KenGen – FY2013 Results Note

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Analyst(s):

Samuel Mugacha

E-mail: samuel.mugacha@fib.co.ke

Head Office

Crawford Business Park, Ground Floor
State House Road
Tel: (254-20) 7606026
www.fib.co.ke
P.O Box 45236, 00100
Nairobi.

Recommendation: BUY

Current Market price (07.10.2013)	16.45
Forecasted EBITDA: FY2014 ('000)	15,150
Target Price	**21.70**
Upside Potential	**31.9%**

Investment Summary

We maintain our BUY recommendation for KenGen and the target price of KES 21.70, which provides a 31.9% upside from the current share price of KES 16.45 (as at 7th October 2013).

Our recommendation is largely informed by the new installed capacity increases being done by the company which will result in increased revenues and earnings.

Profit before tax up 1.2%

KenGen released it FY2013 results, which showed a 1.2% increase in profit before tax to KES 4.09 billion. This was KES 702.4 million shy of our KES 4.8 billion forecast.

Key Results Highlights

Revenues in line with forecast

Revenues in line with our forecast: Electricity revenues went up by 3.6% to KES 16.5 billion, in line with our forecast of KES 16.7 billion.

Expenses up marginally

Expenses also rose marginally: Operating expenses went up by 3.0% to KES 10.6 billion compared to KES 10.3 billion recorded during the previous year. This was only KES 172.3 million higher than our expected operating expenses of KES 10.4 billion.

Gross profit margin up: The gross profit margin went up slightly to 35.7% compared to 35.3% recorded during the previous financial year.

Revenue Drivers

2,504MW to be provided in the next 40 months

Capacity increases: KenGen targets to provide 2,504MW of the 5,538MW the government plans to introduce over the next 40 months. In the current financial year, KenGen expects to bring in 114MW of power and 274MW of power in the next financial year.

Reliable power: Going forward, it is worthy to note that the expected 2,504MW of power over the next 40 months is going to be largely from sources that are not affected by hydrology.

Electricity consumers rising

Electricity consumers/ Demand: Electricity customer numbers have been increasing steadily, with the figure closing FY2013 at 2,330,962. In addition, Kenya Power has resumed connecting new customers after a tussle with the government which saw them suspend this operation.

Strategy and Outlook

ROE up to 7.1%

Growth in return on shareholder funds: The Return on Equity (ROE) for the company went up to 7.1% from 4.0% recorded during the previous financial year.

Funding & Capital expenditure: During the financial year under review, capital expenditure for the company increased by 315% to KES 37.4 billion compared to a capex of KES 9.0 billion recorded during the previous financial year due to the new capacity increase projects being done by the company.

KenGen FY2013 Results

KenGen FY2013 Income Statement '000	FY2012	FY2013	% Change
Electricity revenue	15,872,111	16,451,195	3.6%
Operating expenses	(10,266,022)	(10,575,209)	3.0%
Gross profit	**5,606,089**	**5,875,986**	**4.8%**
Gross profit margin	*35.3%*	*35.7%*	
Interest income	952,621	676,109	-29.0%
Other income	611,599	594,888	-2.7%
Other (losses)) and gains	(152,811)	(53,107)	-65.2%
Operating profit	**7,017,498**	**7,093,876**	**1.1%**
Finance Costs - Net	(2,972,308)	(3,000,802)	1.0%
Profit before Tax	**4,045,190**	**4,093,074**	**1.2%**
Tax income/ (Expense)	(1,222,590)	1,157,062	-194.6%
Net profit for the year	***2,822,600***	***5,250,136***	***86.0%***

KenGen Balance sheet '000			
ASSETS			
Property plant & equipment	120,664,699	153,201,471	27.0%
Other Noncurrent assets	20,192,108	10,344,001	-48.8%
Current Assets	22,288,066	25,127,810	12.7%
Total Assets	***163,144,873***	***188,673,282***	***15.6%***
EQUITY AND LIABILITIES			
Share capital	5,495,904	5,495,904	0.0%
Reserves and other equity	64,683,650	68,632,835	6.1%
Non Current liabilities	77,964,362	96,871,914	24.3%
Current liabilities	15,000,957	17,672,629	17.8%
Total Equity and Liabilities	***163,144,873***	***188,673,282***	***15.6%***

Results Analysis

Net profit increased by 86.0%

KenGen released its FY2013 results which showed an 86.0% growth in net profit to KES 5.3 billion compared to KES 2.8 billion recorded during the previous financial year. This was due to a KES 1.1 billion tax credit the company got as capital allowances due to its energy projects.

Profit before tax however went up by a moderate 1.2% to KES 4.09 billion compared to KES 4.04 billion.

Revenues went up by 3.6%

Revenues in line with our forecast: Electricity revenues went up by 3.6% to KES 16.5 billion, in line with our forecast of KES 16.7 billion. The units sold increased by 11.4% y-o-y to 6,022 GWh from 5,404 GWh due to favorable hydrology and output from new power plants such as Kindaruma (32MW), Sang'oro (21MW), pilot wellhead (5MW) and Eburru (2.5MW).

As indicated in our power sector report, Boosting Capacity to Power More…, KenGen revenues have been fluctuating in the past. Going forward, we are likely to see continuous steady growth in the top line as other power plants are commissioned.

Operating expenses up by 3.0%

Expenses also rose marginally: Operating expenses went up by 3.0% to KES 10.6 billion compared to KES 10.3 billion recorded during the previous year. This was only KES 172.3 million higher than our expected operating expenses of KES 10.4 billion.

Gross profit margin up slightly

The gross profit margin went up slightly to 35.7% compared to 35.3% recorded during the previous financial year.

Interest income down by 29.0%

Interest income declined by 29.0% to KES 676.1 million compared to KES 952.6 million recorded in FY2012. This was attributed to investments in projects and redemption of infrastructure bonds amounting to KES 3.6 billion.

Finance costs went up by 1.0% to KES 3.0 billion compared to KES 2.97 billion recorded in FY2012.

Revenue drivers

Capacity increases

KenGen targets to provide 2,504MW of the 5,538MW the government plans to introduce over the next 40 months. The projects and months of completion are shown in the table below.

	6 months	12 months	18 months	24 months	30 months	36 months	40 months	Total
Geothermal	90	160	100	-	70	-	280	700
Wind	-	-	20	-	-	100	-	120
Hydro	24	-	-	-	-	-	-	24
TOTAL (without JV partners)	-	-	-	-	-	-	-	844
LNG (with JV partners)	-	-	-	700	-	-	-	700
Coal (with JV partner)	-	-	-	-	-	-	960	960
Period Total	114	160	120	700	70	100	1,240	
Cumulative		114	274	394	1,094	1,164	1,264	2,504

Source: KenGen

As the table above shows, in the current financial year, KenGen expects to bring in 114MW of power and 274MW of power in the next financial year.

Increased capacity to contribute about KES 1.5 billion in 2014

We estimate the increase in capacity, 114MW and 274MW, to contribute about KES 1.5 billion and KES 3.5 billion to the top line of the company respectively.

Reliable power

Major sources of power being produced not affected by hydrology

Going forward, it is worthy to note that the expected 2,504MW of power being produced over the next 40 months is going to be largely from sources that are not affected by hydrology.

This will result in a steady supply of power, thereby minimizing fluctuations in revenues and earnings caused by erratic hydrology.

Electricity consumers/ Demand

Customer numbers at 2.3 million

As indicated in our Kenya Power results note, dated October 17th 2013, electricity customer numbers have been increasing steadily, with the figure closing FY2013 at 2,330,962. In addition, Kenya Power has resumed connecting new customers after a tussle with the government which saw them suspend this operation.

Therefore, as customer numbers continue to grow, increasing demand base will continue to improve the investment prospects for power generation.

Strategy and Outlook

Funding & capital expenditure

Capex increased by 315%

During the financial year under review, capital expenditure for the company increased by 315% to KES 37.4 billion compared to a capex of KES 9.0 billion recorded during the previous financial year.

This increase is attributed to Olkaria I & IV's 280MW project under construction, drilling of wells and Kindaruma rehabilitation.

Capital requirements for projects estimated at USD 5.5 billion

Going forward, KenGen estimates the capital requirements for the projects above to be approximately KES 484 billion (USD 5.5 billion). This is expected to be funded through both debt and equity in the ratio 70% debt: 30% equity.

Debt will include; Development Financial Institutions (DFI's), ECA Commercial banks and Capital Markets Authority (CMA) while equity will includes; JVs, trade sale and rights issue.

Growth in return on shareholder funds

ROE increased

The Return on Equity (ROE) for the company went up to 7.1% from 4.0% recorded during the previous financial year.

This can be attributed to the KES 1.2 billion tax credit earned by the company during the review period. However, the company recorded only a 1.2% growth in profit before tax to KES 4.09 billion compared to KES 4.05 billion in FY2013.

Recommendation

BUY recommendation

We maintain our BUY recommendation for KenGen and the target price of KES 21.70, which provides a 31.9% upside from the current share price of KES 16.45 (as at 7th October 2013).

Our recommendation is largely informed by the new installed capacity increases being done by the company which will result in increased revenues and earnings.

Graph showing KenGen share price since January 2013