INRiSC

CREDIT ANALYSIS REVIEW – FINAL

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1. Introduction

This memorandum concerns the high-level credit analysis in connection to the notes issuance of Sollatek Electronics Kenya Limited (**Sollatek**) arranged by Lendahand (the '**Client**'). The scope of the review is limited to a general review of the credit-related risks in association with the issuer Sollatek and the potential issue (the notes issuance). 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 Sollatek Ltd. or the notes issued. INRiSC is not supervised by any regulatory body.

2. Notes issuance & summary

- A senior ranking, covenanted, EUR 2.500.000 facility, drawdown amounts are set between EUR 100.000 - 150.000, each note has a maturity of 2 years, with semi-annual, linear repayments,
- Borrower is Sollatek Ltd., a limited liability company (besloten vennootschap) based in Kenya, with activities primarily in Kenya and to lesser extent Tanzania and Uganda;
- Financing is used for working capital purposes.

RISK ANALYSIS OVERVIEW	
Pros	**Cons**
Company	
Proven track record	Exposed to country risks (see also Coface)
Experienced management team, diverse group of competent people & relevant experiences	
Privately owned; founder is large shareholder	
Business	
Both B2B as B2C products and services	Vulnerable to socio-economic and political situation
Strong strategic partners	Concentration in sales channels
Scalable business model	Highly competitive market
Developing new product lines	
Product	
High quality power control protection products	Expansion with none unique (patented) product (commodity)
Full warranty transferred to end consumer	
Complementary goods offering; solar panels and appliances	
Financials	
Long credit history	FX risks not hedged
Successfully attracted bank loans and grants in the past	Long asset conversion cycle, build-up of inventory (and receivables)
Large portion of assets are fairly liquid	Somewhat volatile net results; loss in 2015 and marginal profit in 2016
Notes	
Short term maturity (2 yrs. semi-annual repayments)	Unsecured
	Second lien CBA behind bank and Global Partnership

3. The Borrower

3.1. The company

Sollatek Electronics (Kenya) Limited has been in operation since 1985 as the sole authorised agent for Sollatek products and the owner of the Sollatek franchise in East Africa. Sollatek Kenya is independently owned. Sollatek UK delivers voltage protection products. Sollatek has its head office in Mombasa (Kenya) and it runs a sister operation in Dar Es Salaam, Tanzania. Sollatek operates as a wholesale and distribution outfit, selling its products through a region wide network of distributors. Sales channels include regional supermarkets, electronics, hardware and general stores.

Sollatek Kenya partners with manufacturers committed to research and development in an effort to diversify its product range and exploit new niches in the market place. The focus is on high quality, cost-competitive products backed by the company's reputable after-sales service. Sollatek UK is currently working on the design and prototype of several new products in the field of voltage protection.

Traditionally, Sollatek is a wholesaler of power surge protection equipment. The electricity grid in Africa is known for its power outages, but also its power surges and limited reliability. During a power surge the voltage level in the grid peaks, causing damage to electronical devices that are connected to it. Power control devices protect the electronics that are connected to the grid when such peaks occur.

Sollatek has, since 1987, been involved in the field of renewable energy; developing solar power products and systems. Since its establishment, the Sollatek Solar Division is active in both the supply of complete turnkey solar systems and ancillary equipment. Sollatek Solar has extensive expertise in designing and implementing bespoke systems resulting in thousands of solar systems having now been installed throughout East Africa. Sollatek Kenya has recently partnered with NIWA Solar a distributor of high quality portable solar lanterns, modular solar home systems and solar appliances for a fully electrified off-grid home.

Through partnerships with solar manufacturers, the company can offer innovative solutions at affordable prices. Sollatek is about to start a partnership with a Microfinance loan provider increasing the affordability and market of their products. SollaTek recently concluded a partnership with Azam a satellite TV operator / cable company with a strong presence in East-Africa. The goal of this partnership is to jointly develop the PayGo TV product line into a complete product offering. The partnership will guarantee compatibility ensuring an integrated product enhancing user experience. The companies will also enhance each other's distribution capabilities and marketing exposure.

The company hopes to be at the forefront of the solar revolution happening in Africa with portable solar lanterns, modular solar home systems, solar appliances and solar refrigeration solutions designed specifically for the African environment. The company has been awarded grants from USADF Power Africa Challenge and the Energy and Environment Partnership (EEP) for our continued work in this field.

In 2013 and 2015, Sollatek Electronic (Kenya) was named one of Kenya's Top 100 Mid-Size companies in East Africa by KPMG Kenya. In 2015 Sollatek were also a finalist for the African Energy Innovation Prize.

3.2. Management

The management team of Sollatek are experienced in all relevant business matters. The company has operated in the industry and region for many years proving they are able to successfully operate their business.

Founder and Chairman Chris Soper is a chartered shipbroker and a successful entrepreneur with over 40 years of experience of running businesses in Kenya. In 1992, Chris became one of the first people in Kenya to explore business opportunities in renewable energy. Managing director Saleem, a qualified accountant, has risen steadily through the ranks of the company and was promoted to take over from Chris Soper as the managing director in 2007. Commercial manager Shemina S. Khodabaksh is responsible for the office management infrastructure and spearheaded the corporate social responsibility program for the past 5 years. Natalie Balck is head of projects and partnerships. She is responsible for developing Sollateks region wide marketing strategy, fundraising and solar project implementation. She successfully managed the USADF Power Africa Solar Run Freezers for Fisherman project as well as EEP Sollatek Direct: Solar Entrepreneurs in Kenya. Sales and distribution manager Samwel O. Odhiambo plays a key role in firmly establishing Sollatek in Kenya but also in expanding the business regionally into Uganda, Rwanda and Burundi.

For this credit report, we have interviewed the managing director Saleem N. Abdulla and Natalie Balck head of projects and partnerships.

3.3. Credit history Borrower

The company was founded in 1985, we have reviewed a relevant five year track record of financial figures. INRiSC has reviewed the company from 2012 onwards. During this period, Sollatek contracted several credit facilities. There are no indications that the company had difficulties repaying its creditors. The company successfully attracted new capital in the form of bank loans and grants over the last years.

4. Business analysis

Sollatek has built a reputable business in Kenya and East Africa over a period of 3 decades., during which it has built lasting relations with a network of distributors. The distribution network gives the company a competitive advantage over potential newcomers in the off-grid solar market. Sollatek has a strong distribution base and local knowledge from which they aim to expand their current business model to a more diversified business. Sollatek sales channels are directly to businesses (mainly for larger power control projects), retail supermarkets and convenient stores. The company does recognize the risk in its lack of a diversified sales channel, which at the moment is largely dependent on large supermarkets, which often apply long payment periods.

The potential for off-grid services in Sub-Sahara Africa is substantial, currently around 600 million people do not have access to electricity. Currently around 80% of Sollatek's revenues is generated by the power control division and 20% is generated by the Solar Division. In the solar power market Sollatek faces competition from cheaper, generic products.

A unique selling point of Sollatek is that it benefits from a strong brand name and is known for its outstanding aftersales services. It guarantees all repairs are done within 72 hours for products within their guarantee period. The manufacturers guarantee periods are the same length as offered to the end-consumer.

Sollatek made a small loss in 2015. This small loss was due to two facts. Firstly, the company's distributor of solar lanterns decided to sell directly to end-consumers. Thereby in effect cancelling their partnership with Sollatek. The company has found a new solar lantern supplier (NIWA). NIWA also offers a growing range of other off-grid appliances Sollatek is planning to sell. Also, the power control division faced a troubling year in 2015. Due to a take-over of the company's supplier in China, the manufacturer renegotiated terms for supplies for crucial components leading to a stock-out of some of Sollatek's fastest moving products. Supply and production has normalized since then. In order to mitigate this risk from occurring anew, the company has secured itself with multiple manufacturers ensuring a steady supply towards the future. Business has picked up and Sollatek managed to be profitable last year, albeit marginally.

As mentioned a new project the company is embarking on is selling solar driven PayGo TV's. The percentage of households owning a television set in Kenya has grown over the last decade in correlation with the disposable income of the middle class. Sollatek aims to sell the television set in combination with a payment plan offered by a local Micro Financing Institution (MFI). By lowering the initial purchase price even more consumers can afford the product. This payment method is growing in popularity in Africa. The exposure to the credit risk associated with the payment plans remain with the financier, as Sollatek is paid the full amount at the time of purchase by the MFI. By partnering with a MFI, Sollatek and the financial institution stay with their core business and are able to grow their respective markets. The project is now ready for roll-out.

Sollatek works according to a distribution model where it acts as a wholesaler. Sollatek has difficulty keeping the days sales outstanding to a minimum especially with their main client group supermarkets. The company has a large market penetration from which it can sell complementary goods.

5. Financial analysis Borrower

INRiSC reviewed the 2012 to 2015 annual accounts of Sollatek Electronics (Kenya) limited. According to the annual accounts Sollatek made a profit in 2012 and 2014 and a small loss in 2015.

The consolidated projections are based on a financial model provided as is by Sollatek. The company's projections are based on sales in Kenya, Tanzania, Uganda and Rwanda. INRiSC was able to obtain a good overview of the financials of the company going forward. 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.

Key financial ratios, realized and projected, excluding notes issuance	2016	2017	2018	2019
Current ratio	2.69	2.64	2.46	2.36
Total debt/EBITDA	6.19	4.10	3.07	2.39
Gearing	1.52	1.18	1.29	1.15
Solvency (TNW/Tot. Assets)	0.40	0.44	0.42	0.44
Own and Assoc. Means/Tot Assets	0.56	0.63	0.60	0.61
Interest cover ratio	1.25	1.51	2.25	2.04
Debt service cover ratio	0.44	0.52	2.25	1.56
cash cover ratio	-12.8	-3.6	-1.4	-2.3

Financial ratios table

5.1. Liquidity

The liquidity position of the company is dependent on the sales and collection of both their power control and solar products. Supermarkets are the main customer group, unfortunately they tend to take a longer time to pay their bills. The PayGo project would in effect not alter the liquidity position of the company. The financial intermediary will pay Sollatek the full purchase amount at the moment of transaction.

The company's current assets are mainly tied in stock and receivables, which generate short term liquidity (if sold and collected). Although the liquidity position seems strong, it also indicates high levels of stock and receivables. Both the days sales of inventory (DSI) and days sales outstanding (DSO) are projected to shorten a bit improving the cash cycle.

5.2. Solvency

The solvency ratio, which is calculated by dividing Total Net Worth (TNW) by total assets, shows that Sollatek is currently relies somewhat more on debt than equity. However, half of Sollatek's debt outstanding are shareholders loans. Technically this is a liability but in effect these loans are deeply subordinated to any other debt thereby functioning as near-equity. For the noteholders, this provides a cushion since the notes would become senior to shareholders loans. To the knowledge of INRiSC there are no new (outside) equity rounds planned. Effectively the shareholders' loans provide for future equity cash infusions, as they are both unrestricted in volume and maturity.

5.3. Cash flow analysis Borrower

The cash flow from operations has remained positive over the period 2013 – 2016. The company has a multi-currency (USD/ KES) overdraft debt facility with CBA bank from which it can subtract working capital. According to the projections Sollatek does not have debt obligations it cannot fulfil in the coming years. Debt service coverage is tight, however the CBA facility has no mandatory repayment schedule, except for the portion of post import finance. Sollatek is aiming at reducing its inventory during this year. Still there are considerable funds tied up in the inventory of the company. When Sollatek would be able to lower the company's overall inventory levels it could positively influence their debt service coverage ratio and lower the company's overall financing need due to higher stock rotation. Currently, the DSCR exemplify the cash flow constraints regarding the company's debtors. This is a risk that noteholders will have to be acutely aware of. In 2017 Sollatek projects to use some of its inventory assets to negate their lower cash flow from operations (low DSCR).

6. Collateral analysis

Currently the CBA bank loan ranks prior to all other claims on the company. The company's assets have been pledged to the bank with additional recourse on its founders. Global partnership, an impact investor from the United States, has a senior unsecured loan outstanding to Sollatek. It is likely that the notes issuance will rank junior to the CBA bank loan and pari passu with the Global partnership loan and account payables. The directors' loans and the before mentioned grants to the company are unsecured and rank junior to all debt.

The company's assets mainly consist of stock and receivables. INRiSC has not researched the intrinsic value of the assets on the books of Sollatek. Since the company sells quality consumer products it is reasonable to assume Sollatek would be able to re-sell its stock fairly easily in case of liquidity problems. In case of such a fire sale, the price at which stock is sold may however be affected. In general, it gives the notes some more assurance – in spite of being unsecured - of being repaid in case of default. However, the level of this assurance is dependent on the execution value, which is not evaluated by INRiSC, also bearing in mind that proceeds first go to CBA bank and Global Partnership loan repayment.

7. Risk analysis

Sollatek management has proven to be capable of weathering business adversity, as it has done in 2015. With the company's long history of doing business in Kenya it has grown a strong network of distributors. Adding the financing capability of a Micro Finance Institution to their product offering, via PayGo, the company hopes to significantly increase their revenue in the coming years. Also the product line development looks promising through partnerships with NIWA and Azam. Sollatek's management hopes to grow their revenue by focusing on new product lines and geographic markets. When entering the off-grid solar market Sollatek will face the risk of competition from cheaper generic products. With their excellent after-sales services Sollatek will hope to differentiate themselves on the market place. The company has proven to be effective in attracting outside funds from both commercial lenders as impact investors.

The company projects that the DSO will shorten in the future. Whether this can materialize is uncertain. Even with this improvement there is still room for Sollatek to improve their cash cycle. The average DSI is extensive as well. This results in money being tied up in the balance sheet due to a long asset conversion cycle. Money that otherwise could be put to work.

Taking on more debt in a foreign currency will increase the FX risks for Sollatek. In the future, a mitigating hedging strategy might benefit the company. Sollatek will also have to deal with specific country risks, like adverse socio-economic developments. The business climate in Kenya is however rated more favorable than their neighboring countries. Expanding in these new countries will bring on risks for Sollatek in this regard.

The company's assets have been pledged to the CBA bank. The note issuance is unsecured and effectively subordinated in rank after the CBA bank loan and pari passu with the Global Partnership debt and accounts payable. Being second in lien increases the loss given default for the noteholders.

A. Appendices

A.1. Information used

- Sollatek Financial projections;
- Sollatek annual accounts 2012 – 2015;
- Sollatek business presentation;
- Loan and grant documentation;
- Supplier agreements;
- Sales reports;
- Phone interview with Saleem Abdulla and Natalie Balck.