

KENYA POWER VALUATION UPDATE

SHADOW DEBT: DE FACTO DEBT ERODES EQUITY VALUE
RETAIL TARIFF REVIEW PUT ON HOLD

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Executive Summary

We have upgraded our investment recommendation for Kenya Power from a **HOLD to BUY**, deriving a **fair value estimate of KES 25.57 (+65.0% upside)** per share, with a sensitivity range of KES 12.04 to KES 43.44. Despite core challenges faced by the business, our revised analysis underscores robust underlying value within the business, propelled by the company's strategic transition within a liberalized power sector and its growing utility as an infrastructure provider. That said, the elevated system losses and problematic receivables warrant close monitoring; any meaningful progress in grid clean-up will serve as a direct driver for margin optimization.

Worth noting:

- The enactment of the Energy (Electricity Market, Bulk Supply and Open Access) Regulations, 2026 marks a structural shift in Kenya's power sector, dismantling the legacy single-buyer model framework and favouring a competitive and multi-supplier electricity market. We believe Kenya Power's business model is set to transition from being an exclusive electricity retailer to an infrastructure landlord. While they face the risk of losing direct retail revenue from their top commercial clients to competitors, their topline will depend on collecting wheeling fees from private players and cleaning up some of the 21% power leaks across their network. **To this end, Kenya Power's future profitability will heavily depend on its ability to run a highly reliable, low-loss transmission network that private energy companies are willing to pay to use.**
- While system losses improved from 23.16% to 21.21% in FY25, they remain uncomfortably high against the regulator's 17.50% target loss factor. This "efficiency gap" is costly as the variance represents a direct hit to the bottom line, given that energy losses exceeding the threshold cannot be recovered through consumer tariffs. **Our back-of-the-envelope calculations indicate that every 1% of system losses above the target quota results in a KES 1.5Bn revenue haircut, implying that the current inefficiencies are leaching c. KES 6.9Bn from annual earnings.**
- We previously noted that the transfer of transmission assets to KETRACO remains pivotal for balance sheet optimization of Kenya Power and compliance with the Energy Act (2019). While asset valuations were initiated in 2024, management has provided no further updates. **We suspect a pricing deadlock; specifically, the firm's asset valuation likely exceeds KETRACO's acquisition threshold, effectively stalling the restructuring process and thus stalling the anticipated relief to finance costs and liquidity.**
- A critical methodological nuance in the Discounted Cash Flow (DCF) framework adopted in this report was the treatment of trade payables as quasi-debt. We contend that the current protracted aging of payables transcends standard working capital fluctuations, signalling either structured reverse factoring or negotiated delays, which are financial debt equivalents. **Consequently, we reclassified these as de facto financial liabilities to ensure a more robust and conservative representation of the firm's true leverage and enterprise value.**
- Kenya Power's electricity tariff review submitted on behalf of the sector has been withdrawn. Our take is that a tariff adjustment needs to involve a technical input by EPRA, which has pronounced itself on the system losses and the likely link of any tariff benefit to a reduction in system losses below the target loss factor.

Sector Highlights

Tariff reviews on Hold: Sector Braces for Stringent Regulatory Targets

The recent withdrawal of Kenya Power's tariff review underscores a persistent structural vulnerability in its revenue model. As disclosed in its FY25 annual report, management highlighted that the utility faces acute revenue shortfalls whenever actual electricity demand deviates from the baseline forecasts used to anchor the current retail tariff framework. Because Kenya Power's revenue projections are rigidly contingent upon meeting these volume targets, any demand deficit translates directly into unrecovered costs that must be absorbed entirely by the company.

While management intended to use the scheduled 2025/26 base tariff review in part to lobby to claw back these cumulative deficits, the withdrawal shifts the focus back to regulatory realities. In our view, any future tariff adjustments will require stringent technical validation from EPRA. The regulator has increasingly tied tariff relief to operational benchmarks, signalling that any upward tariff revision will likely be explicitly conditional upon Kenya Power successfully reducing its system losses below the mandated target threshold and/or expanding its network.

Kenya's Energy (Electricity Market, Bulk Supply, and Open Access) Regulations 2026

The enactment of the Energy (Electricity Market, Bulk Supply and Open Access) Regulations, 2026 (published as Legal Notice No. 79 in Kenya Gazette Supplement No. 115 on May 8, 2026) marks a structural shift in Kenya's power sector. By dismantling the legacy single-buyer model, this framework establishes a competitive, transparent, and multi-supplier electricity market designed to stimulate broader economic growth through three primary channels:

- **Catalysing Private Capital:** The establishment of formalized rules for forward contracts, spot markets, and non-discriminatory open access significantly lowers entry barriers for Independent Power Producers (IPPs), unlocking new waves of private investment.
- **Enhancing Grid Reliability and Industrial Productivity:** By granting the System Operator strict mandates over ancillary services and congestion management, the regulations safeguard power quality and mitigate outages.
- **Deepening Regional Energy Integration:** Clear cross-border trading frameworks within the Eastern Africa Power Pool (EAPP) enables Kenya to monetize surplus domestic generation and seamlessly import lower-cost power addressing domestic supply constraints.

The regulations introduce structural mechanism changes engineered to drive downward pressure on power tariffs over the medium-to-long term:

- **Market-Driven Pricing Discovery:** By enabling direct bulk purchasing for eligible consumers and establishing a dynamic spot market, the regulations allow competitive market forces—rather than rigid, legacy Power Purchase Agreements (PPAs) – to drive transparent price discovery and unlock lower energy costs.
- **Operational Accountability for Transmission Losses:** In a significant development for consumer cost protection, Network Service Providers (Kenya Power and KETRACO) will be financially liable for any energy losses exceeding the “allowable system losses” capped by the Authority. This prevents utilities from passing the financial burden of operational inefficiencies onto end-consumers.

- **Granular Tariff Unbundling:** Tariff structures will transition to a highly transparent model, explicitly unbundled into generation costs, ancillary service fees, and network wheeling charges.

While the legislative framework was officially enacted as of May 2026, competitive market dynamics will mature progressively across three distinct phases:

Phase 1: Immediate Voluntary Transition

The market enters a Transitional Phase where participation is voluntary. Initially, the System Operator will test the online trading portal. Early competition will be driven by large industrial consumers seeking to bypass Kenya Power for cheaper bulk contracts with KenGen or private IPPs.

Phase 2: Commercial Contract Realignment

Merchant competition will steadily escalate as legacy long-term PPA contracts mature or are renegotiated into the forward and spot market structures. The introduction of “Day Ahead” and “Contingency” open-access contracts will gradually activate a live, liquid spot market.

Phase 3: Mature Retail Competition

Full retail competition – characterized by aggressive customer acquisition strategies from competing retail licensees targeting smaller commercial and residential consumers – will take longer to materialize. This phase is contingent upon the rollout of localized retail regulations and the widespread deployment of advanced metering infrastructure (AMI) nationwide.

For Kenya Power,

- **Erosion of Retail Monopoly:** Kenya Power loses its exclusive grip on electricity distribution. As consumers gain the right to select their suppliers, Kenya Power must optimize its service delivery and billing efficiency to retain high-value, large-scale power consumers. KenGen has already applied to break the single buyer model by seeking an Electric Power Transmission and Distribution Licence for its Green Energy Park SEZ in Olkaria, Naivasha.

Centum is also planning to bypass the traditional retail tariff framework, with plans to produce power from Akiira Geothermal facility in Naivasha and wheeling it through the utilities to its special economic zone in Vipingo at the coastal region, powering its own commercial interests.

- **Transition to an Infrastructure Provider:** Kenya Power’s business model will likely pivot toward functioning as a Distribution Network Service Provider (DNSP). Revenue generation, in the long run, will increasingly depend on regulated, predictable streams, specifically “wheeling charges”¹ levied on third-party suppliers utilizing its grid network.

In conclusion, Kenya Power’s business model is set to transition from being an exclusive electricity retailer to an infrastructure landlord. While they face the risk of losing direct retail revenue from their top commercial clients to competitors, their survival will now depend on collecting “wheeling fees” from private players and cleaning up the 21% power leaks across their network. To this end, Kenya Power’s future profitability will heavily depend on its ability to run a highly reliable, low-loss transmission network that private energy companies are willing to pay to use.

¹ At its simplest, wheeling charges are infrastructure rental fees. Think of Kenya Power’s network of grid lines, transformers, and substations as a toll road. If an independent energy company wants to generate electricity and sell it directly to a factory, it doesn’t necessarily have to build its own extensive network of power lines across the country (which would be capital-intensive). Instead, they can “rent” Kenya Power’s existing wires to transport (or “wheel”) that electricity from their power plant to their customer. The fee they pay Kenya Power for this rental is the wheeling charge.

Kenya Power: Every 1% in system losses is a KES 1.5Bn revenue haircut!

While system losses improved from 23.16% to 21.21% in FY25, they remain uncomfortably high against the regulator's 17.50% target loss factor². This "efficiency gap" is costly as the variance represents a direct hit to the bottom line, given that energy losses exceeding the threshold cannot be recovered through consumer tariffs. **Our back-of-the-envelope calculations indicate that every 1% of system losses above the target quota results in a KES 1.5Bn revenue haircut, implying that the current inefficiencies are leaching c. KES 6.9Bn from annual earnings.** Given that the regulatory target loss factor operates on a tightening annual glide path, Kenya Power faces aggressive structural margin compression unless grid modernization efforts are heavily accelerated to close the efficiency gap. Below is a table showing our estimates of the foregone earnings as a result of system losses:

	30-Jun-26	30-Jun-27	30-Jun-28	30-Jun-29	30-Jun-30
Annual System Losses	21.21%	20.71%	20.21%	19.71%	19.21%
EPRA Threshold	16.50%	15.50%	14.50%	13.50%	12.50%
Excess of EPRA Threshold	-4.71%	-5.21%	-5.71%	-6.21%	-6.71%
Foregone Earnings (KES, Bn)	6,926,695	7,764,397	8,449,057	9,224,920	10,014,511

Source: SIB Estimates

To this end, narrowing this gap presents a significant catalyst for margin expansion. We are encouraged by a suite of coordinated interventions, including the accelerated rollout of smart meters, replacement of faulty meters, targeted feeder upgrades, and improved energy accounting, which seems to be bearing fruit – in part contributing to growth in unit sales.

Management noted that while recent gains on system losses were largely driven by curbing commercial losses (*which fell from 6.38% to 4.36%*), low-voltage networks and informal settlements remain a key challenge. It is clear that to address technical losses, sustained infrastructure reinforcement is essential. Kenya Power directed KES 29.4Bn in FY25 toward grid modernization, automation, and last-mile connectivity. We project this capital intensity will persist, with annual outlays estimated between KES 30Bn and KES 32Bn through 2030.

On the operational front, the current meter shortage remains a bottleneck. We believe transitioning to a decentralized, vendor-led model (modelled after the KRA eTIMS system) would be transformative. This would empower consumers to acquire hardware independently, fast-tracking the onboarding of new users and formalizing previously "grey" consumption to further lower non-technical losses, which will significantly better margins and free cash.

We previously noted that the transfer of transmission assets to KETRACO remains pivotal for balance sheet optimization of Kenya Power and compliance with the Energy Act (2019). While asset valuations were initiated in 2024, management has provided no further updates. **We suspect a pricing deadlock; specifically, the firm's asset valuation likely exceeds KETRACO's acquisition threshold, effectively stalling the restructuring process and the anticipated relief to finance costs and liquidity.**

² This metric represents the allowable energy loss during transmission and distribution—essentially an efficiency quota. It defines the maximum percentage of energy waste a regulator deems reasonable and recoverable through consumer tariffs. Because no grid is perfectly efficient, this figure accounts for both technical losses (energy dissipated as heat due to electrical resistance) and non-technical losses (such as unauthorized consumption or theft).

We remain moderately concerned by the increase in captive power³ plants by industrials – the largest consumers of electricity in Kenya, and the Energy (Electricity Market, Bulk Supply, and Open Access) Regulations 2026, which opens the energy market to more players. Another emerging but critical issue is the Constitutional role of County Governments in electricity and gas reticulation and energy regulation.

In FY26, we anticipate revenue of KES 222.9Bn (+1.7% y/y) with gross profits at KES 75.9Bn. Operating costs, in our view, will marginally grow to KES 42.6Bn while pre-tax income climbs 4.4% y/y to KES 36.9Bn. We forecast a net income of KES 25.4Bn, translating to an EPS of KES 13.02 and an expectation of KES 1.50 per share total dividend.

Valuation Model: Inclusion of Shadow debt drags down our fair value

As part of the valuation process, we performed a discounted free cash flow based on the audited⁴ financial statements of the company, assessment of industry trends, plausibility of the strategic outlook, disclosures, and information available in the public domain, and a reasonable growth rate of forecasts to determine the fair value estimate range of the business on all likely fronts.

³ For the period ended December 2025, EPRA reported a growth in captive energy capacity, with an additional 26.24 MW installed, bringing the total to 630.1 MW (accounting for 16.29 % of the country's installed capacity). They further highlighted that captive generation remains dominated by solar PV and bioenergy, reflecting industries' continued investment in renewable sources for sustainability and cost efficiency.

Installed, Effective, and Captive Power Capacity as of December 2025

Technology	Interconnected Capacity (MW)		Captive Capacity (MW)	Offgrid Capacity	Total Installed Capacity	% Total Installed
	Installed	Effective				
Geothermal	940.0	876.1	3.7		943.7	25.72%
Hydro	839.5	809.7	33.0	0.1	872.5	23.78%
Thermal	565.8	558.4	21.3	41.0	628.1	17.12%
Solar	210.3	210.3	326.7	3.9	540.9	14.74%
Wind	435.5	425.5	-	0.6	436.1	11.89%
Bioenergy	2.0	2.0	161.8		163.8	4.47%
WHRC	-	-	83.5		83.5	2.28%
Imports	200.0	200.0	-		200.0	
Total	3,193.0	3,082.0	630.1	45.5	3,868.6	100.00%

Source: EPRA Biannual Statistic Report for financial year 2025/2026

⁴ We noted a few emphases by the Auditor-General. In FY25, the Auditor-General's narration included;

- Variances of c. KES 2.4Bn between electricity receivables as per Kenya Power records and county governments' data. As per the Auditor-General, Kenya Power records show electricity receivables of KES 3.9Bn due from county governments, while county governments' records show balances of KES 1.6Bn – with Nairobi County having the highest variance of KES 2.3Bn.
- Receivables totaling KES 34.5Bn were in respect of the Rural Electrification Scheme (RES), which the company administers on behalf of the government. And since the scheme is considered sub-economic, it was agreed that the government will reimburse the company any deficit arising from the scheme. As of June 2025, no reimbursements were made to cover the deficits – despite a cabinet resolution to disburse KES 19.4Bn to settle the RES losses.
- Delays in customer electricity connections, highlighting that the balance sheet includes work in progress of KES 23.5Bn, which includes projects for which customers have paid a total of KES 12.7Bn for electricity connections. Further reviews showed that 7,740 projects with a total capital contribution of KES 877Mn were yet to start.
- Weaknesses in electricity consumption billings. Review of billing systems showed that 55,063 customer accounts were billed KES 1.1Bn based on estimated consumption for more than 3 consecutive months. Also, reassignments of terminated accounts to new customers without reconciliation of outstanding balances were highlighted to pose a risk of loss of revenue arising from untracking of terminated accounts. The Auditor-General noted that reviews of receivables showed that KES 4.1Bn was due from post-paid customers (with some dating to over 20 years ago), whose accounts were terminated due to non-payment of bills.
- Review of power transmission data showed that system losses occurred in the distribution and transmission networks. However, Kenya Power did not break down losses arising from these networks, which, if accurately determined, can be attributed and borne by the respective distribution schemes under RREC and KETRACO.

Discounting Assumptions

For the market risk premium, we used NYU Stern's country default spreads and risk premium estimates. We applied a beta of 0.96 derived from the correlation of the movement of the stock price vis-à-vis the broad market over the last year. About the risk-free rate, we used the US 5-year bond as the implied risk-free rate. To account for the additional risk on the sovereign above the risk-free rate, we computed a sovereign risk spread between the US and Kenya from the differentials of their 10-year bonds (in US Dollars).

By a terminal growth rate of 13.91% – a function of the sustainable Return-on-Equity and the sustainable retention rate, both from forecasted performance– we estimated the terminal value of the business beyond the 2030 forecasted period at KES 200.4Bn. We then estimated the cost of equity from a rational investor's point of view and calculated the present value of cumulative future free cash flows and the present value of the above terminal value by a weighted average cost of capital of 6.35%.

Cost of Equity Assumptions:	29-May-26
Risk-free rate	4.23%
Beta	0.96
Market Risk Premium	14.26%
Sovereign risk spread	4.14%
Cost of Equity	22.07%
<u>Terminal Assumptions:</u>	
Terminal growth rate	13.91%
Net Earnings FY30	27,872,996
Terminal Value - (Year 2030)	200,361,085

Terminal growth rate	
Forecast ROE	15.72%
Retention Rate	88.48%
Terminal Growth Rate	13.91%

Cost of Debt	3.95%
Value of Debt	206,622,941
Value of Equity	31,648,596
Equity Weight	13.28%
Debt Weight	86.72%
WACC	6.35%

We previously noted that Kenya Power has aggressively reduced its debt profile, which management attributed to early repayment of high-interest loans. Total borrowings dropped from KES 98.5Bn in FY24 to KES 87.6Bn by the end of June 2025, with the weighted average cost of debt easing to 3.84% from 5.03%. Lower interest expenses (which fell by KES 2.58 billion in the last cycle) are now directly padding the bottom line.

For investors who do not share the same level of assumptions on the discounting factor and the terminal growth rate, we have provided a sensitivity analysis for discounted cash flows and dividend models that captures fair value estimates at different levels of assumptions. Laws of congruence should apply to data points not captured in the table.

Discounted Cash Flow Approach

Using a Discounted Cash Flow (DCF) framework, we derived a value (attributable to both equity and debt holders), adjusted for cash & near-cash and total debt, and estimated a base-case fair value of KES 25.57 per share for Kenya Power, with a sensitivity range of **KES 12.04 to KES 43.55**.

A critical methodological nuance of this valuation bridge is the analytical treatment of trade payables as quasi-debt. We contend that the current protracted aging of payables transcends standard working capital fluctuations, signalling either structured reverse factoring or negotiated delays, which are financial debt equivalents. Consequently, we reclassified these as de facto financial liabilities to ensure a more robust and conservative representation of the firm's true leverage and total enterprise value.

Free Cash Flow Model (KES, '000)	30-Jun-26	30-Jun-27	30-Jun-28	30-Jun-29	30-Jun-30
Free Cash Flows	18,720,343	22,454,646	21,243,576	21,750,489	21,847,334
Terminal Value					200,361,085
Time	0.09	1.09	2.09	3.09	4.09
Discount Factor	0.99	0.94	0.88	0.83	0.78
Present value	18,619,504	20,999,305	18,676,584	17,979,734	172,710,669

		Per share
Value of the firm	248,985,797	127.45
Plus, cash & near cash	7,587,478	3.88
Less Actual debt	87,635,178	44.86
Less De facto Debt	118,987,763	60.91
Value of Equity	49,950,334	
Number of shares ('000)	1,953,617	
Value per share	25.57	

	WACC				
	5.35%	5.85%	6.35%	6.85%	7.35%
11.91%	43.55	41.22	38.95	36.73	34.57
12.91%	36.05	33.87	31.74	29.66	27.63
13.91%	29.63	27.58	25.57	23.60	21.68
14.91%	24.08	22.13	20.22	18.36	16.54
15.91%	19.22	17.36	15.55	13.77	12.04

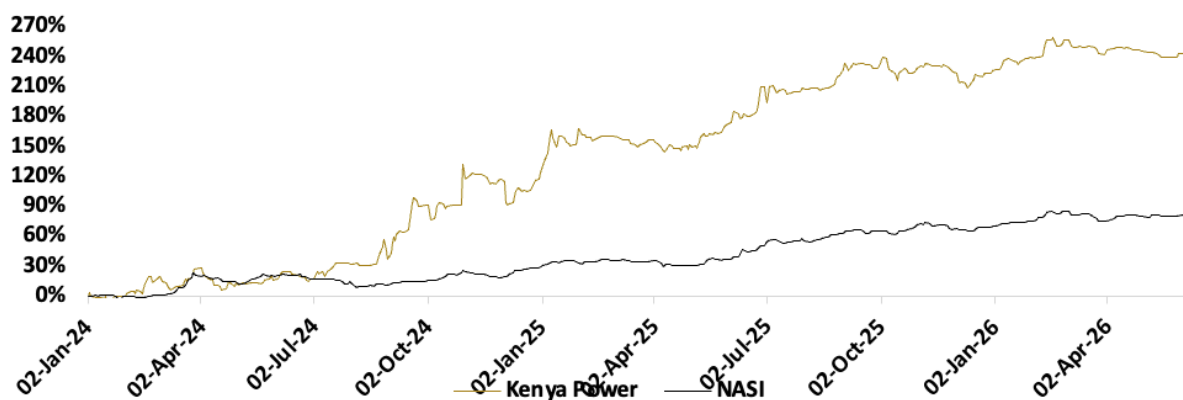
Source: SIB Estimates

We opine that as working capital constraints ease and payable days shrink, which we initially opined would be more feasible under the asset transfer initiative, payable days will likely glide within the 90-120 days. Under such conditions, the reclassification of payables as debt-equivalents would no longer be warranted, significantly enhancing the fair value attributable to equity.

Valuation Summary

The conservative representation of the fair value estimate of Kenya Power attributable to shareholders is **KES 25.57**. From the current market price of **KES 15.50**, the stock holds an upside potential of **65.0%**, warranting a **BUY recommendation**.

Price Chart



Source: NSE, SIB Estimates

Earnings Model

Profit and Loss (KES, '000)	30-Jun-26	30-Jun-27	30-Jun-28	30-Jun-29	30-Jun-30
Total Revenue	222,922,513	225,901,324	224,295,685	225,174,793	226,233,026
Cost of Sales	147,063,583	149,028,727	147,969,475	148,549,429	149,247,553
Gross profit	75,858,929	76,872,598	76,326,210	76,625,364	76,985,473
OPEX	(42,567,972)	(43,647,829)	(43,754,675)	(44,393,893)	(45,075,827)
Operating profit	41,230,506	41,899,634	42,049,819	42,587,583	43,224,884
Profit before income tax	36,915,007	37,655,480	38,403,760	39,393,679	40,461,706
Income tax expense	(11,485,237)	(11,715,618)	(11,948,428)	(12,256,418)	(12,588,709)
Profit for the year	25,429,770	25,939,862	26,455,333	27,137,261	27,872,996

EPS	13.02	13.28	13.54	13.89	14.27
DPS	1.50	1.80	2.10	2.40	2.70

Balance Sheet (KES, '000)	30-Jun-26	30-Jun-27	30-Jun-28	30-Jun-29	30-Jun-30
Non-Current Assets	306,113,839	318,606,781	331,434,061	344,637,800	358,249,713
Current Assets					
Inventories	15,656,302	15,865,510	15,752,742	15,814,484	15,888,806
Trade and other receivables	77,282,631	78,315,324	77,758,682	78,063,451	78,430,318
Bank and cash balances	10,072,485	19,297,057	27,173,596	35,171,769	42,889,260
Other Current Assets	290,126	306,156	323,072	340,923	359,760
Total Current Assets	103,301,544	113,784,047	121,008,092	129,390,626	137,568,144
Total Assets	409,415,382	432,390,828	452,442,154	474,028,427	495,817,857

Total Equity	130,730,409	152,049,258	173,297,493	194,641,571	216,135,300
Non-current liabilities					
Borrowings	69,382,170	67,640,321	65,381,145	63,081,625	60,575,051
Other non-current liabilities	93,406,634	93,806,834	93,584,350	93,699,435	93,838,900
Total non-current liabilities	162,788,805	161,447,155	158,965,495	156,781,059	154,413,951
Current liabilities					
Trade and other payables	84,939,745	86,074,756	85,462,962	85,797,927	86,201,143
Borrowings	19,496,272	20,167,602	20,761,986	21,425,369	22,112,373
Other Current liabilities	11,460,152	12,652,057	13,954,218	15,382,501	16,955,089
Total Current liabilities	115,896,169	118,894,415	120,179,165	122,605,796	125,268,606
Total Equity and Liabilities	409,415,382	432,390,828	452,442,154	474,028,427	495,817,857

Statement of Cash Flows (KES, '000)	30-Jun-26	30-Jun-27	30-Jun-28	30-Jun-29	30-Jun-30
Net cash from operating activities	36,796,507	44,333,080	44,511,153	45,756,630	46,844,189
Net Cash from Investing Activities	(32,349,404)	(30,521,478)	(30,867,226)	(31,433,638)	(32,032,362)
Net Cash from Financing Activities	(1,687,161)	(4,587,030)	(5,767,388)	(6,324,819)	(7,094,335)
Changes in cash and cash equivalents	2,759,942	9,224,572	7,876,539	7,998,173	7,717,491
Cash at start of period	7,312,543	10,072,485	19,297,057	27,173,596	35,171,769
Cash at end of period	10,072,485	19,297,057	27,173,596	35,171,769	42,889,260

Source: SIB Estimates

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