Travel Journal
Kenya
July 2015

TUNDRA FONDER

TRAVEL JOURNAL KENYA – JULY 2015

Introduction

This autumn, Tundra and Tundra Pakistan Fund, our first fund, celebrates four years.

Today we employ fourteen people, where nine are engaged in fund management or research. Our Karachi office opened in early 2014 and now hosts five of our employees. We have two new co-workers that work exclusively with issues relating to sustainability (e.g. environmental aspects, labour legislation and corruption).

Being Swedish, exaggerations are typically kept to a minimum; but with nine investment professionals Tundra is now a leading international fund manager within the developing countries referred to as "frontier markets". Our office located in Pakistan, the heart of the Asian frontier markets, is an important competitive advantage, but this can never replace the impressions we get from our travels. These often constitute the last piece of a thorough analytical puzzle.

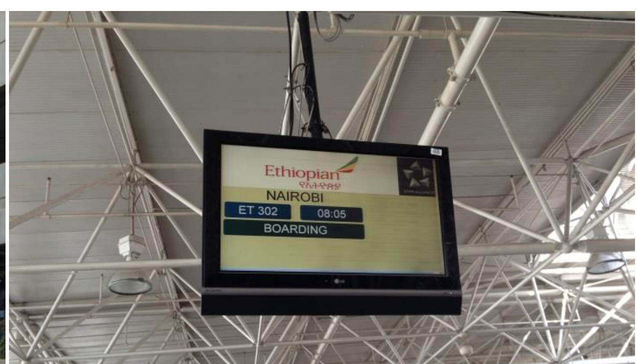
During April and May we travelled to three African countries and had meetings with two thirds of the listed companies included in our investment universe. We also set up meetings with several other companies that we believe will interest investors in the near future. We started our journey in Kenya, where we mainly met with local companies, with the addition of two companies from Uganda, a country that resembles Kenya in many ways, but with slightly different conditions.

We hope you enjoy the travel journal.

Mattias Martinsson

Chief Investment Officer, Tundra Fonder AB

Just landed in Nairobi after a 13 hours flight.



In between flights; in Addis Ababa. Signs in the written Ethiopian language Ge'ez, English and Chinese.

Off to Kenya

A total of six injections, oral cholera solution, a box of malaria tablets, a vaccination certificate – all of which indicate that Africa remains slightly more exotic than other continents we frequently travel. Getting your travel visa though, is one of the less complicated processes we have experienced. After merely one hours wait at the Embassy at Birger Jarlsgatan (just around the corner from our Stockholm office) we are all set to go. The process of getting your visa is normally one of the major restrictions when we want to travel with short notice. This does not apply to Kenya.

Approaching Ethiopia

Outside Jomo Kenyatta Airport

We leave Stockholm with Ethiopian Airlines on a Saturday night at 19.50. After refuelling in Vienna we continue to our first destination; Addis Ababa. A short stop and then we take the two hour flight to Nairobi. We arrive at 10.20, local time after 13 hours of travel.

It is evident that the threat of Ebola is still very much present. In Ethiopia there are thermal cameras to scan passengers for fever. Both in Ethiopia, Kenya and Nigeria the temperature is measured for all individuals that enters or leaves the countries.

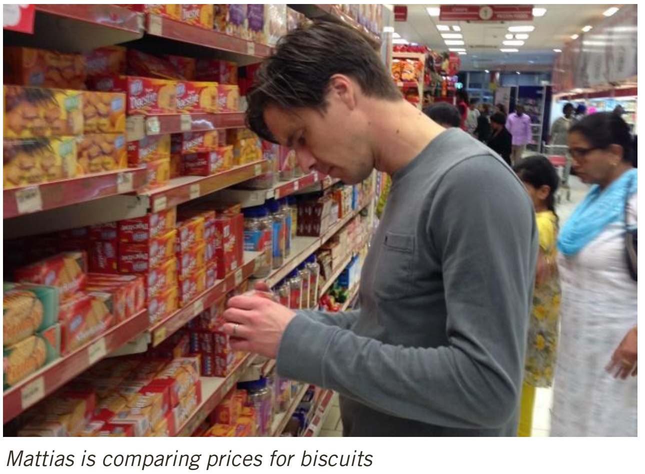
Health screening at the arrival in Nairobi

It is Sunday morning and we have a day before our meetings start on Monday morning. Every time we travel we try to get at least one day without meetings, in order to explore the surroundings. The security situation in Kenya has been frequently discussed during the last two years. The Westgate Shopping Mall is only a ten-minute walk from the hotel where we are staying - this is where an attack killed over 70 people in September 2013. The Westgate attack was followed by new attempts and smaller attacks, and three weeks prior to our journey the massacre at Garissa University College took place. 148 students lost their lives, and several others were injured.

The background for the increased number of attacks in the country is Kenya's military support to Somalia in 2011 in their fight against the terrorist fraction Al-Shabaab. The number of terrorist groups in Kenya is estimated to be much fewer than those in comparable countries like Pakistan and Afghanistan. The fact that these groups have had such an impact on society relative to their size is more likely a consequence of less experience in dealing with these kind of threats.

Traveling in countries that are considered "dangerous" normally does not feel so threatening once you are at the location. Reports from media tend to give the impression that the situation is much worse than it actually is. Some caution is recommended however. Most cities, including Stockholm, have neighbour-hoods that are unsuitable for excursions at certain times of the day. When travelling in new areas we normally consult locals in advance. As can be seen from previous travel diaries we always try to visit a couple of grocery stores. This is to get a feel for current range of products, the pricing of local products versus foreign brands etc.

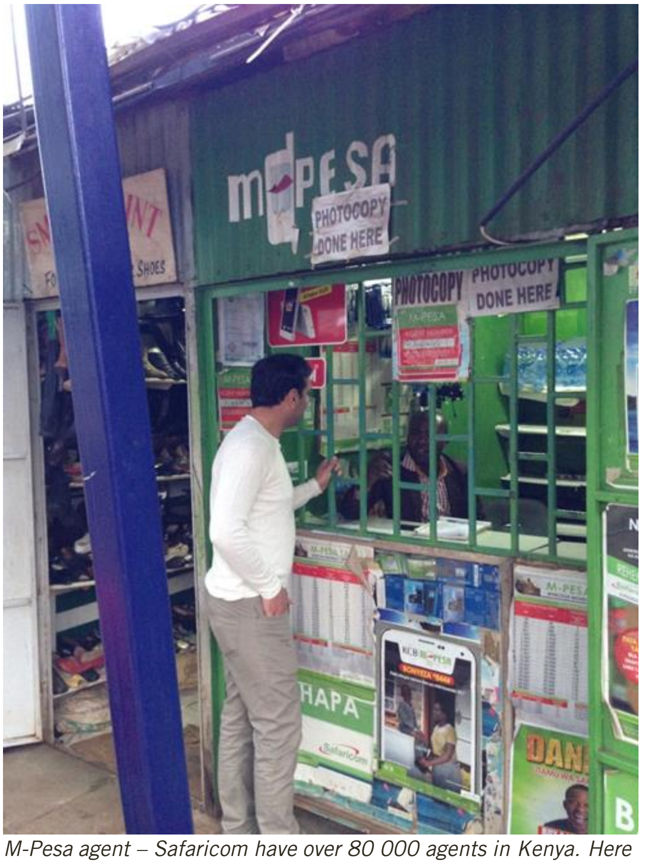
One of the larger grocery stores of Uchumi (Sarit Centre)



Mattias is comparing prices for biscuits

This time we head for Uchumi, one of the oldest food retailers and today a listed company. Uchumi, established in 1975, have experienced a range of problems over the years. The store featured on the picture is their largest one, and it keeps a high standard. We find it odd that there are no beers from Kenya's leading brewery East African Breweries (EABL) on the shelves. Rumour has it some suppliers have stopped delivering to Uchumi following delayed payments. Maybe this is the explanation.

On the way back we pass one of many M-Pesa agents, Safaricom's mobile money payment system.



M-Pesa agent – Safaricom have over 80 000 agents in Kenya. Here you can deposit and withdraw money, make mobile payments (even if you do not own your own mobile phone)

Out of Kenya's 45 million population, about 58% (26 million) have a mobile money account. The leading system, M-Pesa, have 22 million users in total, of which 14 million are active users (indicated by use during the last 30 days). According to the Kenyan national statistical authority M-Pesa handles payments corresponding to 34% of Kenya's GDP annually. Safaricom's importance (M-Pesa was started in 2007) is difficult to exaggerate, the impact on mobile payments in Eastern Africa is vast. Countries like Somalia, Uganda and Tanzania all have over 30% mobile money account penetration, while countries in West Africa like Nigeria (4%) and Ghana (13%) are far behind.

Nairobi down town, view from our hotel

After a good night's sleep it is time for our first meetings. In addition to the Kenyan companies we are scheduled to meet, there is also two Ugandan company visits on the agenda.

Stanbic Uganda

The first meeting of the day is with the CEO of Stanbic Uganda, Patrick Mweheire. Uganda is, with 35 million inhabitants, an exciting part of the East African belt. The economic growth during the last seven years has been on average 6%. In terms of welfare, Uganda is well behind Kenya with an estimated GDP/capita of USD 600-700 as compared to USD 1000-1200 for the latter. There are, however, several similarities with the Kenyan economy. Coffee and tea are the main exports and, like in Kenya, there is a significant twin deficit (budget as well as current account deficit) that the country is trying to invest themselves out of through investments in infrastructure. Uganda is targeting to maintain an average growth of 6% yearly until 2040, and thereby qualify as a middle-income county.

Stanbic Uganda is the largest bank in Uganda (there are 25 in total), with a market capitalisation of USD 500 million, and a market share as measured by total assets of almost 20%. The conditions for our friend Patrick are tricky, to say the least, considering an interest rate policy recently used mainly for protecting the currency, rather than to keep inflation down. At present the Central Bank applies a policy rate of 12% (an increase by 1% last year), at the same time inflation has gone down from 7% to 2% on an annual basis. The country has a history of relatively high real interest rates, which has led to a large proportion of foreign investments in the bond market. The Ugandan shilling has lost almost 15% to the US dollar since end of 2014, which has reversed some of these flows putting further pressure on the currency and resulting in the current extremely high real interest rate closer to 10%. Historically the Ugandan shilling has lost 2-3% to the US dollar annually, a number in the lower end compared to other frontier markets.

Mattias and Shamoon with the CEO of Stanbic Uganda, Patrick Mweheire

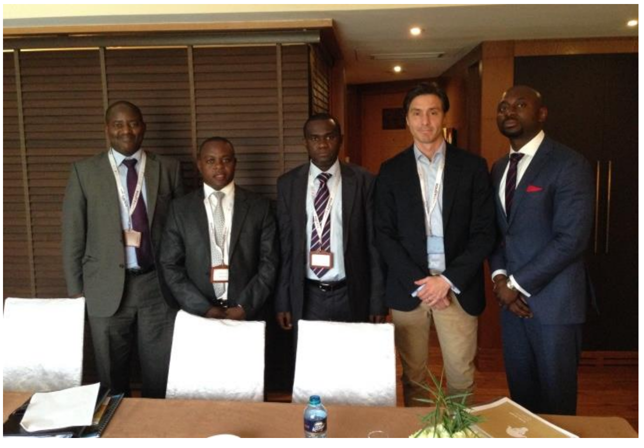
One of the main driving forces in the economy is public investments in infrastructure. It is interesting to note that about 50% of tax revenues (USD 2.5 billion out of USD 5 billon) are spent on expansion of road networks, electricity etc. This creates business opportunities for small-scale subcontractors, an important customer group for new loans. The loan growth is currently estimated to 14% for the sector as a whole. The background for the investments is the discovery of 6.5 billion barrels of oil which from 2019 is expected to render a production of 200 000 barrels a day, generating USD 2 billion a year to the State budget. The oil price assumptions underlying these numbers are however not clearly defined. This, in combination with a budget deficit ranging from 7% to 9% and a deficit in the current account balance of 12% makes the country vulnerable in the medium term perspective.

For the time being the bank sector is in a relatively good condition. The foreign banks (especially those from other African countries) are the ones who are facing the real difficulties; the confidence in outsiders from customers has generally been low, and as a consequence the access to cheap funding (bank deposits) has been limited. For a bank like Stanbic, the largest local bank, the conditions are more favourable. The net interest margin has been stable at 11% and the return on equity of 30% is almost twice the average in the banking sector.

Equity Bank

Equity Bank is the second largest bank in Kenya in terms of total assets, and the largest in terms of market capitalisation. Like in Uganda, an important reason for recent years' strong loan growth has been about trickle down effects from public infrastructure investments that have lead to the emergence of small and medium size enterprises as well as increased employment and an appetite for consumer loans.

We discussed the sustainability in the company's net interest margins (about 10%), which mainly refers to cheap financing (more than 30% of the bank accounts receive no interest at all, and only about 20% have a savings account). The company admits that a certain pressure on the net interest rate margins is inevitable going forward, but claims that state interventions are unlikely. This is because there is a clearly defined goal to try to get more Kenyans to use the banking system.



Mattias accompanied by members of Equiry Bank's management

This, in turn, demands large less profitable investments in rural areas why there might be an acceptance towards current high profitability in the banking sector. One important future business area for the company is their entry into mobile payments, in direct competition with well-known Safaricom (read more about Safaricom below). The key objective for Equity Banks venture, Equitel, is to provide a complete mobile service platform including banking services (where you can also apply for loans, set up savings accounts etc). The technical solution, a thin sim-card that can be appended to the existing one and be used simultaneously, has been delayed as the security was questioned in a legal process. According to Equity Bank a decision in their favour is expected by end of June. The competitors are unsurprisingly not as convinced. If the technical issues are solved it will be possible to challenge the leading player, Safaricom.

The loan growth for Kenyan banks is about 15-25%. Given that the country's tourist industry has had two tough years following terrorist attacks and ebola, that both coffee and tea has experienced a weak price development and that the expected investments in the oil sector might be affected by the new pricing environment for oil we end up in an interesting macroeconomic discussion. Our interpretation is that that the main driving force, like in Uganda, is the public investments in infrastructure. These investments create employment and the emergence of sub-contractors further down the value chain. The focus has in recent ears been on road infrastructure with the ambition to build road systems of 10 000 km, but also comprises a nationwide railway network and pipelines for gas and oil.

5 out of 10 000 km road to-be, under construction in Kenya

Kenya has realised that the country has an opportunity to become the gateway to East Africa, provided necessary infrastructure is in place. On the other hand we conclude that electricity prices are relatively high, in spite of the fact that hydroelectric energy accounts for a large proportion of the electricity supply. The price ranges from USD 0,16-0,18/kWh, this can be compared to Pakistan where the upper pricing is USD 0.145/kWh and where the effects of lower energy prices and years of investments are likely to further lower electricity prices going forward. We believe that Kenya has a challenge when it comes to the balance of infrastructure investments in the years to come. Public and bilateral investments eventually need to be followed by private investments. This requires, apart from better roads and railways, that electricity is provided at reasonable prices and that there is an educated labour force available for local production sites. The major challenges are likely to be political - every new leader seems to have a different agenda than the former one. Continuity and a common agenda assuring investments are made in all areas of infrastructure is likely to be a challenge.

Given that the country continues to nourish a budget deficit and that the current account deficit is just above 8% it will be necessary for the State and the bilateral investors, with lower profitability requirements, e.g. the World bank, to keep on supporting the country in the coming years to maintain the growth. We do feel a bit concerned when we learn that a bank like Equity Bank can receive USD-denominated loans from international funds for developing countries (an example of such is Swedish Swedfund) at interest rates as low as 3%. Money that is subsequently being lent to larger companies at higher levels (7% is mentioned). The relatively lower interest rates for USD-denominated loans have caused these loans to become popular with an increase from 17% to 24% between years 2013 and 2014. If this trend persists it entails a risk for a continued shrinkage in net interest margins, but it is also likely to increase the currency risk in the companies' balance sheets, thereby leading to an increased credit risk for banks like Equity Bank. The bank accentuates its work to ensure that these loans are restricted to companies whose activity renders a corresponding inflow in the same currency.

The presence of considerable risks is evident nevertheless and we sense a general (not specifically for Equity Bank) carefree attitude concerning the situation. With a stroke of luck Kenya can maintain public and bilateral investments long enough, until a permanent and broad base of private investors is ready to play a more significant role in terms of investments and tax revenue. The long-term target is to become a middle-income country by 2040. Risks to be carefully monitored are political changes (e.g. changes in investment balance) and higher international interest rates.

Umeme

We met with the CEO of Umeme, Uganda's leading distributor of electricity. Uganda's power capacity today totals merely 800 MW, where about 550 MW is used to meet full demand. This corresponds to ¼ of Karachi's (20 million inhabitants as compared to Uganda's 35 million) capacity. For further comparison it could be mentioned that Sweden's capacity is about 35 000 MW. With the current growth rate of 6% a year, more investments in the electricity sector is required.

Tundra with Head of business development and CEO at Umeme.

Both existing and planned construction work is mainly about hydroelectric energy. It is interesting to conclude that Uganda has chosen to generously compensate investors that were willing to invest in new electricity capacity. Umeme earns a 20% USD return on the electricity that is distributed. Similar returns have been offered to investors in electricity generation. The generous compensation in generation, as well as distribution, means that the average price for electricity, despite being mainly hydroelectric, is high at USD 0,145/kWh. We do however support the decision to compensate the first international investors well as there is no lack of electricity, and new projects are planned. When we talk to factory managers in other frontier markets they emphasize that access to electricity is more important than the actual pricing. Umeme's present contract expires in 2025, and the State (in theory) has the right to replace the company at the end of the tenure. Given that the company has succeeded in keeping distribution losses low, we believe that this risk is low. An eloquent buy-out clause means that the shareholder in this event will be appropriately compensated. The liquidity in the share is unfortunately not the best, but trading at 7 times net earnings, there is a reasonable risk reward.

Above all, there are two potential risks. First, the electricity sector in itself is very much about politics. Next year elections will be held in Uganda. Hopefully this will mean continuity in the energy policies, but that remains to be seen. Secondly, there is some kind of underlying imbalance in the economy as exemplified in our discussion with Stanbic Uganda (See above). We conclude a more detailed analysis needs to be undertaken.

Bamburi Cement

During our trip we met with both the leading companies in the cement production in Kenya. Kenya's installed capacity of clinker production (when limestone is burnt into pellets) is today about 5 million tonnes. The installed grinding capacity concerning cement factories (the final stage where clinker is grinded into cement and packaged) totals 7 million tonnes. Kenya has reserves of limestone that are expected to last more than 50 years, but the access is limited to a few operators. Since the demand for cement has been high, some operators have instead imported clinker (especially from Asia). The difference in profitability between a fully integrated cement producer and grinders is considerable. Another important factor is transportation and logistics, where the proximity to essential markets (cement transportation is costly) and harbours is highly relevant.

Tundra meets with Bamburi Cement

Bamburi is Kenya's largest cement company and moreover Lafarge's (the world's largest cement producer) affiliate in the country. The main part of the production is placed in Kenya, but parts of activites are located in Uganda and other adjacent countries. The largest factory is in the coastal city of Mombasa, which means an opportunity to use imported coal for fuel, a cost-efficient solution.

The company also have its own limestone quarries. This puts the company in an advantageous position. We conclude that the pricing in Kenya is USD 100-120/tonne, while the pricing in Uganda is about USD 150-160/tonne. The higher price range in Uganda can be explained with a different mixture of energy, with about 20-25% fuel oil since the transport costs makes coal as fuel less advantageous. Instead, about 50-60% of the fuel in Uganda is constituted of alternative sources, such as residue products from agriculture industry. The company estimates that the demand for cement will increase by 10-12% yearly, a development that will last for several years because of investments in road infrastructure and regular construction. We note a certain reluctance to discuss the fact that Bamburi Cement has a 90% capacity utilisation while the sector as a whole in Kenya average 75%. This means the company faces a risk of losing market share unless new capacity is added in the coming years. Our questions on investment plans are not answered. This is not uncommon in the cement industry where the leading players monitor each other's investment activities very closely. With 35-40% market share the company should be able to defend itself should there be a price war. The question is if they will let someone else take market share from them in the years to come. The cement prices in Kenya are higher than in Pakistan and Vietnam, and there is room for a decrease given the available capacity. The valuation of 13x net earnings is slightly on the higher side, but far from excessive, like in Bangladesh (25-30x).

ARM Cement

We also met with Kenya's second largest cement producer, ARM Cement. This develops into an interesting meeting, as the representative is well informed when it comes to numbers and facts that pertain to the industry as well as on the specific conditions that apply to the Kenyan cement industry. The company has a capacity of 2,6 million tonnes of cement, the factory is fully integrated. ARM Cement had their most recent complex up and running by end of 2014, which according to the company will increase the profitability and make them the most profitable player in 2015 (the EBITDA-margin is expected to increase from the current 22% to 33% all other thing being equal). Despite a beneficial growth (volume growth expected at 12% yearly) the company does not intend to increase their capacity until 2017. Instead, they will use the cash flows to pay down debt, which is on the high side. The second largest producer being somewhat restrained in the next couple of years suddenly makes Bamburi's cautious investment plans more logical.

Together these two companies dominate the market, and therefore both have an incentive not to act at expense of the other part. Over the coming years it is the Nigerian company Dangote Cement that is more likely to stir the pot. Their 2,5 million tonne integrated complex in Tanzania (south of Kenya) is expected to be ready in two years. Dangote Cement's choice of location depended on a new mining license with access to a major limestone quarry. On the other hand they will be located far away both from the desirable harbours and the most important catchment areas in Tanzania. Given ARM Cement's large limestone quarry and the fact that the company's manufacturing plants are located favourably, in combination with short-term financial constraints, it is not entirely illogical that a new player targeting East African markets would knock on their door. It would be interesting to hear Mr Dangote's views on the matter.

Tundra with ARM Cement

Kenya Commercial Bank (KCB)

The next meeting is with Kenya's largest bank as measured by assets. It is an interesting meeting where we get the opportunity to follow up on some of the issues from the meeting with the main competitor; Equity Bank. The discussions revolve about Equity Bank's launching of Equitel, where KCB instead has allied with Safaricom's mobile payment company M-Pesa and offer accustomed bank services to M-Pesa users. For natural reasons the views differ on which version will be the superior one. We do, however, get some interesting numbers from the co-operation with Safaricom. Today Safaricom has about USD 400 million in M-Pesa accounts where KCB believes it can enrol 40% into banking services in the long-term. The revenue is shared 80/20 to KCB's advantage. There was a discussion on how "earnings" will be defined and specified as this will depend on how KCB deploys the deposits. According to the company, Safaricom will not be able to influence such decisions. KCB will simply inform Safaricom on the earnings. (We doubt that we would see this kind of trust between parties in a similar setup in Sweden). KCB confirms Equity Bank's opinion that it is mainly the small and medium-sized companies where loan growth currently is strong. The total loan growth is expected to average 16-18% a year, while the growth in the former segment is close to double that. KCB targets to increase SME loans to 20% of the total loan book over the coming years, as compared to 10% today. The net interest margins for these loans are significantly higher than for larger companies. In spite of this, the company has noticed some pressure on net interest margins. An increase in USD-denominated loans is likely to be part of the explanation. Another interpretation is the introduction by the Central Banks reference interest rates, which has increased visibility on lending rates and means borrowers are more careful in checking levels of interest rates before taking new loans.

Tundra meets with Kenya Commercial Bank

Both KCB and Equity Bank seem to be aware that the level of profitability is not sustainable in a long-term perspective. It can be concluded that the pressure on net interest margins should be a slow process, and that banks, all other things being equal, should be capable of maintaining loan growth at 15-20%. Provided credit losses do not accelerate, current valuations of 10-12 times net earnings are not excessive but rather on the low side. There are however significant risks from a macro perspective, as well as in the loan book expansion, that needs careful monitoring going forward.

Safaricom

The last meeting of the day is with the CFO of Safaricom. The company is without doubt, Kenya's pride, with an 86% brand awareness and 88 000 agents for its mobile payments arm M-Pesa. There is an M-Pesa agent at every street corner, all coloured green for recognition. With almost 70% market share within cellular services, and over 90% market share in mobile payments the question is; how much better can it get? The valuation of P/E 27x is among the highest for any telecom company operating in the frontier markets, and the assumptions are that profit growth will exceed 20% during the next five years. Even when discounting the multiple, taking into account the higher growth rate, the valuation is still twice the level for Kcell (Kazakhstan) or Pakistan Telecom. Voice calls still account for more than 50% of the company's revenues while the price levels for regular calls are four times higher than in Pakistan, a country with a comparable level of welfare. Voice prices are also significantly higher than in Morocco where GDP/capita is about 3 times Kenya's level. In Morocco prices fell 70% in five years after competition intensified.

We expect a more competitive climate going forward, where some of the competitors now offer the same packages including voice calls and data traffic at half the price. Voice revenue growth can, according to the company, decrease to 2% over the next twelve months. The penetration rate in Kenya is still "only" about 80% (compared to more than 100% in Pakistan). A precondition for higher subscriber growth in Kenya however is likely increased competition (and lower prices). Thus we find upside surprises in voice revenue highly unlikely. Mobile Internet is growing fast however, its share of revenue now constitutes about 10%, but it is growing by 60% on an annual basis. We do however ask ourselves for how long the company can maintain the growth rate at current pricing, as the major part of sales is still by usage (pay per gigabyte). Considering that some of the competitors now offer package solution, like the ones we are used to in more developed markets (i.e. surf as much as you want at fixed price), we expect some pressure on margins here too in the medium term.

The rationale for the company's valuation is probably instead the enthusiasm for Safaricom's world leading mobile payment service, M-Pesa (12% of the world's mobile money accounts are in Kenya). This company is used as an example on how "the new world" is making technical advances that were not possible when the Western world developed. It is a company that deserves admiration, and that has served as a model for many other countries (e.g. Bangladesh) on how payment solutions can be created in developing countries. As an investor we do however have to focus on the valuation aspect. First, we can observe that Safaricom is likely to have to pay more to distributors of different services (e.g. KCB in the bank co-operation) going forward. As Kenyan consumers are integrated into the banking system, the need for traditional bank products is likely to increase. In its banking venture with KCB Safaricom has had to share 80% of revenue to KCB. If Equitel will have the potential to compete definitely remains to be seen, but the fact is that when Equitel communicated lower prices for mobile payment services, Safaricom immediately lowered their own prices, "to extinguish the sales arguments", as they put it themselves. Competition, thus, does not necessarily mean that competitors will be able to take market share from M-Pesa, it is enough if competition can have an influence on the company's prices and margins. It is probable that the company will keep their leading role concerning all aspects of telecom in Kenya. With Kenya's strongest brand name Safaricom they also have good opportunities to expand in related services that are promoted within their existing brand. During our discussion, advanced plans on launching services like Kenya's *Amazon* and Kenya's *E-bay* were revealed. Further, the company's combined TV/Internet-service *Big Box* is likely to be popular. The Kenyan people in general have a strong confidence in Safaricom, and if they nurture their trademark there are great opportunities to use the brand in different areas. The company's role in the development of the Kenyan economy should also not be underestimated which makes continued political support, at least for now, likely. Our only concern is that there is a risk that investors will be disappointed in the actual profit generation and eventually in the price they are currently paying for Safaricom's shares. As an investor in Kenya you have to consider that the required rate of return for investors should be substantially higher than in developed markets. With a five-year bond at 11.5% and a minimum risk premium of 5% investors should expect an ungeared company (like Safaricom) to return them 16,5% a year.

If we count backwards using a simplified version of Gordon's formula (net present value of future cash flows), we can establish that in order for Safaricom to be correctly valued today the company's cash flows (simplified to equal net profits in this example) need to grow by 25% annually in each of the next ten years. This may not seem far-fetched, but we need to keep in mind that in the last five years Safaricom has only succeeded with such growth once. Therefore we can establish that investors that invest in the company today expect the company from here to accelerate its profit growth rate and that the company then can maintain this rate for the coming ten years. Obviously there is no room for external factors (like a down turn in the Kenyan economy) to deteriorate. Safaricom is a fantastic company and a role model for Kenya. The stock is however currently too expensive, and is currently not included in our portfolio.

Tundra and Safaricom's Chief Financial Officer

We start our second day by meeting with the Kenyan company Transcentury, a subcontractor to companies active within infrastructure investments in Kenya. The company has three core areas:

1) Electrical wires and transformers – sold mainly in retail markets and to smaller contract manufacturers at construction sites 2) Construction planning with a focus on infrastructure, for example road construction, mines and electricity 3) Own construction planning projects – the company has for example built a 35 MW geothermal electrical installation in which the company is an associate partner today. The plan is to have an investment arm as a complement to the other businesses of the company. Electrical wires and transformers are sold mainly in Kenya while the two other businesses are engaged all over East Africa.

Transcentury argues that they hold a market share of between 40-50% within its manufacturing of wires and a 10% market share for transformers. There are 5-6 local competitors within the market for wires but they are very small. The competition is mainly from imports but these are taxed at a 25% import tax. Transcentury is operating in segments that today thrive Kenya's expected overall growth. Kenya has an electrical capacity of 1800 MW in operation today. There is an established plan stating that this capacity will increase to 5000 MW during 2017-18. Kenya is behind, but the growth rate is good; 2500-3000 MW is expected to be installed by the end of 2015. Geothermal energy will be one of the main sources, which due to Kenya's geological conditions is a cost-effective alternative.

Meeting with Transcentury

Subcontractors within the electricity sector have great conditions for growth. This brings us to the problem, the company is small (market capitalisation of USD 50 million) and the risks from construction planning and infrastructure projects of its own are not proportional to the company's current size. During the last two years the company has been forced to do two write-downs, USD 10 million and USD 12 million respectively. The company is therefore considering a larger capital raising, more than the current market value, in order to improve its chances to compete in construction planning and infrastructure projects going forward.

East African Breweries

After the meeting with Transcentury we drive 15 km, out from central Nairobi, to East African Breweries' (EABL) main office. EABL is the leading brewery in Kenya and East Africa. Over 60% of sales is in Kenya, almost 20% in Uganda, and just over 10% in Tanzania. 75-80% of the sales today comprise of beer and low-alcohol beverages, while 20-25% is liquor. The long-term goal is that beer and liquor will account for equally large parts of the sales. The next five years the company expects the sales of liquor to grow to 30-40% of the turnover. The single largest owner is the international giant Diageo that owns about 40% of the company. EABL has about 95% beer market share in Kenya, and a relevant question is when international leading companies like SAB Miller or Heineken will try to enter the market. The consumption in Kenya today corresponds to ¼ of the international average (15 litres per capita in Kenya, versus 60 litres/capita in developed markets) and for Tanzania and Uganda the consumption is about half of what is consumed in Kenya. The long-term conditions for growth are thus good and the company is likely to show decent growth during the coming years, as more people will be able to afford beer (beer is relatively expensive at a cost of 5-10 SEK to each 33 cl bottle). The valuation of EABL is a challenge though, 30-35x annual profit, without notable improvements of margins ahead, and with a growth in the range of 10-15% annually. It is an exciting industry, the company is well managed, but our conclusion is that the stock is too expensive for the time being. We currently do not own any shares in the company.

Tundra meets with EABL's Chief Financial Officer

Kenya Power

The meeting with Kenya Power gives us a good insight in how the Kenyan power industry has developed and what is to be expected ahead. Kenya Power is partly owned by the government and is involved in electricity distribution. The company is responsible for all delivery of electricity to citizens in Kenya, but receives assistance from state controlled entities in less affluent areas outside the metropolitan regions. Today there are about 1 800 MW capacity installed and there is a national plan to increase this to 5 000 MW within 2-3 years. It is unlikely that this plan will be met within the deadline, but the power sector in Kenya will without a doubt increase substantially for a long time to come. By comparison; Poland, with a population as large as Kenya, has a capacity of 35 000 MW. In order to enable sustainable growth in Kenya, it is required that installed electricity capacity increases faster than the economy as a whole. For a company that earns money for each and every kWh used, there is indeed a great potential. We have a good discussion about electricity theft where our experiences from Pakistan are useful. We can conclude that in its agreement with the state Kenya Power today is allowed to lose a maximum of 16.6% of produced electricity, but is currently at 18%. Allowed losses will be lowered during the next few years, and unless the company reaches this goal, they will have to compensate for the difference through their profit and loss statements. It may seem to be great potential for improvements from 18% of electricity losses, but do keep in mind that it is very unusual to see losses below 12% even in very advanced countries. In emerging and frontier markets the losses due to transmission and distribution are often higher than those displayed by KPCL today. This is probably also the reason why the company's valuation, in relative measures, is quite low (P/E 7) despite the good growth potential.

Now to the airport. Next stop Morocco.