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WORLD BANK GROUP

THE WORLD BANK IBRD • IDA | IFC International Finance Corporation | MIGA Multilateral Investment Guarantee Agency

FINANCIAL SOLUTIONS BRIEF

KENYA

KPLC Refinancing

PROJECT HIGHLIGHTS

- KPLC faced an unsustainable financial situation, in part because of an ambitious electrification program. A limited ability to secure long-term concessional loans compounded matters.
- To help KPLC improve its financial sustainability, a comprehensive support package was put together with the World Bank. It consists of: (i) $250 million of IDA credit; and (ii) $200 million of IDA guarantee, which mobilized $500 million of commercial finance.
- The IDA guarantee supports KPLC debt restructuring.
- IDA support helped KPLC continue its work towards expanding access to electricity, while at the same time avoiding the erosion of its balance sheet.

Kenya Power & Lighting Company (KPLC) is a key provider and operator in the electricity sector in Kenya. It is the single buyer of all electricity produced and the sole distributor of electricity to end users. As such, it is responsible for maintenance and operation of the distribution network and certain parts of the transmission network.

KPLC is the first electric power transmission and distribution utility in the Sub-Saharan Africa region to successfully undergo financial restructuring. The utility had accumulated debt to the point where complying with financial obligations and implementing its capital expenditure program was under threat.

In June 2016, KPLC restructured $500 million of its exisiting commercial debt into new, longer-term commercial loans. The restructuring was enabled by a partial International Development Association (IDA) loan guarantee to the commercial lenders. The result was a major improvement in KPLC's financial position. This helped KPLC implement its investment program, including important rural electrification investments, while maintaining its financial viability.

PROJECT DESCRIPTION

After embarking on an accelerated rural electrification investment program, KPLC found itself in a difficult financial position. Its ability to honor ongoing payment obligations on time, continue its investment program, and maintain the pace of rural electrification was in jeopardy, putting into question the utility's financial sustainability.

The company's debt increased more than fourfold in the 2011–2014 period due to the growing investment needed to support infrastructure improvements and rural electrification. A large portion of the accumulated loans in this period were short-to-medium term, with more than 50 percent of the total debt maturing within a 5-year period.

KPLC's debt management challenges also placed much demand on the executive team. There was a risk that operations and the investment program could be adversely affected if the debt burden was left unaddressed. Thus, there was an urgent need for KPLC to overhaul its financial strategy.

CONTEXT

Due to KPLC's pivotal role in the electricity sector, maintaining long-term financial sustainability is a priority for the sector's continued development.

Following the government's ambitious goal of reaching universal electricity access by 2030, with 70 percent access by 2018, KPLC became one of the main implementing entities of the rural electrification program. To meet the government's timeline, KPLC financed most of the program through its own resources, a commitment of over $300 million per year on average. This commitment was in addition to KPLC's network investment and service improvement program. This led to electricity access in Kenya increasing from 27 percent in 2013 to the current 68 percent, and the customer base growing from 2.8 million in 2013 to 6.1 million at present.

While the company succeeded in expanding access and increasing the number of customers, it came at a high cost for KPLC. The ambitious and intensive pace of the rural electrification program, and inability to secure long-term concessional loans within that short timeframe, led KPLC to finance most of these projects through a combination of commercial debt, overdraft facilities, and internally-generated cash.

Most of the commercial debt that was borrowed to finance rural electrification projects had an average maturity of five years and carried high interest rates, which reflected KPLC's deteriorating credit quality. On the other hand, the access projects funded, while having a high development impact and economic return, inherently had a low financial rate of return, long payback period, and moderate revenue growth, thus creating an asset-liability mismatch.

One of the key priorities for the government was to continue the rural electrification program. Yet KPLC was still required to implement its large investment program to reduce technical losses, enforce and enhance grid stability. Therefore it was very important to find a solution that would not interrupt any of these initiatives.

FINANCING

The World Bank support started with a detailed sector due diligence and financial analysis of KPLC. This was focused around three main themes: (i) addressing KPLC's near-term issue financing needs, (ii) ensuring KPLC has a path to long-term financial sustainability, and (iii) continuing with expanding access to electricity and grid enhancement.

To help KPLC improve its financial sustainability, a comprehensive support package was put together by the World Bank, consisting of: (i) $250 million of IDA credit, and (ii) $200 million of IDA guarantee. The IDA credit was designed to allow the government to implement its goal of increased access to electricity using concessional funds. KPLC would remain as the implementing agency, due to its strong technical expertise, but without having to use its own financial resources. The IDA guarantee was designed to restructure the existing commercial debt. This meant raising $500 million of new commercial debt, with a longer tenor and lower interest rate. The funds were used to refinance more expensive existing commercial debt. This refinancing was critical to enable KPLC to restore not only its financial strength but also its liquidity position.

The new $500 million commercial debt facility was competitively priced, and consisted of two tranches. The first is a USD tranche of $350 million with 10-year maturity, and the second tranche is a local Kenya shilling tranche equivalent to $150 million with a seven-year maturity. Both tranches have a two-year grace period.

Standard Chartered Bank, through a competitive process, was selected to be the mandated lead arranger and underwriter. Numerous other banks, both international and local, participated in financing, reflecting the comfort provided by the IDA presence in the transaction.

BOX 1. HIGHLIGHTS OF THE LOAN STRUCTURE

- Two tranches, two currencies used—local currency tranche and US dollar tranche.
- US dollar tranche of $350 million, with a 10-year maturity.
- Kenya Shilling tranche of $150 million equivalent with a seven-year maturity.
- Two years of grace period for both tranches.

IDA GUARANTEE COVERAGE

The $200 million of IDA guarantee provides direct cover to the lenders of the $350 million tranche. The guarantee was structured as a first loss arrangement, backstopping KPLC's debt repayment obligation up to $200 million. In the event KPLC fails to make timely repayments under the loan, the lenders have direct recourse to IDA for servicing the debt.

The guarantee coverage is limited to only principal repayment in the first several years. Once the outstanding loan amount is amortized below $200 million, the guarantee coverage will include scheduled interest payments as well.

BENEFITS OF WORLD BANK GROUP SUPPORT

Because of World Bank support, KPLC could continue its work towards expanding access to electricity, while at the same time avoiding the erosion of its balance sheet. It expects to reach an electrification rate of 70 percent by the end of 2017.

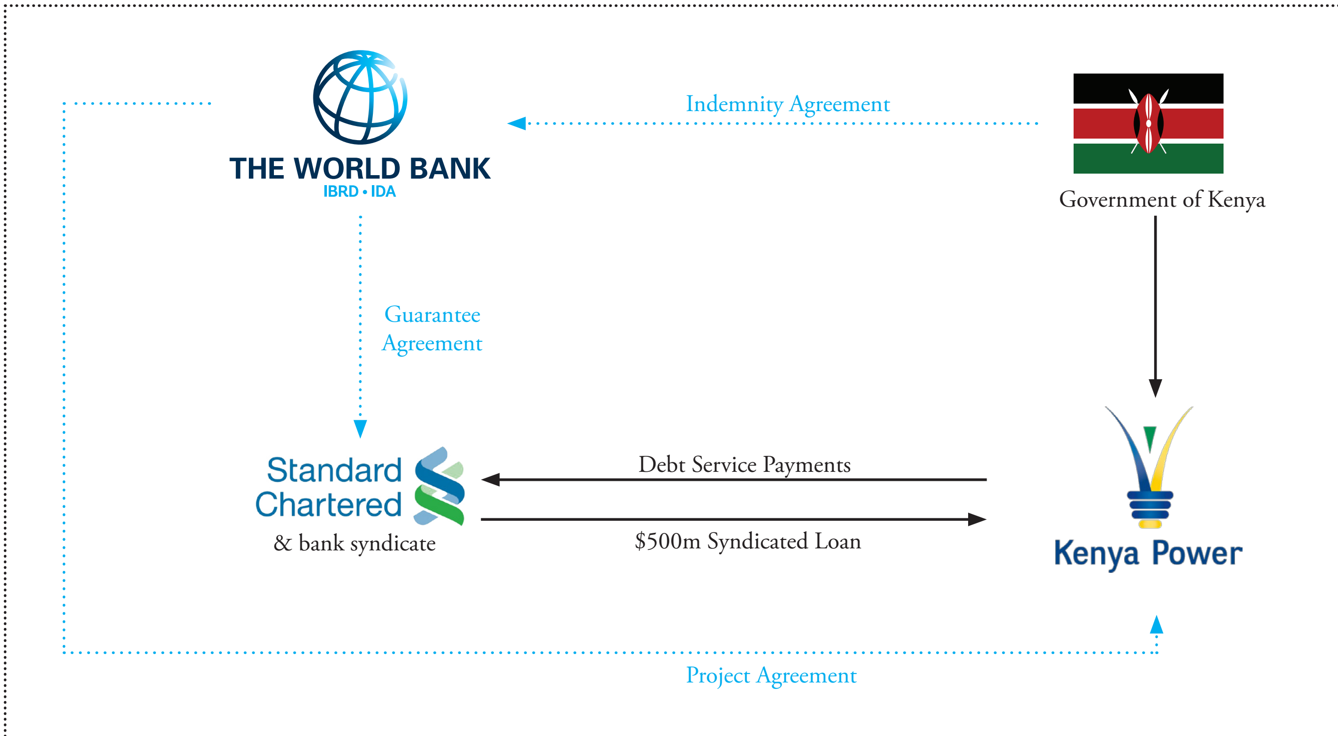
A combination of the grace period and lower interest rate generated $180 million in savings for KPLC in the two years after the refinancing, with further savings generated through the lower interest rates made available. This immediate liquidity improvement has allowed KPLC to pay its power purchase bills and service ongoing debt obligations, while focusing on loss reduction efforts and system improvements.

The new loans helped KPLC improve its commercial discipline and become more efficient at managing its financial performance. This includes paying closer attention to financial ratios and managing the overall loan portfolio, including timely debt service payments. The refinancing reduced the number of commercial loans from 10 to just two, thereby reducing the management time dedicated, for example, to paying individual lenders on different dates.

In addition to executing the debt restructuring strategy with KPLC successfully, the presence of the World Bank helped lead to the loan facility being oversubscribed by nearly 70 percent. This is not a common occurrence in African banking markets given investors' and financiers' limited appetite for sub-sovereign risk in relatively high credit risk emerging market environments.

The outcome for KPLC is a lower cost of debt and longer maturities, a clear indication of the market's confidence in KPLC's future operations. The collaboration with the World Bank builds on a long-term partnership aimed at KPLC's financial sustainability, which is good for its customers and other stakeholders.

GUARANTEE STRUCTURE



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