FEI OGEF

ANNUAL REPORT 2019

LHGP asset management

SunCulture, Kenya

FUND OVERVIEW

Mission

In 2018, the African Development Bank launched the Facility for Energy Inclusion (FEI), an umbrella initiative to catalyse funding into projects and companies that promote energy access. The Off-Grid Energy Access Fund ("OGEF" or "the Fund") is a USD 100m innovative finance strategy within FEI to promote off-grid energy access for critically underserved populations across sub-Saharan Africa.

OGEF's primary mission is to increase the quantum of debt financing available for off-grid energy enterprises in both local and hard currencies, subject to financing needs.

The Fund achieves this mission by:

- Mobilizing public and private capital, including climate, development, impact, and commercial financiers;
- Executing debt investments in local and hard currencies, where possible in partnership with local financial institutions and/or other investors;
- Stimulating additional private capital flows into the off-grid energy sector, directly through syndication and indirectly through demonstration effects.

FUND OVERVIEW

STAKEHOLDER	BOTTLENECKS	OGEF FUND RESPONSES
Companies	• Many private companies are unfamiliar with local capital markets and commercial/institutional investors. • Perception that the borrowing process is expensive/ long. • Preference for often subsidised DFI funding in hard currency.	• Engages borrowers and advisers at an early stage, helping them to understand whether locally oriented transaction is a suitable option. • Undertakes early due diligence and commits as anchor investor to crowd-in others. • Provides TA for preparation and ease of cost burden. • Offers local currencies and prices to market and establishes precedent transaction. • Links potential borrowers to known market intermediaries.
Intermediaries	• Quality of intermediaries (investment banks, lawyers, brokers, traders and rating agencies) is low. • Many have limited, if any, experience in overseeing ring fenced secured loans in Africa. • As a result, borrowers receive inadequate advice and transactions are structured, priced and marketed for short/medium term viability.	• Provides TA funding to support the hiring of service providers in turn assuring quality of documentation and providing experience in structuring viable transaction. • Works closely with intermediaries to ensure bankable structures are developed.
Investors	• Local lenders require transparent, proven structures to meet their internal investment policies and credit risk appetites. • Lack of a credit culture where investors focus on household names, often large foreign financial services, manufacturing, telecoms, retail and local consolidated companies.	• Assists borrowers to engage with local markets. • Supports bankable structures that are attractive to local investors. • Encourages ratings to enhance the quality of credit assessment. • Screens, diligence and investment process by the FM provides confidence to local investors.

Fund Activity

The Fund is an advocate for African local capital markets through:

Pipeline Development: Identifying potential borrowers and high growth market segments (geographies, products, business models).

Advocacy: Informing markets on the advantages of local currency transactions, including diversification of funding and reduced FX risk as well as reduced maturity and interest rate mismatches.

Direct Catalytic Investing: Encouraging co-investment and carrying out efficient investment approval processes to assist borrowers and their financial advisers throughout the bond marketing process.

Due Diligence: Performing rigorous due diligence, encouraging improved credit standards in the market.

Technical Assistance: Supporting legal structuring, accounting, roadshows, credit and social ratings, E&S policy improvements, reporting improvements, third party certification etc.

Transparency: Supporting market transparency by setting high standards for the borrowers' quality of information disclosure.

Sponsor

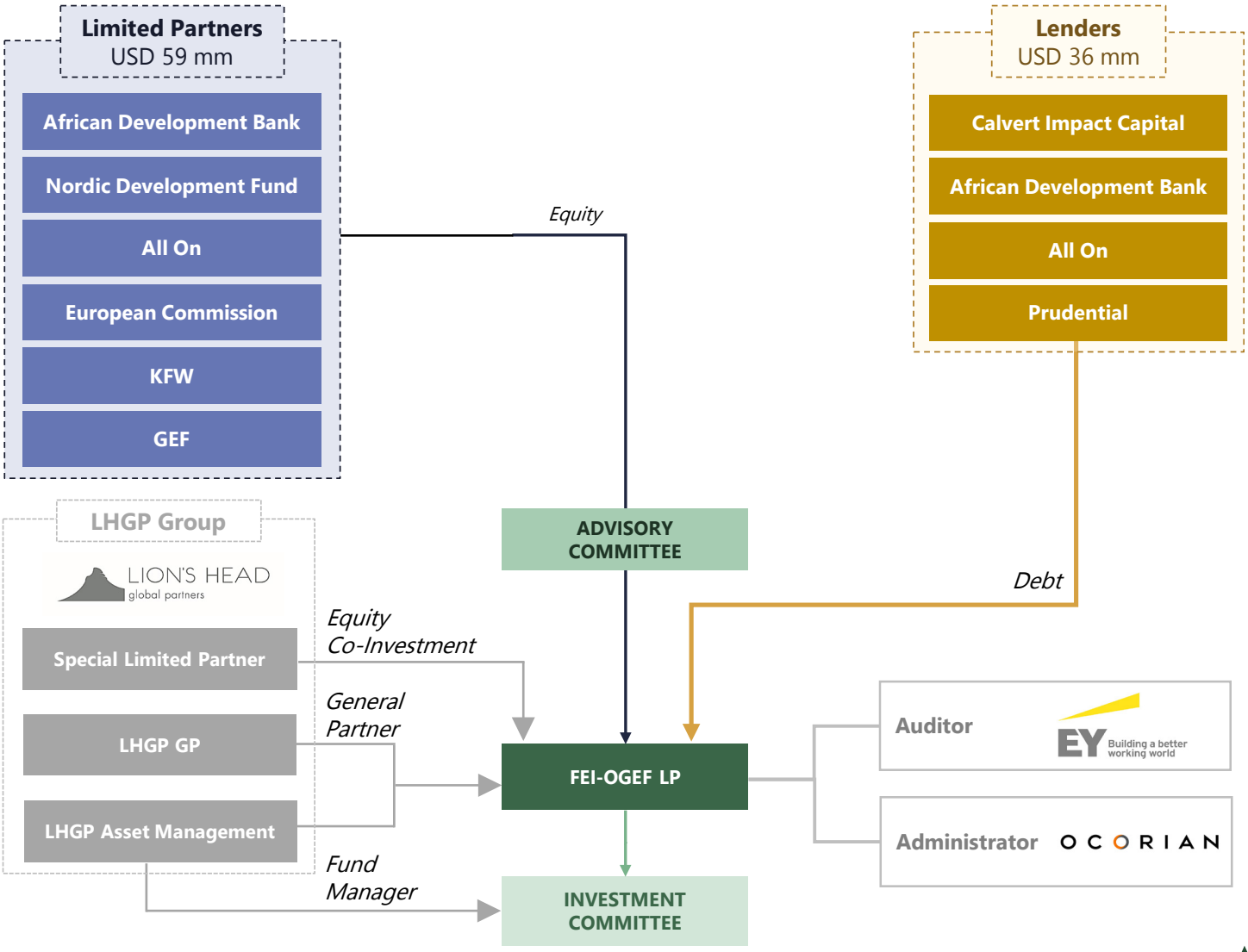
The African Development Bank created an umbrella initiative – the Faciltiy for Energy Inclusion (FEI) in order to catalyse additional funding into projects and companies that promote energy access across Africa. Within the FEI strategy, the AfDB worked with the Nordic Development Fund to create Off-Grid Energy Access Fund.

Investors

FEI-OGEF has raised debt and equity from a range of donors, DFI and private investors to create a blended finance structure. This allows alignment between investors various risk appetites and return requirements and an efficient cost structure that can support a flexible portfolio of transactions.

Fund Manager

LHGP Asset Management is the appointed Fund Manager to FEI-OGEF LP. LHGP Asset Management is part of Lion's Head Group Limited (www.lhgp.com), an investment bank with operations in London, Nairobi, Lagos and New York, applying capital market expertise to development finance initiatives in Africa and other frontier markets. Authorized and regulated by the UK Financial Conduct Authority (FCA), Lion's Head's experience includes fund management, capital markets and financial advisory work across financial inclusion, trade, renewable energy, agriculture and health sectors.



BACK TO TOP

Macroeconomic Summary

In 2019, macroeconomic conditions in Africa remained broadly subdued, with an estimated growth rate of 3.4%. While certain markets, including Cote d'Ivoire and Ethiopia, saw strong rates of growth, continued fragilities in many commodity-reliant countries as well as North and Southern Africa put pressure on the region's overall growth rate.

East Africa remained the fastest growing region in the continent, attaining an estimated growth of 6.0% in 2019, compared to the continental average of 3.4%. This is attributed to increasing investments in infrastructure, growing domestic demand, and increase in foreign investment.

West Africa attained an estimated growth of 3.5% in 2019, a marginal improvement from 3.3% in 2018. The robust growth in WAEMU was offset by sluggish performance in Nigeria's economy. Central Africa remained fragile, although a marked improvement was seen in 2019 with an estimated rise in growth to 2.7%, up from 1.6% in 2018.

Southern Africa faced the most severe challenges, with subdued economic growth in most countries. Challenges included dwindling investor confidence and weak investment, less manufacturing activity due to energy shortages, high unemployment, and natural climate disasters that threatened the economic stability of the region. 2019 saw record global off-grid solar turnover estimated at USD 1.7 billion, out of which SSA accounted for USD 1.02 billion, representing 30% annual growth. Turnover grew in most African markets to generate over USD 5 million sales for the year – though growth remains concentrated in a handful of countries and in the last 12 months was particularly focused on Kenya and Ethiopia.

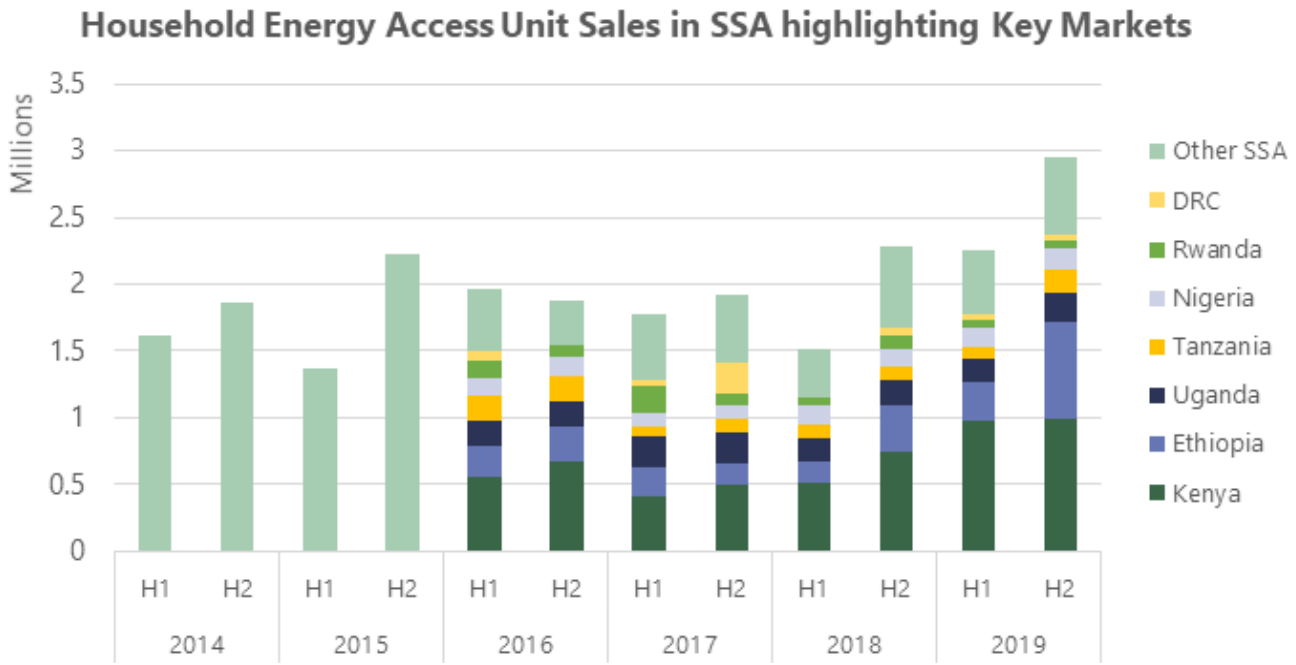
In absolute numbers, GOGLA estimates that total live products as of end of H1 2019 were 84 million, comprised of 79% Pico Solar products and 21% SHS products. Preference depend on market dynamics and consumer behaviours - Kenya is roughly 50/50 unit sales between cash and PAYGO with growth favouring PAYGO, Ethiopia is heavily skewed to cash for sales and growth, Nigeria is relatively stagnant, Tanzania has seen a resurgence in cash sales, while Uganda and West African markets have PAYGO growth and plateauing/falling cash sales. This overall market growth has been accompanied by a number of general developments in sector.

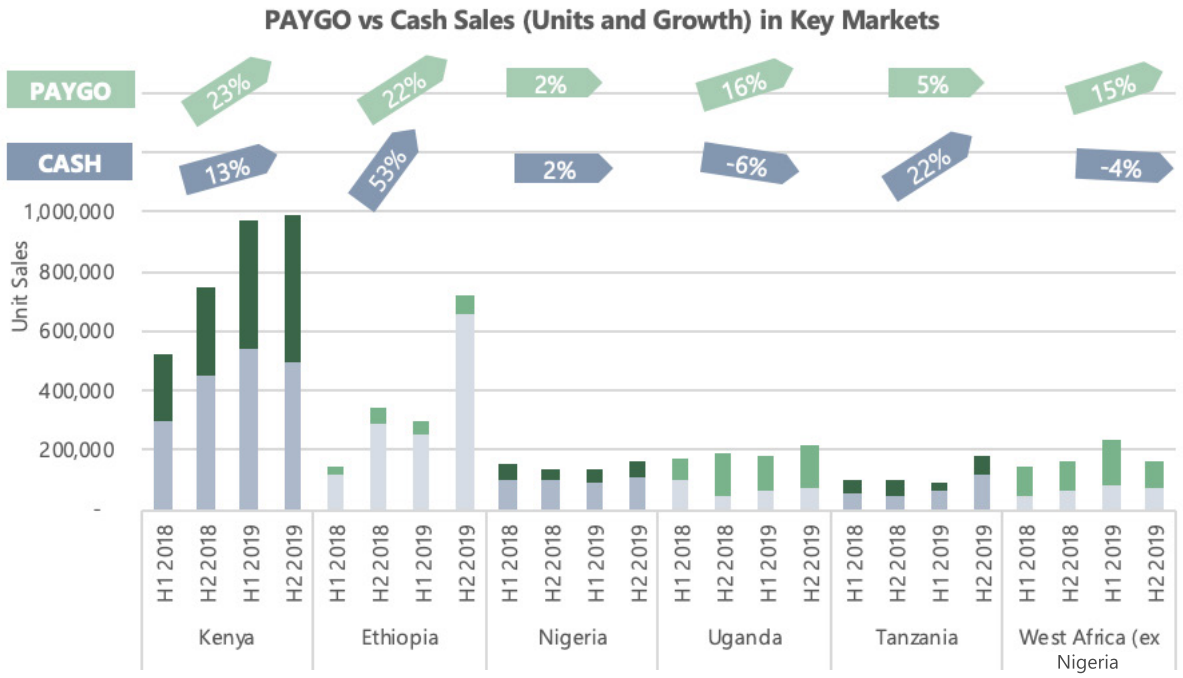
Conservative geographic expansion by the larger players. Companies are more aware than ever of the risk of over-stretching and use of equity funding rather than cover period until profitability. While there is some new activity, more established players have now a phased and methodical approach to expansion into new markets to acknowledge the challenges of tailoring products and services and building out strong local teams.

Increased range of products and services. Companies recognise that different consumers demand different products. There is scope to capture larger value from the consumers already accessed by companies. As such the market is seeing larger systems, larger and wider range of appliances and focus on productive use and telecoms as levers to drive growth.

Second generation companies proving themselves. Given the above, and with the technology and business model more or less established, the next generation of companies with a focus on one/two key initial markets and 2-4 years operations are expanding energy access products to new and more challenging markets where local knowledge and focus are essential (almost all of the Nigerian companies, upOwa, EasySolar, Yellow Solar, Nuru). This growth is being positively encouraged by donor interventions such as REA in Nigeria, Power Africa in Malawi, DFID in Mozambique.

Fertile ground for specialisation. These companies are increasingly disaggregating the business model using third party supply chains (BioLite, GLP, Rural Spark, Auxana), software (Angaza, Solaris) and financing (Sterling Bank, Finca, Baobab, MTN) to simplify operations, reduce costs and leverage established networks for rapid growth.


Household Energy Access Unit Sales in SSA highlighting Key Markets
Millions
3.5
3
2.5
2
1.5
1
0.5
0
H1
H2
2014
2015
2016
2017
2018
2019
Other SSA
DRC
Rwanda
Nigeria
Tanzania
Uganda
Ethiopia
Kenya


PAYGO vs Cash Sales (Units and Growth) in Key Markets
PAYGO
23%
22%
2%
16%
5%
15%
CASH
13%
53%
2%
-6%
22%
-4%
Unit Sales
1,000,000
800,000
600,000
400,000
200,000
-
H1 2018
H2 2018
H1 2019
H2 2019
Kenya
Ethiopia
Nigeria
Uganda
Tanzania
West Africa (ex Nigeria

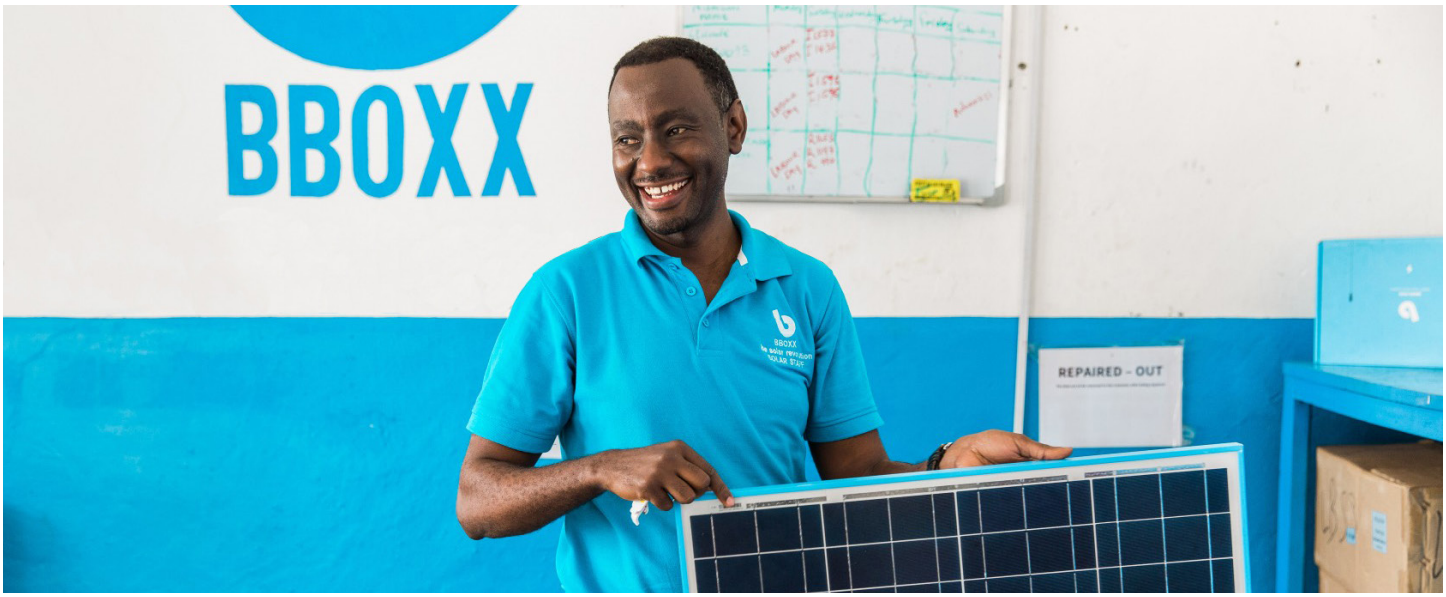
BACK TO TOP

Financing

2019 saw capital inflows in excess of USD 200 m invested in more than 20 companies in SSA. Of the publicly disclosed transactions, equity investments were approximately USD 120m in 10 companies, the largest being a USD 50m investment in BBOXX by Mitsubishi Corporation, ENGIE, MKB, DOEN and Bamboo Capital. Other notable equity investments include USD 26m in Azuri by Marubeni Corporation and USD 9m in Arnergy, a distributed energy utility company operating in Nigeria. On the debt front, the sector saw more than USD 80m investment deals in 12 companies, including the SunCulture and BBOXX Rwanda investments made by FEI-OGEF. The largest debt investment in 2019 was USD 18m d.light deal through a consortium of lenders including SunFunder, DWM and SIMA Funds; OGEF plans to join this syndicate in 2020.

New funds and intermediaries were launched with a combined size of more than USD 700m. Fund Manager notes that:

- Across all investors, there is a general shift to more specialisation by geography, segment / technology and ticket size in order to promote specific strategies (e.g. Rockefeller Foundation's focus on minigrids);
- Strategic investors – utilities, industrial companies and developers from established markets - are becoming significant equity investors offering partnership and exits for longstanding patient investors, with EDF, EDP, Engie, Mitsubishi, TATA, Mahindra, Rolls Royce all expanding operations in the region;
- There is a proactive return to equity and mezzanine strategies in recognition that specilised funds (EAVF, KawiSafi) as well as generalists (Helios, AIIF, Investec, Blue Haven) have had mixed experiences and limited bandwidth to support the breadth and diversity of opportunities in the market but instead have to focus on promoting best in class companies in a given sub-segment;
- Local lenders remain largerly excluded – with many still only coming to market when driven by donor credit lines (BRD, BPR, Bank of Industry in Nigeria);
- Transaction management and implementation has become more defensive and territorial in particular driven by lenders. This reflects increased competition for deal flow and activity, as well as wariness created by restructurings and insolvencies for major market players



including Mobisol, Solar Now and Solar Kiosk, and lower profitability and growth across the sector. Taken together, these have prompted unsecured lenders and secured lenders to limit co-lending even in instance where there is no financial value placed on collateral assets through negative pledges and/or restrictions on releasing assets from all asset debentures. OGEF has been designed to promote a more structured approach to establish precedents for shared and or ringfenced security – and the Fund Manager will continue to promote a more collaborative and coordinated approach to provide more dynamic funding for companies' working capital needs.

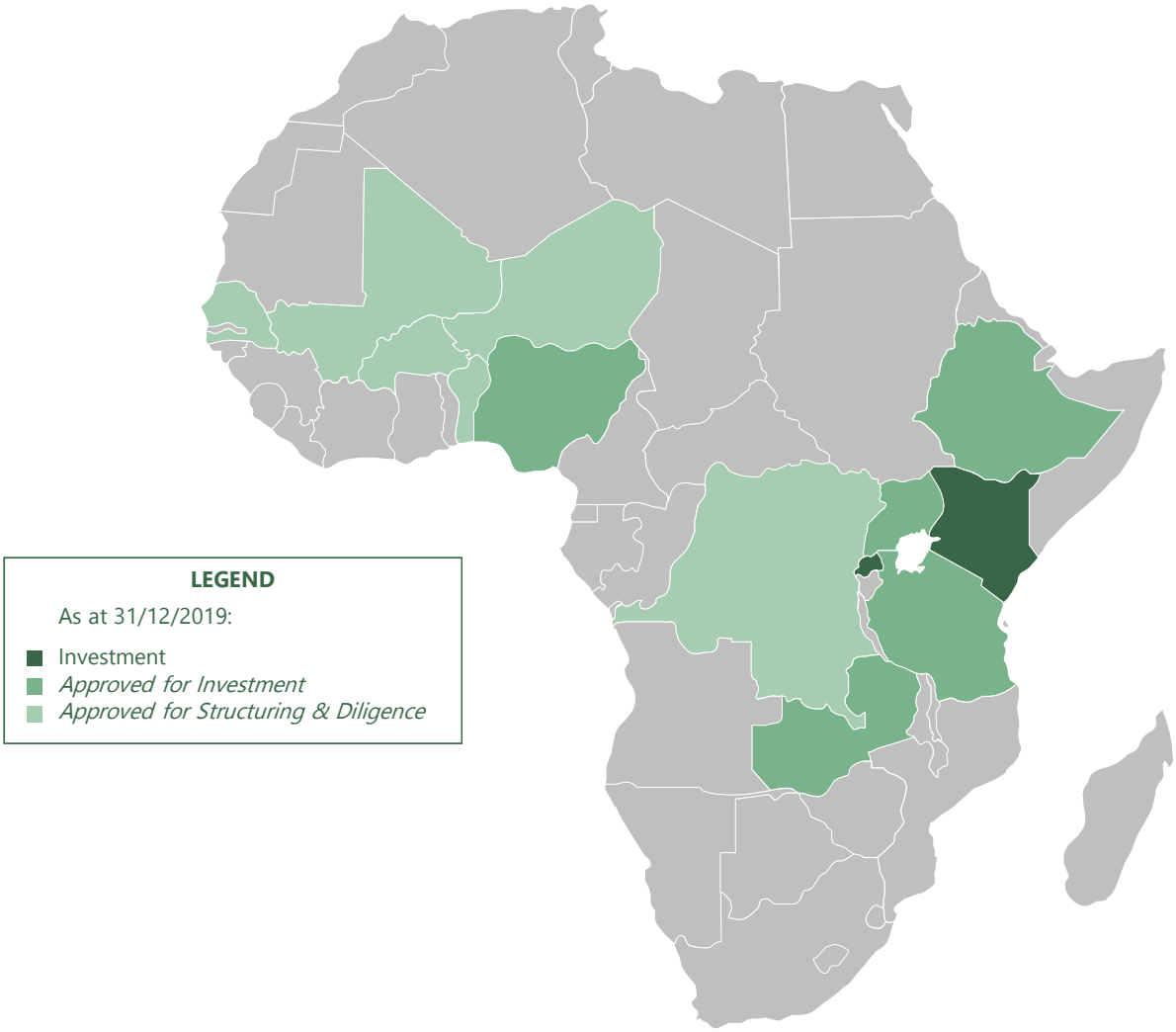
Activity

OGEF held seven IC meetings from launch to year end 2019 reviewing thirteen investment memos (eight remain active) and four investment proposals (three remain active).As of 31st December 2019, the Fund had made two investments with an outstanding commitment of USD 10.25m and disbursed capital of USD 6.9m.

Geography

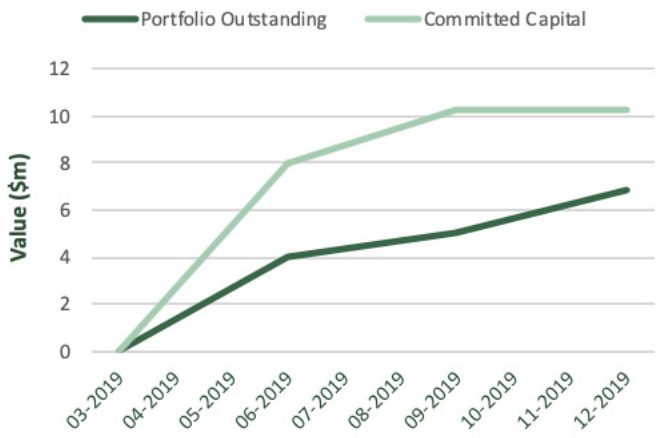
OGEF was created to deploy funds across Africa rather than focus on specific countries or regions. The outstanding portfolio at year end was focused on Kenya and Rwanda, with a wider pipeline of fully and partially approved transactions spanning the rest of the continent.

Distribution of Dealflow in 2019



BACK TO TOP

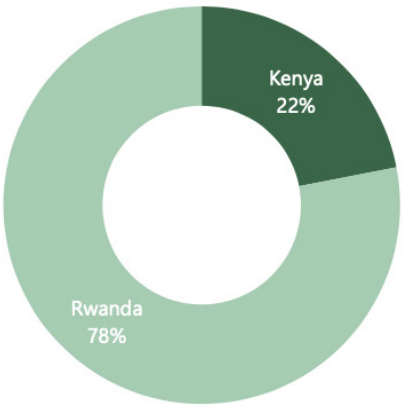
Portfolio Review



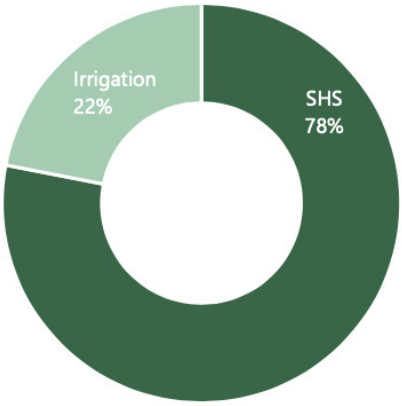
Portfolio Summary	USD m
Disbursed Capital	6.9
Committed Capital (incl. disbursed)	10.25
Investable Capital*	73.0
Investments (#)	2
Companies (#)	2
Countries (#)	2

Cash in Bank & Undrawn Capital

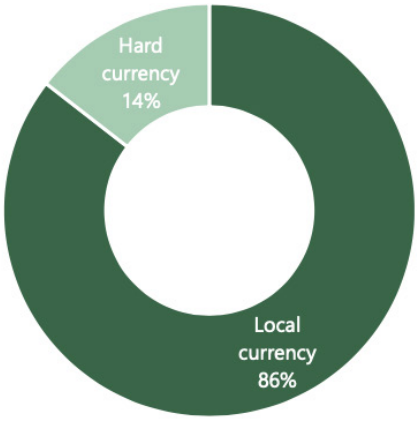
COMMITTED PORTFOLIO BY COUNTRY (%)



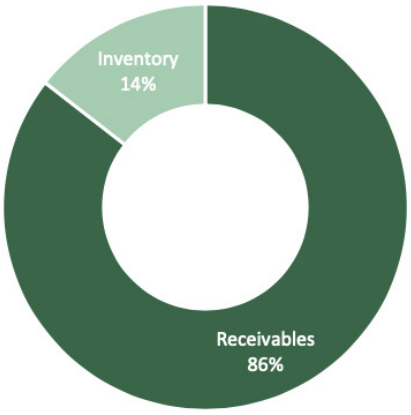
COMMITTED PORTFOLIO BY SECTOR (%)



DISBURSED PORTFOLIO BY CURRENCY



DISBURSED PORTFOLIO BY DEAL TYPE



Transactions

BBOXX Capital Rwanda Limited

BBOXX is a UK headquartered PAYG SHS company. Since 2011 the company has distributed 150,000+ systems in 35 countries. The company designs and develops its own hardware and software and manufactures products through a wholly owned Chinese subsidiary. For sales and distribution, BBOXX operates a franchise model in most countries; however, the group directly manages subsidiaries in Rwanda, DRC, Togo and Kenya.

In June 2019, FEI-OGEF invested USD 8 million equivalent in Rwanda Francs in BBOXX Capital Rwanda, to facilitate the growth of operations in Rwanda. The on-balance sheet investment has a tenor of 5 years with a bullet repayment structure, reducing the company's medium term principal repayments pressure, while allowing for refinancing at maturity.

The loan is secured by a pool of named receivables updated on a quarterly basis. This pool of security is dynamic – as contracts mature or are no longer performing, BBOXX removes underperforming contracts (set as those falling below 65% utilisation) and assigns alternative contracts to the pool to maintain the overall value of the security. In order to qualify for inclusion in the collateral pool a contract must have a minimum utilisation rate of 80% and minimum 3-month vintage in order to eliminate early defaulters.

SunCulture Kenya Limited

SunCulture Kenya Limited is the only operational subsidiary of Savant Group Limited focused on providing solar irrigation and agriculture products to smallholder farmers across Africa. The company designs and develops its own software and hardware and carries out field tests with rural farmers in Kenya. Manufacturing is outsourced to contract manufacturers in China.

In August 2019, FEI-OGEF invested USD 2.25 million in SunCulture Kenya Ltd to finance purchase of inventory from China and importation into Kenya, where assets are warehoused and distributed to customers. The transaction is on-balance sheet with a 2-year bullet structure, reducing medium pressure on refinancing, and was SunCulture's first corporate debt deal.

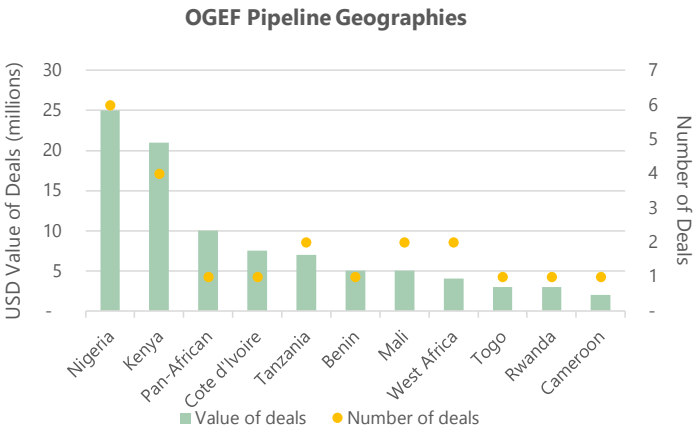
While the facility is guaranteed by the parent, the commercial focus of the security is SunCulture Kenya Ltd's inventory and an associated inventory cash account. Inventory used as collateral in the transaction is discounted in line with internal stock management, depending on delays in the supply chain and changes in sales volumes (and thus potential resale value).

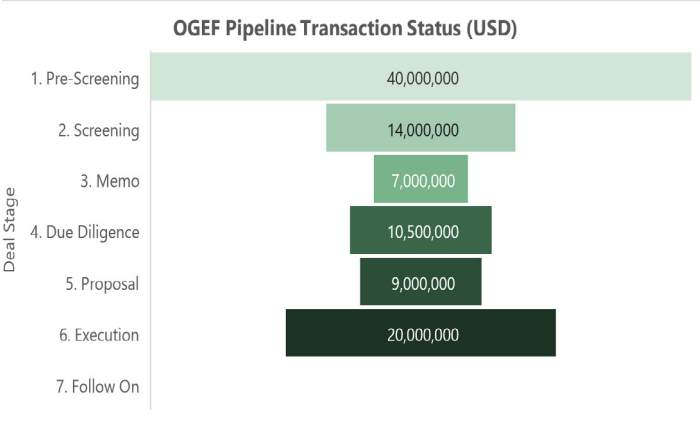
Pipeline

OGEF had a diversified and active pipeline of transactions at the end of 2019.

As at 31st December 2019, the Fund's pipeline had two transaction approved by the Investment Committee pending execution each valued at USD 10m, three transactions in proposal stage for USD 2m to USD 4m value and a further USD 10.5m across three transactions that had passed initial review by the investment committee. In addition, the manager was preparing over USD 60m of potential transactions with USD 21m in concrete screening and memo preparation in anticipation of presentation to the Investment Committee.

The overall distribution status of the Fund's pipeline at year end 2019 was as shown below:





In part driven by a desire to develop this pipeline and in part due to OGEF's role as respected energy access sector stakeholder, the Fund participated in a large number of industry events over the course of the year notably including:

- 5th ARE Energy Access Forum;
- AVCA Annual Conference;
- GOGLA Annual Meetings;
- SEforALL Charrettes;
- African Energy Forum;
- Off-Grid Energy Access Forum;
- Unlocking Solar Capital Africa;
- Africa Investment Forum;
- EEP Knowledge Exchange Forum.

Measuring Impact

The Fund's impact thesis is grounded in the overall objective to facilitate access to long-term and short-term debt funding in local and hard currency to enhance the efficiency and affordability of African businesses supporting energy access at the consumer level.

OGEF's impact framework is broken into two sections:
1) impact outcomes linked to the Fund Manager's profile, and
2) four broad impact objectives at the Borrower level

	Objectives	Description
1	Fund Manager Profile	Fund manager's role in job creation and enhancing fiscal benefit derived from the Fund's operations
2	Borrower Level Impact	
	Increased access to finance	Improving access to sustainable funding for Africa's emerging off-grid energy-access finance providers who provide payment solutions and access to Solar Home Systems through leasing or PAYG model
	Increased access to renewable energy	Increased renewable energy access for MSMEs and households without access to stable on-grid power supply
	Environmental, Economic, and Social Benefits	Additional economic, social and environmental benefits resulting from increased energy access
	Improved Financing Environment	Improved financing environment for borrowers and improving the financial capacity of local banks to engage with the energy access sector

Summary Impact Results

This report presents the E&S impact performance of FEI OGEF in 2019 as defined by the Fund's Social and Environmental Management System. As of 31st December 2019, the Fund had made two investments in Kenya and Rwanda, amounting to USD 6.9m. Impact metrics for the two companies are broadly standardised with a few differences on sector-specific metrics.

ENVIRONMENTAL AND SOCIAL IMPACT

SDG	METRIC	FUND MANAGER	BORROWER
1 NO POVERTY	End user USD savings over the product life	-	14,275
	Increased revenue per household per year - USD	-	2,300
2 ZERO HUNGER	Number of solar irrigation units financed by OGEF investment	-	2,260
3 GOOD HEALTH AND WELL-BEING	Number of customers using products to offset kerosene use	-	9,100
5 GENDER EQUALITY	% female employees	43%	21%
	% female senior management	33%	33%
7 AFFORDABLE AND CLEAN ENERGY	Total number of active customers	-	65,188
	Average utilisation rate	-	76%
8 DECENT WORK AND ECONOMIC GROWTH	Number of employees	14	290
	Number of jobs created by SMEs using products	-	3,485
	Use of product to support enterprise	-	58%
9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	Units financed	-	15,260
	Local sourcing	-	32%
13 CLIMATE ACTION	GHG Savings (Metric Tons CO2e)	-	15,156
17 PARTNERSHIPS FOR THE GOALS	Net financial flows to government (USD)	768,755	1,354,317
	Third-party co-investment (USD)	2,000,000	-
	Local bank funding (USD and % of total)	-	251,630 (4%)

THE FUND

c/o Estera Management
6th Floor, Tower A,
1 CyberCity,
Ebene 72201
Port Louis, Mauritius

W: www.ogefafrica.com
E: info@ogefafrica.com

FUND MANAGER

LHGP Asset Management 18 Ltd,
130 Buckingham Palace Road,
London SW1W 9SA
United Kingdom

W: www.lhgp.com
E: info@lhgp.com