengths going forward it is likely to benefit from a significant surge on YoY profits due to base effects.
- KenGen continues to enact its Good to Great (G2G) initiative that seeks to increase its capacity by 721 Megawatts (MW) to a total of 2,539MW by 2025.
- To this effect, the company aims to deliver Olkaria I Unit 6 geothermal power plant which will add 83.3MW to the national grid by the end of the year.
- The main risk to the company's grid expansion plan is the single buyer model in which Kenya operates, whereby power producers can only sell electricity to one off-taker, KPLC.
- To curb the foregoing, the firm's has embarked on a diversification drive centered on providing geothermal consultancy services, which as at FY21 brought in 4% of total revenue (305% YoY growth).
- Other effects of the expansion strategy include higher capital expenditures (Capex) over the next few years and increased debt to fund said expansion which is likely to drive up finance costs.
- Investors in KenGen must be cognizant of the fact that the firm is likely to underperform in the short-term with the fruits of its expansion strategy being spread out over a number of years.

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