



### KENGEN 1H20 AND FY19 EARNINGS UPDATE

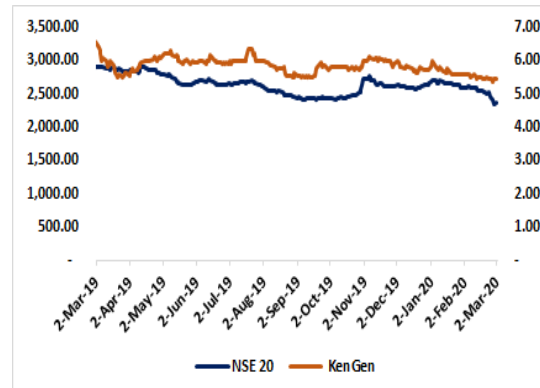
Dear all,

KenGen released its 1H20 and FY19 unaudited results recording a 98.1% y-o-y increase in profits after tax to KES 8.2 BN in 1H20. In FY19 however, the bottom line remained fairly flat y-o-y at KES 7.9 BN. Basic earnings per share (EPS) edged up 97.5% y-o-y in 1H20 to KES 1.24. Trailing EPS stands at KES 1.81 per share. The Board did not recommend an interim dividend for 1H20 and has advised that it will make recommendations on a final dividend for FY19 once the audit of its financial statements is complete following the appointment of an auditor general.

#### Key Highlights:

- Gross sales were fairly flat y-o-y both in 1H20 and FY19 gaining 0.8% and 1.5% respectively to KES 22.3 BN and 46.0 BN. Total gross income edged up 6.7% y-o-y in 1H20 to KES 19.6 BN on account of a 6.4% y-o-y increase in electricity revenue to KES 16.0 BN and a 16.8% y-o-y reduction in net reimbursable expenses to KES 3.4 BN. We highlight that other income grew 127.0% y-o-y owing to the returns of the two drilling contracts the company secured in Ethiopia. Gross profit margins recorded a 485 bps y-o-y improvement to 87.8%.
- In FY19, total gross income increased 12.7% y-o-y to KES 39.6 BN on the back of KES 3.2 BN reported under other net gains in contrast to a KES 1.1 BN net loss in FY18. As such, gross profits margins increased by 485 bps y-o-y to 86.1%.
- We foresee better top line performance in the second half of FY20 as capacity revenues from Olkaria V stream in, this being the typical nature of the company's revenues in the years when new plants are commissioned.
- Total expenses grew 9.8% y-o-y in 1H20 primarily owing to an 11.2% upswing in depreciation and amortization costs to KES 5.7 BN arising from the depreciation expense on Olkaria V; and an 11.8% y-o-y increase in operating expenses to KES 5.6 BN. Operating profit margins remained fairly flat gaining 9 bps y-o-y to 30.0%.
- As at FY19, total expenses rose by a slight 2.6% y-o-y to KES 7.8 BN on account of a 6.0% increase in operating expenses to KES 10.6 BN. Operating profit margins edged up 799 bps y-o-y to 33.3%.

KENGEN: 52 WEEK PRICE PERFORMANCE



(Source: NSE, DBIB Research)

Price	Absolute	Excess
Return	Return	Return
3 months (%)	(5.5)	3.9
6 months (%)	(0.4)	3.7
12 months (%)	(5.5)	3.9

#### KEY METRICS

Recommendation	BUY
Current price (KES)	5.48
Target price (KES)	9.60
YTD Return (%)	(5.5)
52 week low (KES)	5.38
52-week high (KES)	6.58
Issued Shares (BN)	6.6
Market Cap (KES BN)	36.2

#### Research Analyst

Cynthia Wangari

Email: [cwangari@dyerandblair.com](mailto:cwangari@dyerandblair.com)

Telephone: +254709930130

- **Finance costs declined 14.6% y-o-y in 1H20 to KES 1.1 BN after having risen 66.4% y-o-y in FY19 to KES 5.0 BN.** This was partly on account of the final repayment of its 10-year, KES 25.0 BN infrastructure bond in October 2019.
- **Profit before tax grew 4.3% y-o-y to KES 6.3 BN in 1H20** after remaining fairly flat y-o-y in FY19, shedding a measly 0.8% to KES 11.65 BN.
- **Profit after tax saw a 98.1% y-o-y upswing in 1H20 in contrast to the 0.1% y-o-y decline observed in FY19.** This was a result the capital allowances received following the completion of Olkaria V (165 MW) that resulted in a KES 1.9 BN tax credit in contrast to a 1.9 BN tax charge reported in FY18.
- **Dividends:** The board has advised that it will make recommendations on any final dividend for FY19 once the audit of financial statements is complete following the appointment of an auditor general. We expect that the final dividend will come in at between KES 0.3 per share and 0.5 per share on the following basis:

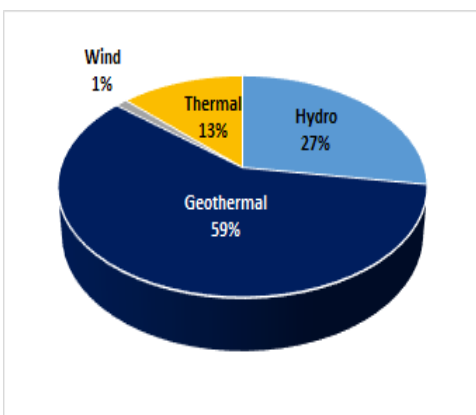
Assuming that other reserves are held constant, we work backwards to find:

<b>Reserves and retained earnings</b>	<b>FY19</b>
Opening balance (KES BN)	151.5
<u>Closing balance (KES BN)</u>	<u>156.3</u>
Change in retained earnings (KES BN)	4.9
<u>PAT (KES BN)</u>	<u>7.9</u>
<b><u>Implied Dividends (KES BN)</u></b>	<b><u>3.0</u></b>
Number of shares issued (BN)	6.6
<b><u>DPS (KES)</u></b>	<b><u>0.46</u></b>

*(Source: Company filings, DBIB Research)*

- **The cash and cash equivalents balance at the close of 1H20 stood at KES 5.3 BN, 40.3% lower than the balance at the end of 1H19.** This was on account of KES 4.1 BN in net cash and cash equivalents **used** in contrast to KES 5.4 BN **generated** in 1H19. The reduction in cash was partly attributable to lower disbursements from borrowings following the completion of Olkaria V.
- KenGen's cash and cash equivalents balance at the close of FY19 had risen 171.6% y-o-y to KES 9.2 BN primarily on the back of 74.7% y-o-y increase in cash generated from operating activities.

#### ELECTRICITY REVENUE BY SOURCE



(Source: NSE, DBIB Research)

**Going forward:** We continue to see value in the company's focus on geothermal energy highlighting that it avails numerous opportunities for growth.

Firstly, we foresee strong topline performance in the second half of FY20 supported by increased **capacity revenue** from Olkaria V and increased **energy revenue** from the more lucrative tariffs on geothermal units. We see even better performance beyond FY20 following the commissioning of Olkaria 1 unit 6 (83 MW) expected in FY21. Like Olkaria V, we expect that this project will both significantly boost top line through increased capacity and energy revenues and the bottom line through **capital allowances**.

Secondly, increased geothermal capacity offers KenGen an avenue to generate supplementary income in the form of **steam revenue**, which, incidentally, contributed 17.5% (KES 6.2 BN) of total revenue in FY18 and which we expect will on average account for at least 15.7% of total revenue over the period to FY21F. This revenue is obtained from tariffs charged by the company to cover investment, operation and maintenance of geothermal wells intended to produce steam for the power plants.

Further, we see opportunities for the company to leverage on its years of experience and industry expertise to expand its **geothermal service business** by participating in tenders to offer geothermal consultancy and drilling services across Africa, as it has done in Ethiopia. We underscore that Kenya is currently ranked the 8<sup>th</sup> largest geothermal power producer in the world.

We remain bullish on **dividend prospects** both for FY19 and going forward. We expect that dividends will hold constant at KES 0.4 per share in FY19 and increase thereafter to KES 0.51 and KES 0.63 in FY20F and FY21F respectively. We see this being driven by increased revenues from the commissioning of new projects (Olkaria V and Olkaria I unit 6), tax credits expected as a result of commissioning new plants outside the major cities and the enactment of the Finance Act 2018 that exempts the company from paying compensating tax effective from 1st January 2019.

Lastly, we anticipate a **slow down in capex** going forward given that the company's next project, Olkaria VI is to be done under a PPP arrangement whereby a Special Purpose Vehicle (SPV) will finance, construct, own, and operate the power plant and associated facilities. Under this arrangement KenGen will have the right to make a cash investment in the SPV constituting an ownership participation of only 25% .

**On a trailing basis**, KenGen is trading at P/E and EV/EBITDA multiples of 3.0x and 7.9x against a peer average of 13.7x and 8.5x respectively. We maintain our **BUY** recommendation.

## INCOME STATEMENT

KES MN	1H20	1H19	y-y % ch	FY19	FY18	y-y % ch
Gross revenue	22,361	22,185	0.8	45,966	45,290	1.5
Reimbursable Expenses	(3,447)	(4,145)	(16.8)	(10,192)	(9,406)	8.4
Revenue net reimbursable expenses	18,914	18,040	4.8	35,774	35,884	(0.3)
Other income	479	211	127.0	619	274	125.9
Other net gains	246	158	55.7	3,179	(1,050)	402.8
Total Gross Income	19,639	18,409	6.7	39,572	35,108	12.7
Steam costs	(1,661)	(1,667)	(0.4)	(3,357)	(3,549)	(5.4)
Operating expenses	(5,569)	(4,980)	11.8	(10,571)	(9,969)	6.0
EBITDA	12,409	11,762	5.5	25,644	21,590	18.8
Depreciation and Amortization	(5,708)	(5,133)	11.2	(10,360)	(10,148)	2.1
Operating Profit	6,701	6,629	1.1	15,284	11,442	33.6
Finance income	723	733	(1.4)	1,423	3,341	(57.4)
Finance costs	(1,145)	(1,340)	(14.6)	(5,054)	(3,037)	66.4
Profit before tax	6,279	6,022	4.3	11,653	11,746	(0.8)
Income tax expense	1,892	(1,898)	(199.7)	(3,769)	(3,855)	(2.2)
Profit after tax	8,171	4,124	98.1	7,884	7,891	(0.1)
Fair value and revaluation gains	(3)	12	(125.0)	(62)	(623)	(90.0)
Comprehensive income	8,168	4,136	97.5	7,822	7,268	7.6
EPS	1.24	0.63	97.5	1.20	1.20	(0.1)

Source: Company, DBIB Research

## BALANCE SHEET

KES MN	1H20	1H19	y-y % ch	FY19	FY18	y-y % ch
Share capital	16,488.0	16,488	-	16,488	16,488	-
Share premium	22,151.0	22,151	-	22,151	22,151	-
Reserves and retained earnings	164,492.0	152,964	7.5	156,326	151,465	3.2
Shareholders' Funds	203,131	191,603	6.0	194,965	190,104	2.6
Non Current Liabilities	177,836.0	179,662	(1.0)	180,860	168,370	7.4
Current Liabilities	19,626.0	21,539	(8.9)	25,597	20,879	22.6
Total Liabilities	197,462	201,201	(1.9)	206,457	189,249	9.1
Total Assets	400,593	392,803	2.0	401,422	379,353	5.8
PPE	349,722.0	341,985	2.3	346,737	328,082	5.7
Other NCA	19,475.0	19,972	(2.5)	21,056	19,859	6.0
Current Assets	31,396.0	30,846	1.8	33,629	31,412	7.1
Working Capital	11,770	9,307	26.5	8,032	10,533	(23.7)
Net Assets	203,131	191,602	6.0	194,965	190,104	2.6

Source: Company, DBIB Research

## CASH FLOW STATEMENT

KES MN	1H20	1H19	y-y % ch	FY19	FY18	y-y % ch
Cash generated from operations	8,827.0	24,568.0	(64.1)	30,585	17,509	74.7
Cash generated from investing	(8,564.0)	(18,895.0)	(54.7)	(28,808)	(14,843)	94.1
Cash from financing activities	(4,275.0)	(293.0)	1,359.0	4,094	(7,144)	(157.3)
Change in ex rates	(83.0)	-	-	(70)	29	(341.4)
Change in cash & equivalents	(4,095.0)	5,380.0	(176.1)	5,801	(4,449)	(230.4)
Cash at the start	9,324.0	3,383.0	175.6	3,383	7,831	(56.8)
Cash at the end	5,229.0	8,763.0	(40.3)	9,184	3,382	171.6

Source: Company, DBIB Research

## OPERATING PERFORMANCE

	1H20	1H19	y-y bps ch	FY19	FY18	y-y bps ch
Gross Profit margin (%)	87.8	83.0	485	86.1	77.5	857
Operating Profit margin (%)	30.0	29.9	9	33.3	25.3	799
Pretax margin (%)	28.1	27.1	94	25.4	25.9	(58)
PAT margin (%)	17.2	27.1	(999)	17.2	17.4	(27)
	1H20	1H19	y-y % ch	FY19	FY18	y-y % ch
Fixed Assets Turnover (x)	0.1	0.1	(1)	0.1	0.1	(4)
Current Assets Turnover (x)	1.4	1.4	(1)	1.4	1.4	(5)
Current Liabilities Turnover (x)	2.3	2.1	11	1.8	2.2	(17)
Working capital turnover (x)	3.8	4.8	(20)	5.7	4.3	33
Current ratio (x)	0.6	1.4	(58)	1.3	1.5	(13)

\*Annualized ratios

Source: Company, DBIB Research

## FINANCIAL PERFORMANCE

	1H20	1H19	y-y % ch	FY19	FY18	y-y % ch
Net debt (KES MN)	172,607.0	170,899.0	1.0	171,676.0	164,988.0	4.1
Enterprise value/share (KES)	31.61	31.36	0.8	31.47	30.46	3.3
Net debt/equity (%)**	85.0	89.2	(422.1)	88.1	86.8	126.6
Net debt/EV (%)**	82.8	82.7	14.2	82.7	82.1	57.6
EV/EBIT (x)	15.7	15.6	0.8	13.6	17.6	(22.6)
Current ratio (x)	1.6	1.4	11.7	1.3	1.5	(12.7)
Interest cover (x)	5.9	4.9	18.3	3.0	3.8	(19.7)
CFO/share (KES)	1.3	3.7	(64.1)	4.6	2.7	74.7
Book value/share (KES)	30.8	29.1	6.0	29.6	28.8	2.6

\*\*changes in bps

Source: Company, DBIB Research

## INVESTMENT RETURN

	1H20	1H19	y-y bps ch	FY19	FY18	y-y bps ch
Return on Assets (RoA)	4.1	2.1	198	2.0	2.1	(12)
Return on Equity (RoE)	8.0	4.3	374	4.0	4.2	(11)

\*Annualized ratios

Source: Company, DBIB Research

## APPENDIX

### COMPANY INVESTMENT RATINGS

**Buy:** Share price may generate more than 15.0% upside over the next 12 months

**Overweight:** Share price may generate between 5.0% and 15.0% upside over the next 12 months

**Hold:** Share price may fall within the range of <+5.0/ -10.0% over the next 12 months

**Take Profit:** Target price has been attained. Look to accumulate at lower levels. Company fundamentals however remain strong

**Underweight:** Share price may generate between 10.0% and 15.0% downside over the next 12 months

**Sell:** Share price may generate more than 15.0% downside over the next 12 months, significant business and/or financial risks present, industry concerns

**Not Rated:** Counter is not within regular research coverage

### SECTOR INVESTMENT RATINGS

**Overweight:** Industry performance better than that of the whole market

**Equal weight:** Industry performance about the same as that of the whole market

**Underweight:** Industry performance worse than that of the whole market

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