# INRiSC

CREDIT ANALYSIS REVIEW – FINAL

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## 1. Introduction

This memorandum concerns the high-level credit analysis in connection to Lendahand's (the '**Client**') potential loan to SolarNow B.V. (SolarNow). The scope of the review is limited to a general review of the credit-related risks in association with the issuer (SolarNow) and the potential issue (the note request). This memorandum does not intend to provide any advice regarding a potential investment in the request under review. Client should make its own considerations and investigations regarding any investment or any offering thereof made to its customers and clients as intended. No rights can be derived from the use of this document. We note that, apart from credit risks, various other aspects might be relevant when considering an investment, e.g. (local) market circumstances, technology risk, country risk, etcetera. The analyses of such other aspects are excluded from this review. Any comments made on such aspects should be seen in conjunction with credit-related analyses and have no value of their own, nor intend to indicate any deeper analyses of such underlying aspects. Information used in this review is limited (as referenced in Appendix A.1). No due diligence or verification of information received has been made. INRiSC has no further interest in the issuer (SolarNow) or the notes issued. INRiSC is not supervised by any regulatory body.

## 2. Notes issuance & summary

The request concerns:

- A senior ranking, covenanted, EUR 1,000,000 facility, the first drawdown amounts EUR 150,000, each note has a maturity of 2 years, with semi-annual, linear repayments,
- Borrower is SolarNow, a limited liability company (besloten vennootschap) based in the Netherlands, with activities in the installation and servicing of solar panels and electrical appliances in East-Africa, momentarily Uganda and in the future Kenya;
- Financing for working capital purposes; the financing of stock and bridging cash flow until a new equity financing round is concluded.

| RISK ANALYSIS OVERVIEW<br>**Positive aspects** | **Negative aspects** |
|---|---|
| **Company** | |
| Experienced and balanced management team | Relevant business activities in foreign countries (which is however part of the typical investment opportunity). |
| Successful track record in attracting outside money | Scale-up; dependent on large new equity investments EUR 8m in next 2 years |
| Knowledge of local circumstances (socio-economic & regulation) | |
| Established network of (N)GO's and investors | |
| **Business** | |
| Large (untapped) market for sustainable (energy) solutions | Country risks in Uganda and Kenya |
| Straightforward supply chain, no dependencies on single suppliers | Low barriers to entry, better funded competitors active in the same market, albeit with smaller volumes |
| Large distribution network in place | |
| **Product** | |
| Decentralized off-grid solar utilities | Limited collateral value (first 1/3 of payment plan period asset value below outstanding lease amount) |
| Additional sales from ancillary products | |
| **Financials** | |
| Separate SPV offers lower financing costs | Change in accounting methods resulted in corrections |
| Payment behavior of the customer is well understood | FX-risks that are momentarily not hedged |
| Adequate provisioning for unearned income/ interest | |
| **Facility/ Notes** | |
| Short term to maturity (2 yrs. with semi-annual repayments) | Dependent on new equity rounds |
| **Loan Structure** | |
| Senior ranking | Unsecured |

SolarNow will use the note issuance for stock purchases and as a bridge to gap negative cash flow operations until the upcoming fundraising round is concluded. Due to the split in the operating company most of the credit risk to customers is 'contained' in a separate financing SPV that provides vendor leases. The operating company, SNUG has negative cash flows and continuous financing is needed to break-even. FX-risks can have large impact on the profitability of the company and the ability to repay the loan to Lendahand. The payment behavior and creditworthiness of the customers are important variables for the financing SPV, but will not immediately affect the notes. The notes are not directly exposed to credit risk arising from the vendor leases in the SPV. Debt service capacity of SolarNow is however affected by margins that remain within SNUG, the operating company, or SAFi SPV, the financing vehicle. SNUG does not show positive operating cash flow, indicating further funding is needed to sustain the company and limited intrinsic debt service ability.

## 3. The Borrower

### 3.1. The company

The company, SolarNow BV, is a Dutch based holding company with operational companies in Uganda and Kenya that sells and services solar panels and electrical appliances. Operations started in Uganda in May 2011 after recognizing the potential of Uganda to develop a scalable commercial business. The founders build on seven years of experience with the Rural Energy Foundation, training rural entrepreneurs to develop solar energy enterprises. After Uganda, Kenya is seen as a suitable, perhaps even easier, market to establish a new sales network. Sales in Kenya are planned to start in 2017. SolarNow sells quality solar systems combined with an in-house finance program through a wholly owned branch network. The target group are rural customers and businesses. Compared to competitors on the market, SolarNow offers a product differentiated by quality, more upgrade variety's supporting more appliances and a 60 month service/ warranty.

The company structure is shown in Appendix A.3. Basically SolarNow comprises of local operating companies with each a local financing vehicle. The Dutch Holding company is 100% owner of all the subsidiaries. The SolarNow servicing company in Uganda (SNUG) is where the operational activities take place; mainly sales, installation and after-sales servicing. All the direct cash sales to customers are handled by SNUG. The Financial Company has no activities, it is a transaction vehicle for all the loan payments and basically merely serves as a bank account for customer payments. The SolarNow SPV (SAFI) is holder of the vendor lease portfolio. If the customer uses a 'Payplan' (estimated at 70% of total customers) the SPV will buy the product from SNUG and sell it to the customer and will be the beneficiary of the proceeds through lease payments. SNUG handles the installation and after-sales servicing. According to research procured by SolarNow from a third party, Lendable, the delinquency rates are manageable. Customer credit risk is managed via customer selection processes, but are subject to macro-economic effects. In Kenya the corporate structure is a mirror of the structure in Uganda.

### 3.2. Management

The Board of Directors reflect an international track record in microfinance, engineering with a focus on renewable energy and consumer products in emerging countries. The holding company is based in the Netherlands whereas management, operations, sales and marketing is concentrated in Africa. In the supervisory board of SolarNow there are active shareholders present with experience in investing in the region and the industry.
We have interviewed management, Mr. Nolens (CEO). Mr Nolens shows thorough knowledge of the business and the direction it needs to take, local environment, significant micro-finance experience and a good sense of the "umwelt" related to emerging market energy solutions.

### 3.3. Credit history Borrower

The company was founded in 2011, management has been working together since 2009. There is a relevant three year track record of historical figures. The company has attracted credit since 2012 and there is no indication it has had difficulties repaying their creditors up till now.

## 4. Business analysis

The key business activities are concentrated around the sales and after-sales of PV-panels batteries and appliances. PV-panels and appliances are purchased from suppliers located mainly in China. SolarNow offers a payment plan (payplan) to grant a larger customer base access to energy. Key business driver of SolarNow is the sales of an off-grid solar solution, either with or without a payment plan. Around 30% of sales are direct sales, the other 70% of sales go through the payment plan. SolarNow benefits from a strong base of mobile banking technology and subsequent supportive infrastructure to consumer credit activities in Africa. It is noted that there is considerable country risk on Uganda; changing (tax) regulations and slow economic developments create uncertainty around the business climate. Kenya has slightly better economic environment, yet is more bipolar in differences between rural and urban areas.

Initially, the branches of the dealer network were managed as franchises, but resulted in lower productivity levels, due to the lager 'distance' between SolarNow and the dealer network. Initially, SolarNow used franchises for its distribution, but due to low productivity level and control, management changed this into a branch model. In the second quarter of 2016, management started streamlining the branches, dismissing unproductive staff and standardizing daily work plans, optimization of distribution and implementing controls and targets for all field staff. The company is slowly decentralizing credit management to promote flexibility (tailor made solutions) and realize more customer intimacy. These changes resulted in a productivity and revenue increase in the same year.

In order to finance working capital, the company has to attract outside funds. The financing SPV SAFI, established in 2016 with the expertise and direct financing of SunFunder, was primarily done to gain access to capital at a lower financing cost. By separating the lease portfolio, its cash flows and the underlying assets, a secured and ringfenced financing vehicle is created. This technique is seen more often in asset based finance and the company utilizes this technique to its advantage. It also helps to shorten the cash cycle in the operating company SNUG and mitigate part of the credit risk in SNUG and SolarNow

BV. This is favorable to financiers at that level of the company. However, on the other hand, most of the tangible collateral of the company is 'off limits' to other financiers as these are pledged to the financiers of the SPV.

SolarNow seems to be effective in terms of credit management. Here the micro-finance experience of management pays off. Credit assessments are made of each customer by the sales staff by means of e.g. debt to income ratios; lease payments cannot exceed half of the free disposable income of a family in a bad month. The credit assessment also takes into consideration six community references that need to vouch for the borrower. As seen more often in micro-finance, social surveillance by the community in which the applicant lives serves as a strong incentive to ensure repayment. Payment reminders are sent automatically via text messages. If repeatedly no payment arrives, SolarNow will start making calls and seeks social workouts if such case arises. Low customer satisfaction results in higher percentage of delinquent customers. SolarNow therefore offers appropriate financing solutions from the start with focus on after-sales. This strategy resulted in maintaining fairly low delinquencies and losses.

## 5. Financial analysis Borrower

INRiSC reviewed the consolidated annual accounts 2012 until 2015. In this period revenues have risen steadily with an operating profit margin that is line with industry averages of the green & renewable energy companies in emerging markets and substantially higher than that of a distributing company. SolarNow is operating at net losses and negative cash flow. But it did grow their asset base in the form of vendor leases considerably. The historical financials indicate a rather large indebtedness (as may be expected) relative to the company's capital and operating cash flow. The company relies heavily on funding and capital infusions to sustain cash flows. This is also reflected in the projected ratios.

The consolidated projections are based a financial model provided as is by SolarNow. The projections include SolarNow BV in the Netherlands and the two branches in Uganda and Kenya. Both branches consist of an Operational Company, Financial Company and Portfolio SPV which holds the loan portfolios. The projections are based on the sales of said goods in Uganda and Kenya and includes the loan portfolio profits. INRiSC was able to obtain a good overview of the financials of the company going forward, including intercompany relations. Please note that INRiSC did not test the reality of the projections in terms of market share captured, underlying price levels, costs related to the realization of the product or its components. Nor did we test for consumer payment behavior, payment terms or consumer default rates and loan losses for Uganda or Kenya.

| Key financial ratios, projected, excluding notes issuance | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|
| Current ratio | 3,13 | 6,96 | 8,97 | 7,15 |
| Total debt/EBITDA | Neg | 10,75 | 2,83 | 1,61 |
| Gearing | 10,81 | 2,12 | 0,93 | 0,75 |
| Interest cover ratio | -1,71 | 0,89 | 3,13 | 5,57 |
| Debt service cover ratio | -1,71 | 0,89 | 3,13 | 5,57 |
| cash cover ratio | 15,6 | 20,5 | 22,3 | 20,9 |

### 5.1. Liquidity

Cash coverage in SolarNow BV is dependent on sales and collections plus new equity fundraising. Both the quick and current Ratio are sufficient in a consolidated analysis going forward. According to the projections the company will keep sufficient cash in hand to service its debts. The intercompany payables are supplementary to this liquidity position. Liquidity is particularly realized through new infusions of debt and capital.

### 5.2. Solvency

Historically solvency was low due to high indebtedness on a consolidated basis. That indebtedness is primarily concentrated in the SAFI SPV. Nevertheless, on a consolidated level considerable cash infusion is required to be maintained to keep pace with the funding requirements. Solvency will improve moving forward and is primarily the result of capital infusions. Gearing reduces accordingly. Due to strong sales projections Debt/ EBITDA decreases significantly.

### 5.3. Cash flow analysis Borrower

Cash flows have been negative historically. This is the case already on operating cash flow level. Until SNUG becomes cash flow positive, or break-even for that matter, there is an imminent need for external financing. The company is currently seeking to bridge cash flows until a new equity financing round is concluded. This cash flow pattern and fund need is customary for the current growth stage of the company. The company however needs to move to an operating cash flow neutral situation in order to become sustainable. The projections show positive operating cash flows as of 2018. At that point the company will become less dependent on external financing.

SolarNow has an extensive network among governmental organizations and NGO's. Supplemental financing from NGOs is an important form of funding in this stage. For instance the company attracted a EUR 2m grant from the Dutch embassy of Uganda which is used to subsidize customers. Apart from NGO's SolarNow has proved to be able to yield interest from and contract funding in a wide range of investors. This is imperative to meet the short term financing needs of the company, including debt servicing.

## 6. Collateral analysis

The notes will be unsecured. A large part of the tangible assets in the company are pledged to financiers (SunFunder in the SPV, local banks in the operating company). SolarNow BV has stock which represents a value of around EUR 1m, according to the annual account of 2015.

## 7. Risk analysis

The proceeds of the notes issuance by SolarNow BV is used to purchase stock and support working capital financing needs in the operating company SNUG. Due to the structure of the company credit risk is mainly concentrated in the SAFI SPV. The financial risks in SAFI SPV are ring-fenced. Cash flows streaming up to SNUG are rather secure. Realized sales in SAFI via vendor leases are financed by the financier of the SPV. Currently however a larger part of the margins in the company are trapped in SAFI. This is disadvantageous to the financing of SolarNow BV as less cash is available for debt servicing. Excess liquidity in the SPV can however be disbursed to SolarNow BV improving its debt service capabilities when financing covenants on SAFI debt permit it. As such the notes are mainly exposed to operating risk in SNUG (local operations) and SolarNow BV (procurement entity).

Debt service of the notes in SolarNow BV depends largely on upstreaming of cash to SolarNow BV (mainly the result of direct sales to SNUG). SNUG's and SolarNow BV's liquidity are in part highly dependable on the success of future fundraising rounds at this stage. Until the company realizes an operating cash flow neutral situation, there is no sustainable situation going forward and the company will remain dependent on further financing. When the company is able to improve its operating cash flows, together with the use of financing SPVs that should make a sustainable company. The company reaches positive cash flow from operations in 2018. Due to the investments needed to support growth, the financing need however is considerable. Cash flows before external funding are negative for the projected years up to 2019. Total external funding required exceeds USD 16 million for the projected period.

SolarNow business activities inherently has to deal with FOREX risk. This risk is exacerbated by the fact that there lies an exposure on both USD (suppliers) and the EUR (loan) and local currency. SolarNow is examining different routes for mitigating these risk, by for example attracting funds in local currency. In the future a local currency financed SPV could offer a natural hedge against FOREX exposure. At the moment however noteholders are exposed to FOREX risk.

The notes have priority over other liabilities in SolarNow BV, but rank below local financing (banks in SNUG, and SunFunder in SAFI SPV). The assets in stock in SolarNow give support to the servicing of the notes, by means of realized sales thereof. No claim can be made against them. The notes are therefore deemed structurally subordinated even though being senior ranking in SolarNow BV and depend on available cash flow in SolarNow BV for debt servicing, which mainly comes from new capital infusions and debt financing.

# A. Appendices

## A.1. Information used

The information used in this analysis were obtained from Client and include:

- Business presentation;
- Annual accounts 2013- 2015;
- Projections Solar BV, SNUG, SAFI and consolidated 2016-20121;
- Term sheet notes Lendahand;
- Finance agreement SAFI;
- Finance agreements SNUG;
- Interview conducted between management Mr Nolens (CEO) and INRiSC.

## A.2. Concept term sheet

| *Item* | *Characteristic* | *Quick Assessment* |
|---|---|---|
| *Borrower* | SolarNow B.V. | Dutch borrower with finance docs under Dutch law |
| *Type* | Unsecured Notes | Purpose: working capital financing |
| *Start Date* | Not known yet at time of analysis | |
| *Maturity* | 2 Years | At final maturity an extension option can be discussed between parties (with potential increase in principal) |
| *Currency* | Euro | See hedging below |
| *Initial Amount* | EUR 1,000,000 | Utilization of EUR 100,000 tranches min. and EUR 250,000 max. Each note has a maturity of 2 years. |
| *Interest and repayment* | Semi-annual | Semi-annual repayment reduced lender's risk. Repayment of older note issuance may occur with new drawdowns (only during availability period). |
| *Interest rate* | Not known yet at time of analysis | Will be fixed interest rate, no hedging requirements |
| *Rank* | Senior, pari passu | Ranks senior to debt in SolarNow B.V. Notes are however structurally subordinated to local (senior) debt at the level of SNUG and SAFI. |
| *Security interests* | None | Cash flow financing, only coverage from cash flow, Negative pledge protects assets for encumbrance by potential other lenders. |
| *Solvency ratio* | Required to be at least 35% | (Total Equity) / (Total Assets) |
| *Cash reserve* | Cash/ 3 month debt service amount = 1.0 | (Cash) / (Principal & Interest Payments next 3 months) shall be 100% or higher. |
| *DSCR* | EBIT / debt service amount = 1.50 | (Earnings Before Interest & Tax last 12 months) / (Principal + Interest Payments next 12 months) > 1.5 |
| *Cash flow coverage ratio* | Operating cash flow / debt service amount is required to be at least 1.50 | (Operating Cash Flow) / (Principal + Interest Payments next 12 months) > 1.5 |
| *Governing law* | Dutch law for the documentation | |
| *FX position* | Unhedged currency position will remain between -25/ +25% of total equity and foreign currency provision at any time | (Total Foreign Currency Assets – Foreign currency Liabilities) / (Total Equity + FX Provision) |

## A.3. SolarNow legal structure