INRiSC

CREDIT ANALYSIS REVIEW – FINAL

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Contents

1. Introduction

This memorandum concerns the high-level credit analysis in connection to the notes issuance of SimGas Kenya Ltd (SimGas) 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 (SimGas) 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 (SimGas) 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 with 4 year availability and individual notes term of 3 years, each note with semi-annual, linear repayments,
- A Kenya based operational company, with activities in the delivery of decentralized biogas utilities in East-Africa, notably Kenya;
- Financing for working capital purposes (including the pre-financing of vendor lease program).

RISK ANALYSIS OVERVIEW Positive aspects	 Negative aspects
Company	
Relevant technical & engineering knowledge and experience	Foreign legal jurisdiction
Strong focus on competencies in the specific jurisdictions	Scale-up, structural changes organization
Knowledge of local circumstances (socio-economic & regulation)	Limited (relevant) credit history
Business	
Large market for sustainable (energy) solutions	Dependency on one supplier, no immediate backup who can offer similar prices in case of calamities
Straightforward supply chain	Long cash cycle due to 24month vendor lease to small farmers
Reduced complexity due to outsourced production with partially prefixed prices and margin deviations	Country risk Kenya
Product	
Decentralized off-grid utilities (biogas digesters)	Initial technical setbacks with digester (however seem to be solved)
One product family (digester) with several variations, not too complex	
Additional sales from ancillary products	
Financials	
Possible support to SimGas Kenya from sale of carbon credits	Relying on projections which do not reflect the current state of business
Independent credit assessment	Repayment depending on payment behavior of customers
Farmer cooperation acts as third party in agreements partly mitigating customer repayments risk	
Customers are obliged to take out life and cattle insurance decreasing their business risk	
Notes	
Medium term only; 4yrs with semi-annual repayments, extendable	FX risks (to be hedged in the future)
Working capital purposes, financing of cash cycle	Indirect credit risk on consumers
Monthly payments on vendor loans reducing risk on Notes repayment	
Notes Structure	
Senior facility	Unsecured
No other senior debt	Financial covenants with limited strength
	Uncertainty regarding final organizational structure

In essence, SimGas will use the notes issuance for working capital purposes. According to the business plan of SimGas there will be short term financing needs that exceeds the notes issuance discussed in this analysis. The vendor lease approach demands considerable continuous funding. Key risk is payment behavior and credit strength of (Kenyan) customers, in particular small scale farmers. There is a change for the company to outgrow itself if funding and collections are outpaced by sales. Although the technique is not complex, during 2014-2015 technical issues with the digesters were experienced. The digesters showed cracking and leakage of gas due to soil mechanics (water pressure in different soil types). As a result customers stopped paying. These technical issues have been solved. Part of the digester was redesigned, soil mechanics and soil suitability were mapped. Subsequently production was outsourced after a process redesign.

3. The Borrower

3.1. The company

The company, SimGas Kenya Ltd, is a Kenya based operational company with activities that focus on the delivery of decentralized biogas units (digesters) to East Africa. SimGas Kenya is part of a group that consists of East-African (Kenya, Rwanda, Tanzania) and Dutch subsidiaries. The holding company Simgas Holding is a Dutch limited liability company. Intellectual property rights are established in the Netherlands and held by a separate entity. The operating companies are based and operate in East Africa. The company was founded in 2009.

3.2. Management

The Board of Directors reflect an international track record predominantly Dutch and African. There is combined track record in engineering, general management, and business development in emerging countries. Management, research and development and business development is concentrated in the Netherlands whereas operations, sales and marketing is concentrated in Africa. SimGas recently contracted a new local finance manager in Kenya. The new manager is a Dutch woman with several years of experience in East Africa. Management reflects a good combination of experience, required skills and entrepreneurship in a local context. INRiSC interviewed management, in particular Messrs. Castro (CEO) and Van Giersbergen (CFO a.i.), during which the general aspects of business activities, problems encountered, solutions, and the activities going forward were discussed. Management shows that they are on top of technology and the business. However, management faces some challenges in the financial structuring of the business.

3.3. Credit history Borrower

The (parent) company was founded in 2009. Operational activities started in 2013 after concluding product development. Due to technical issues with the digester sales were halted in 2015 to address these issues and redevelop parts of the digester. Simultaneously the company was restructured, reducing cost while outsourcing production. As a result historical financials reflect limited relevance going forward. The activities in 2013-2014 show unprofitable activities, with operational losses..

There is no relevant track record in debt service of SimGas Kenya. Repayment of the intercompany loan is scheduled to commence in 2017.

4. Business analysis

The key business driver of SimGas is the sales of decentralized utilities based on biogas. SimGas engineered a digester that transfers biomass into biogas which can be used to cook on, or to generate small scale electricity. The company focuses on a vast market of self-reliant customers/ farmers in East Africa. The user of the digester reduces costs associated with heating and cooking, and can increase crop growth by utilizing the slurry that comes out of the digester as a natural fertilizer.

First launch of the product was in 2013, with sales realized up to 600 digesters. Cracking of the digesters due to soil mechanics forced the company to focus on solving these problems and the servicing of existing customers experiencing difficulties with their digesters. These problems manifested in around 60% of the digesters. As a result people stopped paying. In 2015 the problems were all solved, people are paying again and the company is ready to scale up. Part of the digester was redesigned to withstand greater pressure. Simultaneously soil through Kenya was mapped and depending on the relevant soil mechanics, the soil in which the digester is placed is enhanced (with addition of sand or concrete). After solving the soil related issues only three new incidents were reported. Renewed sales results indicate that demand remains significant for this product.

The business activities are concentrated around the sales and after-sales, delivery and (on-site) assembly of digesters and utilities. Production of the digester components is outsourced to business partner (Silafrica Tanzania Ltd.) under a long term contract. Additionally the company foresees to earn revenues with refrigerator devices and trading of carbon rights received for the implementation of the digesters.

As the investments in the digesters are quite significant for the customers, SimGas offers vendor leases (to own) to reduce the upfront investment required by the customer. SimGas' business model is therefore characterized by a long cash cycle. When assuming that the technology risk is reduced to a minimum, SimGas' business model highly depends on the capabilities to control the cash cycle, in particular the collections of the leases (and limiting of losses due to consumer non-payments). It is understood that SimGas, the customer and the farming cooperation in which the customers participate agreed to a three-party agreement, in which the cooperation acts as guarantor for the payment of the customer towards SimGas. This will reduce the risk of non-payment significantly. At the moment 50% of the sales are handled in this manner and the aim is that in the future all sales will be three party agreements. The digesters are frequently serviced (maintenance) so as to increase customer satisfaction, which is imperative to payment behavior. Payment services are provided by M-Pesa, a large mobile payment services operator, which is regulated by Kenyan authorities. Payment frequency is monthly. SimGas is investigating daily payments. Actual collections are monitored by SimGas. It is understood that the vendor leases are insured by means of life and cattle insurance. These insurances are offered by local banks, Equity Bank and Sidian Bank.

Initially SimGas and Silafrica set up a joint venture but it was decided in 2015 to cooperate on an individual basis, each party focusing on their core business. The outsourcing of production, allows the company to focus primarily on sales and after-sales servicing of the product. The supply chain of SimGas is quite straightforward, yet the dependency on the supplier also renders this function more critical. SimGas however has a long term contract, largely based on fixed prices (variable prices of raw plastics are constrained by pre-agreed bandwidths in between which prices may vary from time to time) and a first right of use of the machinery. The machine used in the production was designed by SimGas and sold to Silafrica. This machine can produce up to 10,000 digesters per year. It is estimated that with this current machine, production until 2019 can be supported, if quality of process and product is assured.

5. Financial analysis Borrower

The projections are based on a sales forecast and financial model provided as is. The projections are based only on the delivery of biogas digesters. Additional utilities have not been included in the forecast. The projections for Kenya only show direct sales, the long cash cycle due to vendor leases (i.e. supplier credit) is not reflected in these figures, which in the opinion of INRiSC is an important omission as cash flow projections will be too high. SimGas provided INRiSC with projections of how a new corporate structure including a separate SPV holding the lease portfolio would look like. The numbers provided were however unconsolidated. Without a full consolidation INRiSC cannot make a thorough, complete analysis. As the relevance of the received financials is limited, INRiSC has not tested the specific financial ratios of the company. The omission of adequate insight in the consolidated impact of vendor leasing is deemed highly unfavorable to the business case. The accurate reflection of the long cash cycle in the projections for the company is important to adequately reflect the funding requirements due to its projected sales.

In order to test for the impact of the longer cash cycle that is to be expected, INRiSC reviewed the growth of the loan portfolio in connection to the projected growth in sales and associated funding requirement. The funding need increases rapidly due to the impact on net cash flows. Leasing is a capital intensive business. Depending on actual sales, the funding need will outpace the funds obtained through the client's supported notes issuance. Future significant borrowing by the borrower is expected to be required to sustain the projected growth. During 2016 SimGas was able to sell carbon credits to the World Bank. The company will redress these revenues to SimGas Kenya via a shareholders' loan in order to support solvency, funding need and debt servicing.

SimGas Kenya pays its supplier Silafrica in USD creating an extra FX reliance. KES and USD are not pegged to one another. Sales are in KES, while cost of goods sold is predominantly in USD, so gross margins depend on forex volatility. In other words cash flows and debt service capacity are exposed to forex risk. The fulfilment of EUR payments required by SimGas Kenya is subject to the movement in FX rates in both currencies. SimGas is currently investigating the hedging of forex risk by means of either swaps or forward contracts, which is imperative to manage and contain forex risk. No further details are available.

Please note that INRiSC has not tested 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 INRiSC test for consumer payment behavior, payment terms or consumer default rates and loan losses for Kenya. Notwithstanding the lack of consolidated financials provided, INRiSC performed some analyses on a best effort basis.

5.1. Liquidity

Cash coverage in SimGas is highly dependent on sales versus collections. In an ordinary B2B situation SimGas Kenya would be exposed to applicable payment terms as agreed in connection with the purchase orders and invoicing. Instead, SimGas is exposed to much longer payment terms due to the vendor leases to retail clients (small farmers) (even considering that B2B payment terms in Africa can be long). This will be reflected in a lower cash coverage for the notes. Early warning signals such as rapidly decreasing operating cash flows should be heeded in such cases. SimGas Kenya has a fair amount of intercompany payables. This may lead to some leakage of cash for debt service.

5.2. Solvency

The company states a negative equity value in the audited financial statements. With respect to Kenya ltd. intercompany loans from SimGas bv are treated as near-equity, as these are provided by shareholders. Solvency is therefore adequate and will remain so with the notes issuance. With the projected sales solvency will further improve in due course. Note that for leasing-like companies a lower solvency of ca. 15-25% is commonly accepted due to the capital intensive nature of the business. Debt/ebitda levels are expected to propel upward , in order to keep pace with this growth (and cash flow)due to the significant additional funds required.

5.3. Cash flow analysis Borrower

Due to the vendor leasing program the net cash flows are negative. Growth as projected is financed by contracting new debt. There is considerable risk that net cash flows cannot become break-even without continuous funding.

6. Collateral analysis

The notes are uncollateralized. There are no security rights in any of the firm's assets, nor in its IPR. Loan servicing for the notes depends on cash flow to be generated through sales, and effectively through lease payments. As a failsafe SimGas has the ability to shut down the digester operationally if the customer fails and continues in failing to make lease payments. Repossession when the customers continues to fail payments could lead to reselling of the digester to a new customer, swapping one customer for another. Legal right to repossess the digesters and ancillary utilities, and recovery of residual losses and associated costs incurred have not been tested. The price of reselling (if realized) will determine the losses incurred. Although losses may be limited, this can lead to significant arrears affecting cash coverage for the notes. A reselling value for the digesters has not been established yet, as such situation has not occurred yet. The company did not need to decommission and repossess its products due to non-payment; until now SimGas experienced little payment arrears and arrears that did occur were repaid within the month. As a result no (relevant) reselling value has been established yet. Decommissioned products were stocked and used for spare parts. The company deems repossession and reselling remotely viable. INRiSC therefore considers the indirect collateral value negligible.

7. Risk analysis

The risk of SimGas Kenya not fulfilling its obligations towards the notes strongly depends on the payment moral and debt service ability of its customers. By making tri-party sales agreements the company is effectively decreasing this risk. The leases have 12 month or 24 month tenure, the effect of which is slower sales revenues (collections) that impact debt service capacity of SimGas. The lease option that SimGas offers, facilitates sales by reducing the investment hurdle for the customers, yet on the other hand creates a long cash cycle and subsequent uncertainty if full payment for the delivery of the product will be obtained.

Credit assessments are made of each customer. These assessments are obtained via a third party. The credit assessment strongly leans on social surveillance by the community in which the applicant lives. A "guarantor" signs an agreement in which he vows for the applicant. A specific credit officer monitors the credit applications of the customers. At the back end of credit management, payment reminders are sent automatically via text messages. Mobile payment services are commonplace in Africa and a customary means of payment. If repeatedly no payment arrives, SimGas will start making calls and seek social workouts if such case arises. SimGas advocates customer intimacy in order to control payment behavior and collections. It is understood that high customer satisfaction and service level result in better payment behavior by SimGas customers. If payments on the leases start lagging then debt service ability of SimGas Kenya will decrease. There may rise a risk of new drawdowns being used to finance interest and repayment of previous drawdowns. If such a situation occurs effectively financing is used to service debt, creating a further downward spiral (as business itself remains unfunded) if improvements fail to happen.

In the current setup intended notes issuance will finance the working capital of SimGas Kenya. In fact this includes the financing need due to the vendor lease program. In the future the company intends to make use of a revolving fund to finance the leases on a more remote basis, and is currently investigating the setup of such financing vehicle. If such a vehicle is setup, the customer credit risk will be transferred to that vehicle and risk in SimGas Kenya will be reduced significantly as customer credit risk is then transferred to that vehicle. As a consequence the cash cycle for SimGas Kenya will be significantly shorter (as will funding need) as sales will be realized directly (and longer cash cycle is transferred to the leasing vehicle). The leasing risks (credit risk) will then be separated from the sales organization. The current "mixing" of business models adds uncertainty to the business case. Even when separated, if the leasing company has too many arrears there is a risk that the internal settlement between lessor and sales organization for the sales generated becomes disturbed and credit risk claws back to the sales organization. The risk impact in connection with the current notes issuance will need to be reassessed if such a structure is implemented (estimated within one year).

If debt is contracted at the holding level, and passed on to subsidiaries, the conditions of the intercompany loans reflect the same terms and conditions as these external loans. There are no senior (bank) loans at the level of the parent SimGas companies. SimGas Holding B.V. and SimGas B.V. do have convertible loans in place. The convertible loans are expected to convert into shares in 2021 and 2023, respectively. Currently there are no other (bank) loans in SimGas Kenya. New (senior) financing from third parties at the level of SimGas Kenya may affect the position of the notes, if and when such (re)financing occurs, depending upon the conditions of such new indebtedness. In principle, the notes are equivalent in status to each other and other debt (pari passu).

In view of the long cash cycle and the required ability to keep arrears and defaults to a minimum, there is considerable risk for the lender even with its senior ranking position as the company may outgrow itself, even with low arrears. Further indebtedness to finance projected growth is needed and new debt may affect the current position of the lender (even though pari passu).

A. Appendices

A.1. Information used

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

- Business presentation;
- Organizational chart and individual shareholdings;
- Annual accounts 2014 & 2015;
- Projections SimGas Kenya 2016-20120;
- Projections vendor lease portfolio 2016-2020;
- Term sheet notes Lendahand;
- Convertible loans documentation;
- Shareholder loan documentation;
- Memorandum of Understanding KDA;
- Interview conducted between SimGas management Messrs. Castro (CEO) and Van Giersbergen (CFO) and INRiSC.

A.2. Concept term sheet

Item	*Characteristic*	*Quick Assessment*
Borrower	SimGas Kenya ltd.	Local borrower with notes documentation under Dutch law
Type	Unsecured Credit Facility	Purpose: working capital financing including vendor leases
Start Date	December 2016	
Maturity	4 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 drawdown has a maturity of 3 years.
Interest and repayment	Semi-annual	Semi-annual repayment reduces lender's risk, but lagging sales may result in repayment of older drawdown through 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	Conditions to further indebtedness relevant to lender.
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 50%	(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.
Debt service coverage ratio	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 1.0	(Operating Cash Flow) / (Principal + Interest Payments next 12 months)
Governing law	Dutch law for the documentation	Borrower in Kenyan jurisdiction
FX position	Unhedged currency position will remain between -25/ +25% of total equity	(Total Foreign Currency Assets – Foreign currency Liabilities) / (Total Equity)