



Japheth Kibaar is a farmer who supplies Sorghum Pioneer Agencies in Meru, Kenya. Sorghum Pioneer Agencies, a gender-inclusive sorghum business, provides stable incomes for about 7,500 smallholder farmers. Photo credit: © Stuart Freedman/Argidius Foundation.

Performance Report

Q2 2016

OVERVIEW

In Q2 2016, Root Capital hit one of our most exciting milestones yet, reaching \$1 billion in cumulative lending since making our first loan in 2000. With those dollars, we have supported a remarkable 628 businesses with their capital needs, helping them increase the incomes of more than one million smallholder farmers. Together, those farmers have been environmental stewards of more than 1.65 million hectares, preserving vital resources such as soil fertility and water quality for generations to come. Perhaps most exciting is the business growth that \$1 billion in loans has unlocked: our lending over the last 16 years has contributed to more than \$6 billion in revenue for our clients, and more than 80 percent of that has been paid directly to farmers.

Reaching \$1 billion in disbursements represents a major moment for us, but more so for the clients and farm families we serve. As we take stock of what we have accomplished, one thing remains clear: none of this would have been possible without funders whose collaboration and generosity allows us to serve our clients.

Root Capital has always worked where few others toil, providing capital and training to improve the livelihoods of people at the end of the dirt road. We have continually sought to push the frontier of agricultural lending — heading into places like the Democratic Republic of the Congo (DRC), reaching businesses in underserved local value chains and offering innovative services like training in mobile technology — to create proof points and blueprints for others to follow. The journey as a pioneer is not always easy; we, like our clients and the farmers they serve, face daunting challenges every day. Helping businesses confront those challenges and overcome deep market failures is at the heart of why we exist.

The myriad challenges that [we have reported previously](#) — risk factors around volatility in the commodity and foreign currency markets, coffee leaf rust, erratic weather patterns — persisted through Q2. These are deep-rooted challenges, and they will likely continue to affect portfolio performance and quality for the next several quarters to come. As you will see from the financial performance detailed below, we are experiencing an operating deficit halfway through the year, and we expect to post one at year end. In the midst of these challenges, we continue to exercise cost discipline, work to strengthen our balance sheet and pursue off-balance-sheet opportunities that allow us to broaden our reach and expand our lending base while moderating our direct risk exposure.

In Q2, the Council on Smallholder Agricultural Finance (CSAF) published its [2015 Year in Review](#), highlighting growth trends and risk factors affecting the nine CSAF members, Root Capital included. Among other findings, the report underscores that Root Capital is not alone; in 2015, growth slowed substantially for the sector, declining from 64 percent in 2014 to 5 percent in 2015. CSAF members also collectively reported a doubling in risk in their portfolios, citing commodity price volatility, crop failure due to diseases and extreme weather events and currency volatility as the top three factors adversely affecting portfolio quality. While the challenges and risks discussed in these pages are felt by lenders, it is important to note that they are more acutely felt by the clients we serve and the farmers who rely on them for their livelihoods.

Through the first half of 2016, investors like the Overseas Private Investment Corporation (OPIC) doubled down on their commitments, and new philanthropic partners like the IKEA Foundation and the Cartier Charitable Foundation signed up to support Root Capital, helping us expand our reach and our impact on our clients. These funders play a critical role, but the need is great, especially during times of increased hardship and vulnerability for farmers.

Portfolio Performance and Impact

The 267 enterprises we reached in Q2 2016 connected more than 695,600 smallholder farmers to local, regional and global markets. These clients are on track to generate \$1.15 billion in revenue this year, about \$932 million of which will be paid directly to producers.

In Q2, continued challenges within the global specialty coffee market led to materially lower activity in South America and Rwanda. Root Capital's average outstanding balance declined 11 percent year over year to \$92 million, as clients dealt with low prices and many struggled to secure contracts for certified coffee. Two additional factors further compounded these long-standing coffee market challenges throughout Q2:

- A [widespread, 45-day transportation strike in Colombia](#) (now resolved) that prevented coffee, among other agricultural products, from being brought to market. According to Global Coffee Monitor, [Colombian coffee exports in July were 50 percent below normal](#). The strike came on the heels of a poor coffee-growing season, as drought and higher-than-normal temperatures associated with El Niño reduced coffee quality.
- In May, the Rwandan government instituted a new zoning policy that requires coffee farmers to sell their product to coffee washing stations within their geographic zone. The policy is intended to [apportion work more equally across coffee washing stations](#) in the country, thereby facilitating farmer access and increasing the amount of fully washed coffee in the market. While expected to be an overall positive development for farmers, the policy has led to reduced demand, and therefore decreased credit needs, of coffee washing stations run by key Root Capital clients.

The noteworthy exception to lower-than-expected lending activity within the coffee sector was in the Democratic Republic of the Congo (DRC), a country in which specialty coffee farmer associations have played an instrumental role in building peace, hope and better livelihoods for farmers. In Q2, as [demand for DRC-produced coffee swelled](#), we disbursed \$2.93 million to seven clients serving nearly 23,000 producers in the DRC, up 87 percent from the same period last year. According to data from the Council on Smallholder Agricultural Finance (CSAF), Root Capital accounted for 90 percent of credit disbursed by CSAF lenders to businesses in the DRC during 2015.

In Q2 2016, loans to coffee businesses comprised slightly less than half (47 percent) of Root Capital's average outstanding balance, in line with the 2015 industry average of 46 percent. Cashew and cocoa were our next largest industries outside of coffee, respectively comprising 6 percent and 5.6 percent of the quarter's average outstanding balance. Collectively, loans to non-coffee businesses such as cocoa, nuts, grains and seed businesses (classified as "other agriculture" industries on page 7) made up 43 percent of Root Capital's Q2 average outstanding balance. Loans to clients classified in "non-agriculture" industries such as handicrafts and textiles accounted for 10 percent of the Q2 average outstanding balance.

Portfolio Quality

Root Capital ended Q2 with a Portfolio-at-Risk (PAR) greater than 90 days of 10.6 percent. The total outstanding balance in PAR over 90 days was \$8.8 million, up from \$5.1 million in Q2 2015 but down from \$10.1 million last quarter. In Q2, we downgraded \$1.46 million in loans to nine clients. Two loans totaling \$424,000, both previously in PAR over 90 days, were repaid in full during the quarter.

During the quarter, we wrote off eight loans totaling \$2.1 million, bringing our 12-month net write-off rate to 5.5 percent. The vast majority of that amount was due to the write-off of a \$1.7 million loan to a canned vegetable

business in Peru that experienced prolonged liquidity issues. Root Capital continues to make its best efforts to collect on all loans that have been written off; in Q2, recoveries, including for guaranteed loans, amounted to approximately \$193,000.

Advisory Services

Beyond lending, Root Capital is also well-positioned to provide a range of services that strengthen and build the capacity of businesses in Latin America and Africa. In challenging market contexts, we believe that trainings and workshops focused on financial management, agronomic planning, and mobile technology are more important than ever for helping our clients — and the farmers they serve — weather challenges. During Q2, the Advisory Services team delivered 688 days of training to 121 businesses, representing a 42 percent increase over Q2 activity in 2015. This brings the current total to 1,073 days of training year to date for 154 groups, respectively representing 51 percent and 55 percent of our 2016 targets.

Notably, 16 percent of the training days from Q2 were focused on topics other than financial management (up from eight percent in Q2 2015), reflecting a continuous effort to address a broader spectrum of client risks and barriers to growth. Through Q2, for example, we offered mobile technology services to over 20 businesses in Latin America, helping them digitize their manual data collection and analysis processes. In April, we hosted a five-day mobile advisory workshop in Peru as the capstone exercise for seven clients who have been digitizing their farm-level inspections to enable improved analyses and business decisions by cooperative managers.

Through the first half of the year, we also expanded our collaboration with [Partners in Food Solutions](#), a close ally in East Africa since 2010, in order to connect food science expertise from top-tier food companies in the United States and Europe (e.g., General Mills, Cargill, Royal DSM, Bühler and Hershey) with our current and prospective processor clients in West Africa. These volunteer experts provide pro-bono advisory on topics like food safety, equipment selection, plant layout, nutritional enhancement and packaging. The work with Partners in Food Solutions formally launched in Ghana during the first quarter of the year, and to date, 10 food processing businesses have received a total of 43 days of Advisory Services. During Q2, the partnership expanded to the Ivory Coast with the hire of a local Food Technologist who will coordinate future client engagements.

Conclusion

We continue to see growing momentum in support of rural entrepreneurship and a broad recognition of the essential role our clients play in improving food security, increasing farmer livelihoods and igniting local economic growth. In Q2, Root Capital CEO Willy Foote participated in several high-profile events where he spoke about the range of opportunities that agriculture presents for entrepreneurial development and technological innovation. He spoke first at the [Global Entrepreneurship Summit](#), convened by President Obama at Stanford University, and later at the White House Summit on Global Development, which came on the heels of the landmark passage of the Global Food Security Act.

Indeed, investing in agricultural entrepreneurship in places where commercial markets are insufficient has never been more relevant, or more necessary. Through all the milestones and celebrations, the bumps and bruises, we remain committed to making agriculture work for smallholders and the businesses that link them to markets. We are grateful for our donors and investors whose support allows us to blend debt capital with philanthropic contributions to make markets work while generating impact well beyond what would otherwise be possible. Your ongoing and steadfast support enables us to continue addressing the myriad challenges faced by our clients and to fuel businesses that are engines of transformation in rural communities all over the world.

Q2 2016 DASHBOARD

Metric	Result	Full Year Target (unless otherwise noted)	Results as % of Target
Social and Environmental Metrics			
Number of Producers Reached	696K	760K	91%
<i>Producers supplying business</i>	564K	601K	94%
<i>Producers buying inputs</i>	131K	159K	82%
Purchases from Producers	\$931.9M	\$1.1B	89%
Total Revenue of businesses	\$1.1B	\$1.3B	89%
Sustainable Hectares under Management	571K	669K	85%
Lending Program			
Loan Disbursements	\$60.5M	\$137.9M	44%
Average Outstanding Portfolio Balance ¹	\$92.0M	\$106.3M	87%
Average Outstanding Balance per Active Loan	\$346K	\$397K	87%
Number of Clients Reached ²	267	323	83%
<i>Clients Reached, Current</i>	218	247	88%
Portfolio-at-Risk Over 90 Days *	10.6%	< 7.0%	
Net Write-off Ratio *	5.5%	< 6.0%	
Advisory Services			
Number of Businesses Served	154	282	55%
Days of Training Delivered	1073	2107	51%
Operating Results			
Total Operating Expense	\$7.3M	\$15.8M	46%
Debt to Equity Ratio*	3.51	< 5.00	
Capital Utilization *	86%	90%	96%

¹ Average Outstanding Balance figures are for Q2 only. During Q2, we updated the average outstanding balance calculation to reflect foreign-exchange gains or losses in the lending portfolio. All average balances presented in this report for current and historical periods are calculated using this new methodology, as are ratios in which average portfolio balance is an input.

² Starting in Q1 2016 "Clients Reached" includes the total number of clients with an outstanding balance at any point in the quarter. Previously, only clients with current loans were included as reached in that quarter.

* Figures represent performance on last day of quarter.

Terms and Acronyms

Clients Reached: We report "clients reached" to capture the number of businesses reached by our capital. Clients reached are those that had an outstanding balance at any point in the quarter, including clients that did not receive a disbursement in the quarter. This is a cumulative metric; clients are added to the annual total in the quarter in which they are first reached.

Gender-Inclusive Clients: By Root Capital's definition, a gender-inclusive business either has a supplier and nonmanagerial employee base composed of 30 percent women or more, or is made up of 20 percent women or more and has a woman leader.

Net Write-off Ratio: A trailing 12-month figure representing the previous 12 months' write-offs, net of recovered funds, as a percentage of the average outstanding balance during the same period.

Debt to Equity: Notes payable and other debt, divided by lending net assets. Our calculation treats long-term subordinated debt as equity, reflecting its equity-like characteristics.

Capital Utilization: Capital utilization measures the proportion of available capital that is deployed in our lending portfolio at a point in time, calculated as: (Gross loans outstanding) / (Notes payable + lending net assets).

Region Acronyms: MAC (Meso America & Caribbean), SAM (South America), EAF (East Africa), WAF (West Africa), ASI (Asia [currently Indonesia only]).

PORTFOLIO PERFORMANCE

Social and Environmental Metrics

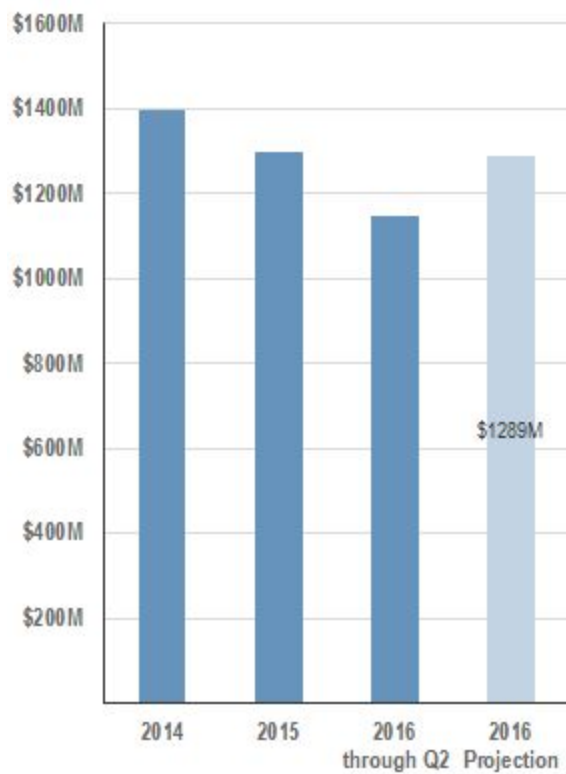
Producers Supplying Business



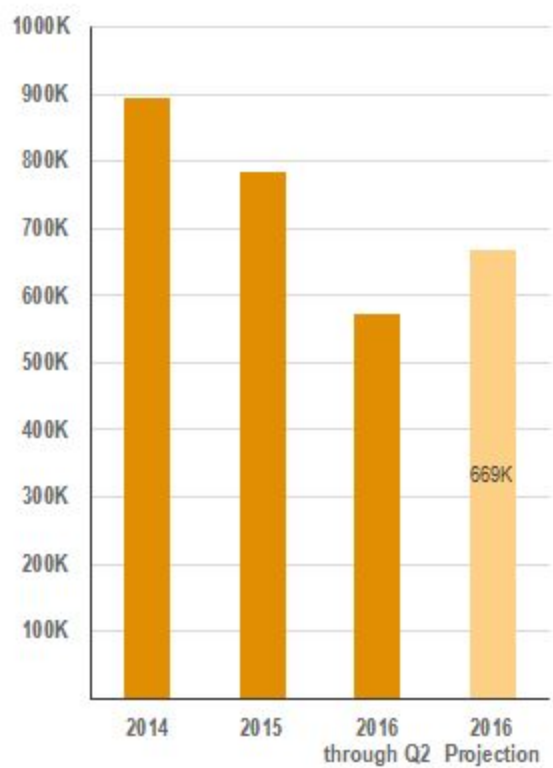
Purchases from Producers



Total Revenue of Businesses

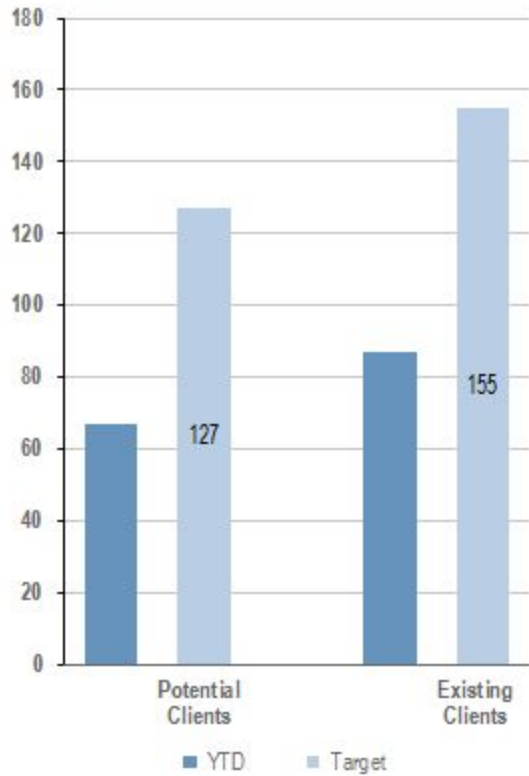


Sustainable Hectares Under Management

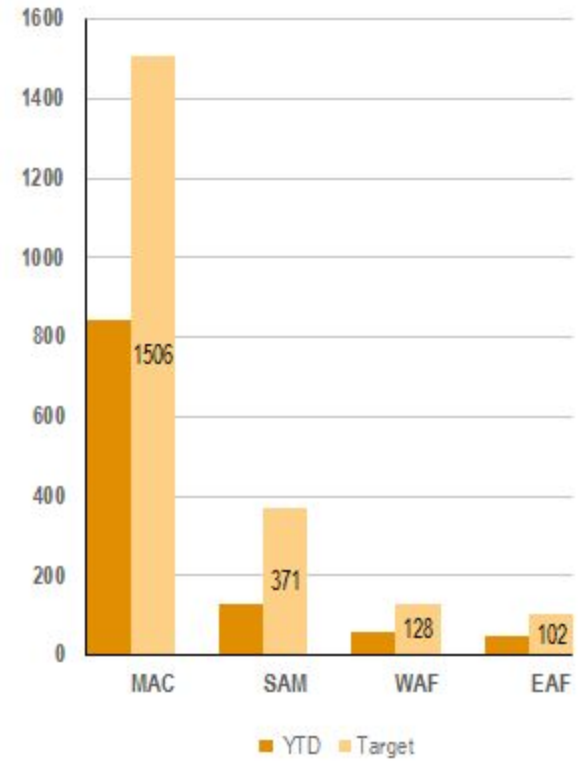


Advisory Services

Businesses Served (through Q2)

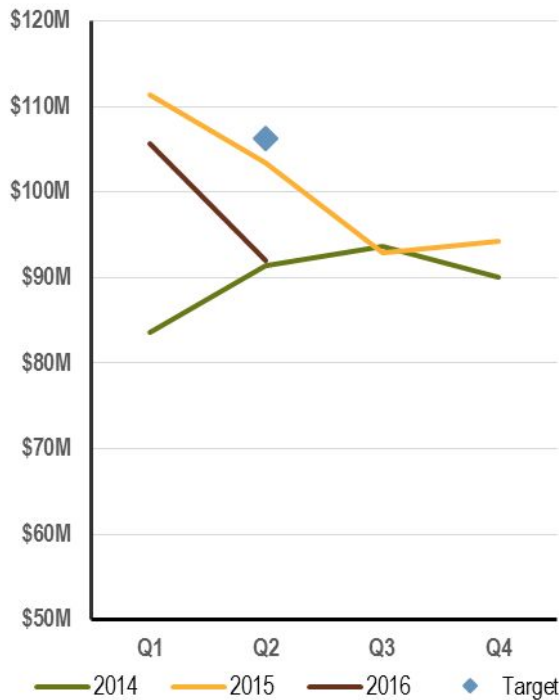


Days of Training Delivered (through Q2)

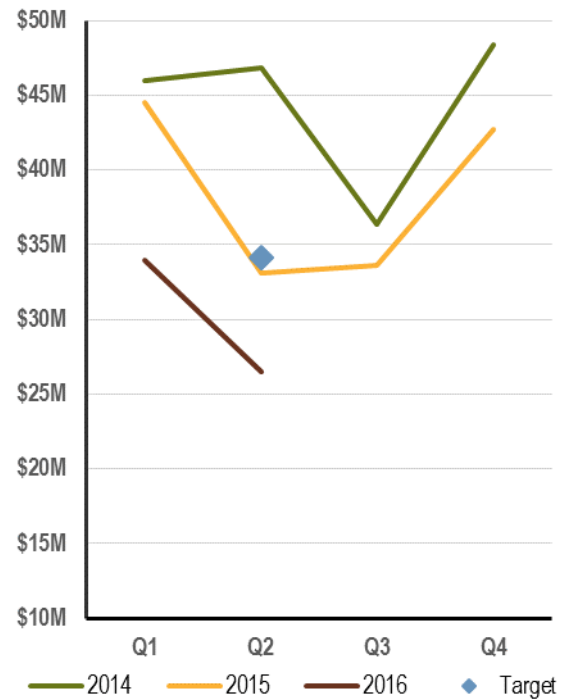


Lending Performance

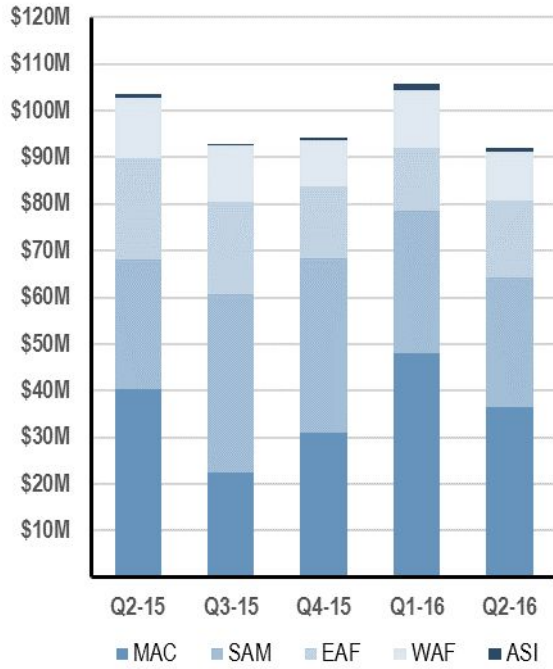
Average Balance by Year



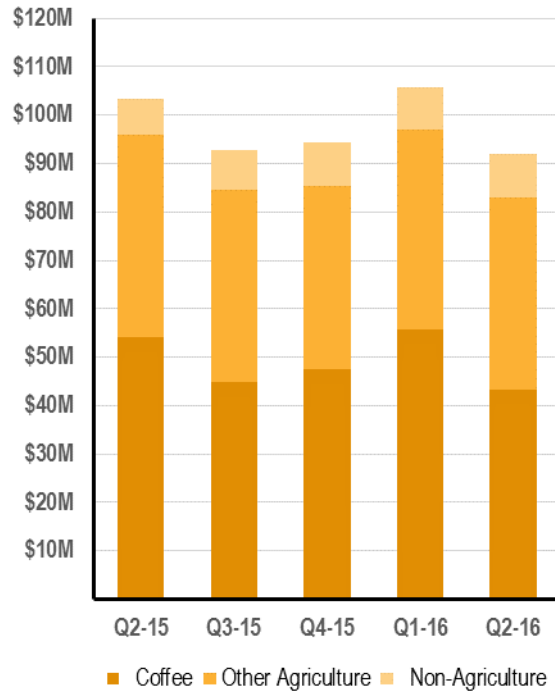
Loan Disbursements by Year



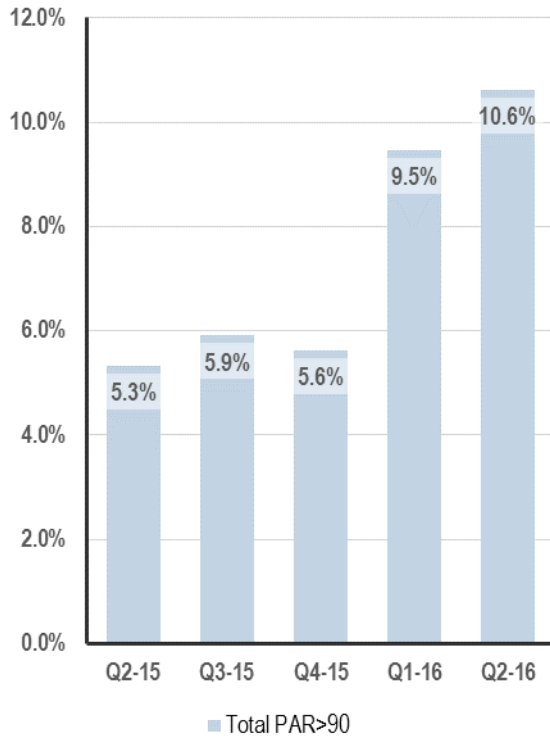
Average Balance by Region (Trailing 5 Quarters)



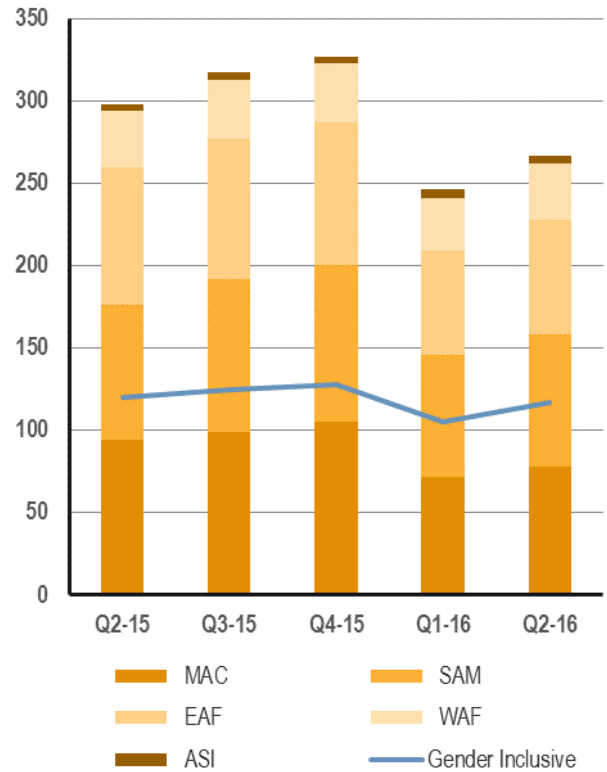
Average Balance by Industry (Trailing 5 Quarters)



Portfolio at Risk > 90 Days



Number of Clients Reached by Region



FINANCIAL RESULTS

Balance Sheet

Balance Sheet Highlights	06/30/16	06/30/15	Yr/Yr Growth
All numbers in thousands	Actual	Actual	
Cash and Short-Term Investments	33,533	32,334	4%
Total Loans Receivable	83,131	95,948	-13%
Less: Allowance for Credit Losses	(6,193)	(4,753)	30%
Loans Receivable (net)	76,935	91,195	-16%
Grants Receivable	3,874	5,538	-30%
Other Assets	7,280	5,519	32%
Total Assets	121,623	134,586	-10%
Total Debt	85,785	101,869	-16%
Subordinated Debt, Long-term	6,200	400	>1000%
Other Liabilities	6,056	2,603	133%
Total Liabilities	98,041	104,871	-7%
Lending Net Assets & Op Reserve	18,247	24,280	-25%
T/R Net Assets (Purpose & Time)	5,335	5,434	-2%
Total Net Assets	23,582	29,715	-21%
Total Liabilities & Net Assets	121,623	134,586	-10%

Key Financial Ratios	06/30/16	06/30/15	Yr/Yr Growth
	Actual	Results	
Debt-to-Equity Ratio	3.51	4.13	-62 bps
Capital Utilization	86%	85%	+1% pts

* \$8.3M of conditional grants are excluded from the T/R Net Assets, as required by US GAAP. As grant conditions are met in future periods, we will add to the T/R Net Assets.

** Debt-to-equity treats long-term subordinated debt (\$6.2M) as equity, reflecting its equity-like characteristics.

Balance Sheet

The quarter-end loan balance declined by 16 percent year-over-year due to the previously mentioned challenges in the premium coffee market that led to materially lower lending activity in South America and Rwanda in particular. Total Assets were further reduced by a 30 percent year-over-year increase in allowances for loan losses, as we provisioned for elevated credit risk in the portfolio.

While a year-to-date operating deficit of \$3 million eroded net assets, we maintained a low level of leverage with a debt-to-equity ratio of 3.5:1. In response, we reduced our debt under management to \$92 million and finished the quarter with an 86 percent capital utilization rate, slightly below our target of 90 percent. Over the quarter, we repaid more flexible sources of capital to manage to the decline in lending activity in Q2, ending the quarter with a modest amount of excess funds for lending. Over the past year, we have raised \$8.5 million in committed, long-term subordinated debt to compliment our net asset base. To date we have \$6.2 million of subordinated debt outstanding and will continue to draw on committed funds to support our balance sheet needs.

Temporarily Restricted Net Assets

We ended the quarter with a temporarily restricted net assets balance of \$5.3M, up from \$4.8M in Q1 2016. In addition, we currently hold \$8.3M of temporarily restricted assets off the balance sheet. The \$13.6M sum of on-balance-sheet and off-balance-sheet temporarily restricted assets represents a significant positive trend. This increase was due to the closing of conditional grants from key funding partners.

Statement of Activities

<i>In thousands of USD</i>	Statement of Activities		
	YTD Results	2015 YTD	Yr/Yr Growth
Loan Interest and Fees	4,664	6,579	-29%
Gain (loss) on FX Lending	(288)	(1,089)	-74%
Interest & Fee Revenue	4,375	5,490	-20%
Net Interest Expense	1,213	1,276	-5%
Net Interest & Fee Revenue	3,162	4,213	-25%
Provisioning Expense	3,650	2,806	30%
Net Revenue after Provisioning	(488)	1,407	-135%
Operating Expenses	7,317	7,494	-2%
Contributions for Operations	4,337	5,940	-27%
Other Income	380	25	>1000%
Operating Surplus / (Deficit)	(3,088)	(122)	N/A

Loan Interest and Fee Revenue

Loan Interest and Fee Revenue fell by 29 percent year over year as challenging coffee market dynamics dovetailed with regulatory issues in Rwanda and a devastating transportation strike in Colombia, which reduced top-line lending revenue. In addition, increased write-offs contributed to the decline in revenue earned year over year.

Funding Costs

Interest expense fell 5 percent as we reduced our level of debt funding in the face of lower loan demand.

Net Provisioning Expense

The Q2 net provisioning expense of \$1.4M was in line with expectations and down from Q1 (\$2.3M). Year to date, net provisioning remains elevated relative to Q2 2015 as a variety of client-specific issues in multiple geographies and industries adversely affected borrowers' ability to service their debt.

Operating Expense

Total operating expenses for the quarter were 7 percent lower than target as we implemented a number of cost saving measures in terms of personnel, external contractors and travel. Expenses remain tightly controlled to maintain a leaner operating structure during this period of heightened credit risk.

Contributions for Operations

As of June 30th, Root Capital has recognized \$4.3M in contribution revenue, \$2.2M during the period, and has secured over \$9M in new grant funding to be used in future periods, providing us with a total grant asset balance of over \$13.6M for future use. Specifically, in Q2 the Investor Relations team closed \$6.9M in new and renewing grants from key funding partners, including \$6.8 in new multi-year donations that will support Root Capital's work into 2021.

Disclosure

Interim financial data is deemed accurate, but is not audited. Annual audited financial statements will be provided to the Board of Directors, donors and investors. In the event of material differences, a reconciliation will also be provided. Additionally, past performance is not indicative, nor a guaranty, of future results, and no assurances can be given that the Notes will be repaid.

For additional information, please go to www.rootcapital.org or email info@rootcapital.org.

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