# Performance Report
# Q2 2018

*Cristhian Cruz, agronomic extension worker for Root Capital client Federación de Campesinos de Cauca.*

root capital

# OVERVIEW

Through the first half of 2018, Root Capital reached 183 businesses that connected 590,000 smallholder farmers—more than 222,000 of whom were women—to markets. These businesses generated $798 million in revenue, over 80 percent of which was paid directly to producers. In addition, we provided nearly 1,300 days of training to 276 agricultural businesses.

This impact is significant, particularly given the overall trends and challenges faced by agricultural lenders. The Council on Smallholder Agricultural Finance (CSAF), a pre-competitive alliance of 12 financial institutions serving small- and medium-sized agricultural enterprises—and of which Root Capital is a founding member—recently released its "2018 State of the Sector Report." The report noted tremendous growth in the sector over the past four years, with lending by CSAF members more than doubling from $345 million in 2013 to $716 million in 2017. Last year, financing from CSAF members collectively connected 2.2 million smallholder producers—35% of whom are women—to domestic and international markets, and provided 82,000 permanent jobs in rural communities.

However, over the 2016-2017 period, flat lending volumes, a reconcentration of lending in the coffee sector, and a decrease in the total number of borrowers signaled an industry-wide slowdown in lending activity. The report noted that lenders are having difficulty finding prospective borrowers that meet risk-adjusted returns expectations. This is due, in part, to continued market volatility, as well as legal, regulatory, and policy barriers that inhibit the growth of the agricultural finance market.

Despite these challenges, it remains clear that each of the businesses we support generates significant impact for its community—from improved livelihoods to job creation to climate resilience to opportunities for women and youth. Clients' impact is exemplified by businesses like ANEI, a cooperative of 700 indigenous Colombian farmers that Root Capital has financed since 2012. As a changing climate threatens farmers' livelihoods, ANEI has helped its producer members diversify into crops more suited to changing growing conditions, and has made investments in technology and training to boost farmer productivity. Read more about ANEI in our client profile at the end of this report.

### Portfolio Performance and Impact

Through Q2 2018, our average outstanding portfolio balance was $59.9 million, a 30 percent decline over this time last year and lower than projected. Likewise, disbursements during the first half of the year totaled $58.5 million, 21 percent lower than this time last year.

Lower balance and disbursements were largely due to lending results in Central America, a region that typically drives our peak lending period during the first and second quarters of the year. As previously reported, there were a number of factors that led to lower lending volumes, including: increased competition from other lenders, consolidation in the global coffee market that affected buying patterns in the coffee supply chain, a decline in the coffee price year over year, and decreased crop yields in Nicaragua and Honduras—two of our largest markets in the region.

The lower Central America lending activity coincided with lower-than-expected lending volumes in South America and West Africa. While lending activity in South America typically ramps up during the second quarter of the year, delays in the start of the coffee harvest in Peru, our largest market globally, pushed disbursements later in the quarter compared to last year. In addition, due to risk levels and performance of existing loans, there has been limited lending to businesses in West Africa as we continue to focus on managing existing loans in the portfolio and leading with more advisory support.

Loans to coffee businesses composed 54 percent ($32.5 million) of our year-to-date average portfolio balance, while processed nuts and cocoa businesses were the next largest industry exposures at $6.1 million (10 percent) and $4.8 million (8 percent), respectively. Seventy percent of loans in the portfolio were *additional*, meaning that through those loans Root Capital filled credit needs unmet by commercial lenders.

## Portfolio Quality

At the end of the second quarter, our Portfolio-at-Risk (PAR) greater than 90 days improved, declining to $4.4 million (7.7 percent) from $7.8 million (12.7 percent) last quarter. Year to date we wrote off $3.8 million of nonperforming loans, of which $2.6 million was written off during the second quarter. Over 85 percent of our second quarter write offs was to three borrowers: two cashew businesses in Benin and a pulse producer in Tanzania. We recovered $1.7 million in written-off balances year to date with $1.4 million being recovered in the second quarter, resulting in a trailing twelve-month net write-off ratio of 4.4 percent.

## Advisory Services

During the second quarter, Root Capital delivered over 750 days of training to more than 200 agricultural businesses across Latin America, Africa, and now Indonesia, bringing our total days of advisory training to date in 2018 to 1,296 days to 276 businesses. Nearly 70 percent of the businesses that received training were potential lending clients that continue to make advances toward financial preparedness.

In Q2, Root Capital also held its first-ever “Training of Trainers” event in Africa. This provided an opportunity for our advisors from eight countries, including Indonesia, to further develop their training methodologies and become immersed in Root Capital’s advisory curriculum.

In addition, through a project funded by USAID and Keurig Dr Pepper, we awarded small grants to ten clients in South America to implement projects designed to build resilience by improving farmer productivity, strengthening technical teams, and supporting rural youth. The projects—which range from investing in soil testing and conservation to training young producers in the art of coffee cupping—enable businesses to provide the next generation with valuable skills and the knowledge they need to lead in the future.

Workforce development is one of the biggest challenges for the agricultural businesses we support. While agriculture remains the dominant industry in many of the rural areas in which these businesses operate, fewer young people are seeking out agricultural careers, instead leaving their community farms behind to seek opportunities elsewhere. As part of our partnership with the Mastercard Foundation, we have developed a "Talent Partnership Program" that matches recent graduates with rural entrepreneurs, creating compelling careers in agriculture for young professionals and value for our client businesses. In the program's first year, we have supported four business entrepreneurs and young graduates across Senegal and Ghana, and will soon expand the program to Cote d'Ivoire. Read more about the program here.

**Financial Results**

At mid-year, Root Capital posted a $1.1 million deficit, which remained steady from the first quarter and in-line with our projections, as higher-than-expected contribution revenues offset the continued effects of elevated provisioning expense from the first quarter.

Gross provisioning expense for the first half of 2018 was $4.2 million, higher than projected. The increased provisioning expense resulted from downgrades of loans to businesses across a small number of sectors, from coffee to macadamia nuts to dried beans. However, strong recoveries of $1.7 million partially offset this expense, resulting in net provisioning of $2.4 million year to date. Notably, our second quarter net provisioning expense of $0.6 million was significantly below projections for the quarter of $0.9 million. Interest and fee revenue on our lending portfolio totaled $3.0 million, 10% behind year-to-date projections due to lending challenges in the first quarter. We continued to control costs, with year-to-date operating expenses falling five percent below projections.

At quarter-end, Root Capital's $57.2 million lending portfolio was supported by $9.5 million in net assets for lending and $8.5 million in long-term subordinated debt, resulting in a debt-to-equity ratio of 3.6x. In addition, we continued to have a strong level of grant commitments, with a total of $19.3 million in grant net assets, a 7 percent increase over this time last year.

We are excited to share that Root Capital and Investing in Women, an initiative of the Australian Government, launched a partnership this quarter to promote women's economic empowerment in Southeast Asia by financing agricultural enterprises owned or led by women. Investing in Women has committed AUD 2 million to Root Capital for the initial, year-long phase of a planned ten-year program. This will support our market research and exploration in three countries in the region: Indonesia (where we have built a lending presence over the last three years), Philippines, and Vietnam.

**Capital Partners**

Throughout 2018, we continue to meet the needs of certain businesses—particularly those with the largest credit needs—through off-balance sheet activities, including: participation sales, whereby lenders purchase portions of loans in our portfolio; syndicated lending, in which exposure is shared pro-rata among one or more partners; and Lending for African Farming Company (LAFCo), an African-domiciled investment company that targets small- and medium-sized enterprises that contribute to food security across the continent. Through the second quarter, the average balances in our Capital Partners' activities totaled $12.5 million: $7.7 million in participations and syndications and $4.8 million in LAFCo.

**Thought Leadership**

As we have noted in previous reports, we published our "efficient impact frontier" approach to integrating social and environmental impact into our risk-return framework in a feature article in the Winter 2017 *Stanford Social Innovation Review*. More recently, Root Capital worked with the Impact Management Project to publish "Constructing a portfolio on the efficient impact frontier within one asset class," which outlines four steps that any investor can take to implement the approach in their own context. Root Capital staff members have presented the approach at dozens of conferences, industry groups, financial institutions, nonprofits, and schools, and the article has been incorporated into syllabi in graduate programs in business and policy.

During the first half of the year, Root Capital launched the "Efficient Impact Frontier Collaboration," in which investors in diverse sectors and with different types of capital develop their own approaches to quantitatively integrate impact alongside financial risk and return. In addition, we have developed a simulation that allows participants to step into the shoes of an impact investor and build their own portfolio of loans based on data about those loans' impact, financial risk, and financial return. As part of our efforts to share these tools with the larger impact investing community, we have made the simulation and materials publicly available on our website. You can read more here.

**Conclusion**

With the first half of 2018 behind us, we are focused on the road that lies ahead. We are committed to addressing the myriad challenges faced by agricultural businesses at the end of the dirt road. Together, with your support, we are enabling those businesses to create more resilient and prosperous rural communities all over the world.

# SECOND QUARTER DASHBOARD

| Metric | Result | Full Year Target (unless otherwise noted) | Results as % of Target |
|---|---|---|---|
| Social and Environmental Metrics | | | |
| Number of Producers Reached | 590K | 595K | 99% |
| Purchases from Producers | $647M | $754M | 86% |
| Total Sales of Businesses | $798M | $979M | 81% |
| Sustainable Hectares under Management | 386K | 415K | 93% |
| Lending Program | | | |
| Loan Disbursements | $58.5M | $131.0M | 45% |
| Average Outstanding Portfolio Balance [1] | $59.9M | $66.8M | 90% |
| Average Outstanding Balance per Active Loan [1,2] | $388K | $388K | 100% |
| Number of Businesses Reached [3] | 183 | 225 | 81% |
| Portfolio-at-Risk Over 90 Days [1,4] | 7.7% | < 7.0% | |
| Net Write-off Ratio (Trailing 12 Months) [1,4] | 4.4% | < 6.0% | |
| Advisory Services | | | |
| Number of Businesses Served | 276 | 301 | 92% |
| Days of Training Delivered | 1296 | 1965 | 66% |
| Operating Results | | | |
| Total Operating Expense | $7.3M | $15.0M | 49% |
| Debt to Equity Ratio [4] | 3.6 | < 5.0 | |
| Capital Utilization [4] | 75% | 87% | 86% |
| Capital Partners | | | |
| Average Outstanding Balance [2] | $12.5M | $18.8M | 67% |
| Number of Businesses Reached [3] | 21 | n/a | |

*[1] As of December 31, 2017, we have segregated and removed a segment “other collateralized assets” from the PAR greater than 90 days and total portfolio balances. At the end of Q2, we held $5.0 million in other collateralized assets.*
*[2] Average balance targets are presented on a year-to-date basis.*
*[3] “Businesses Reached” includes the total number of clients with an outstanding loan balance at any point in the year-to-date period. See Terms and Acronyms below.*
*[4] Figures represent performance on last day of quarter.*

## Terms and Acronyms

**Businesses Reached:** We report “clients reached” to capture the number of businesses reached by our capital. Clients reached are those that had an outstanding loan 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.

**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 + unrestricted net assets).

**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.

**Gender-Inclusive Clients:** A gender-inclusive business either has a supplier and non-managerial employee base composed of 30 percent women or more, or is woman-led with 20 percent or greater participation by women producers and/or employees.

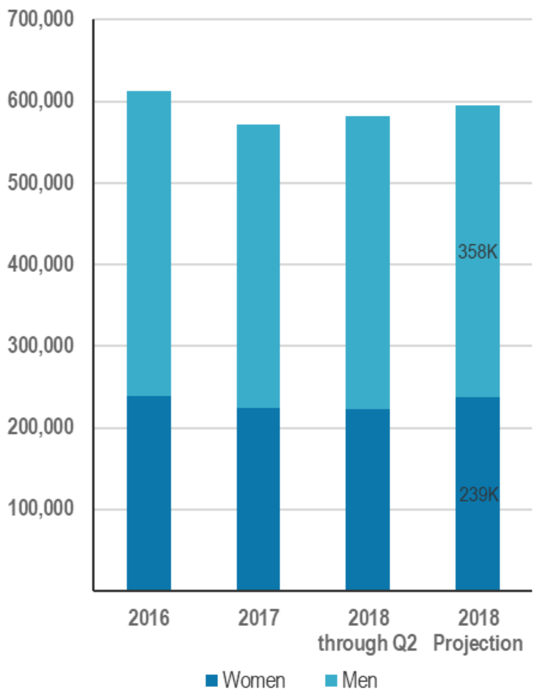
**Net Write-off Ratio:** A trailing 12-month figure representing the previous 12 months' write-offs, net of recovered funds, as a percentage of the average outstanding balance during the same period.

**Region Acronyms:** MAC (Mesoamerica & Caribbean), SAM (South America), EAF (East Africa), WAF (West Africa), ASI (Southeast Asia — currently Indonesia).

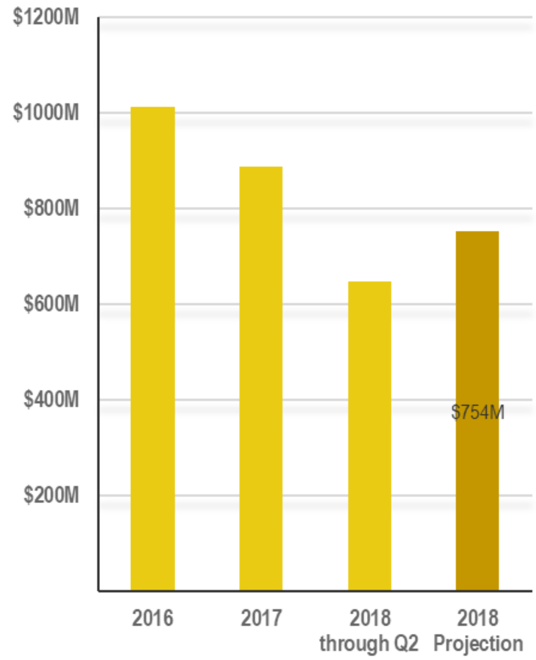
# PORTFOLIO PERFORMANCE

## Social and Environmental Metrics

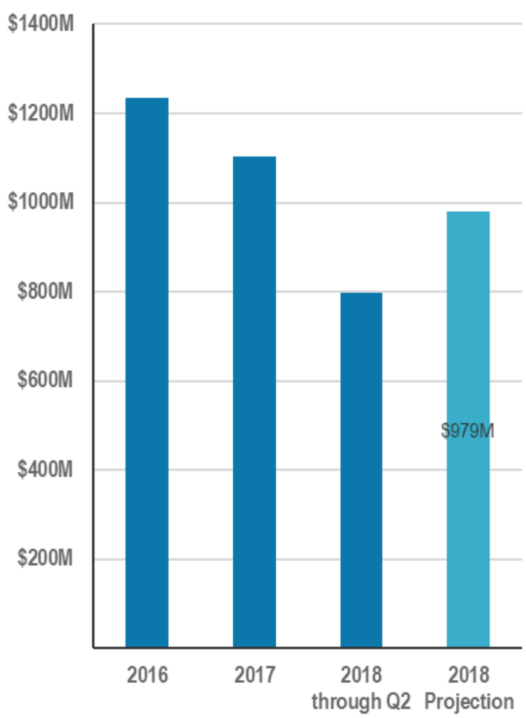
### Producers Supplying Business



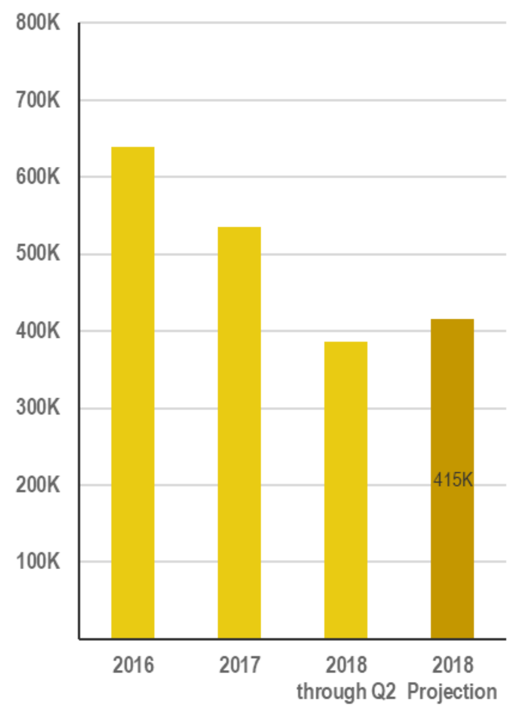

### Purchases from Producers



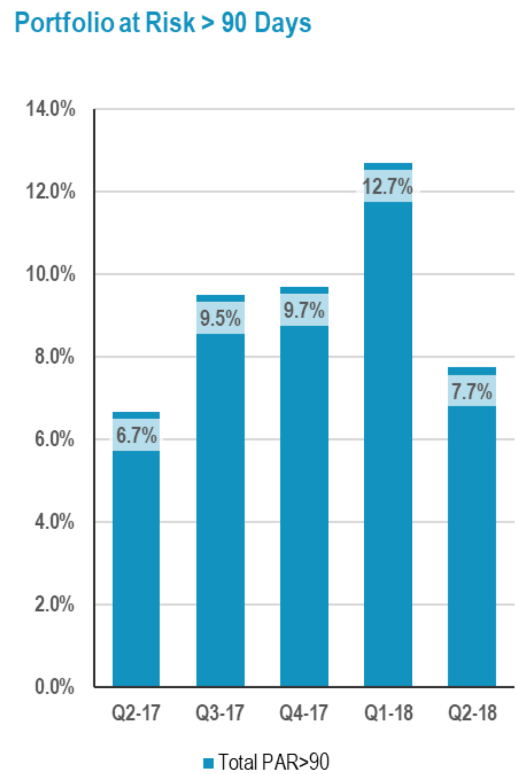

### Total Sales of Businesses

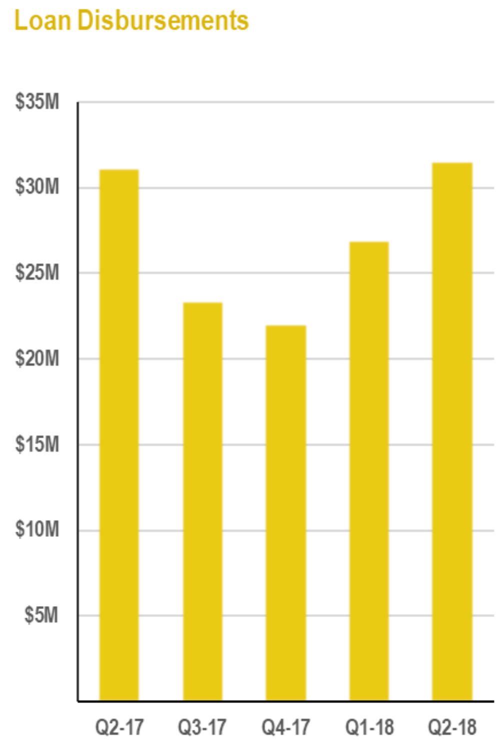


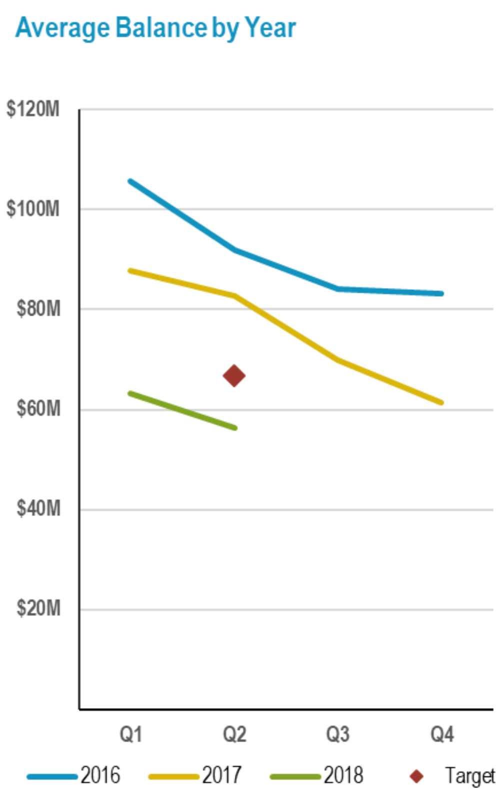

### Sustainable Hectares Under Management

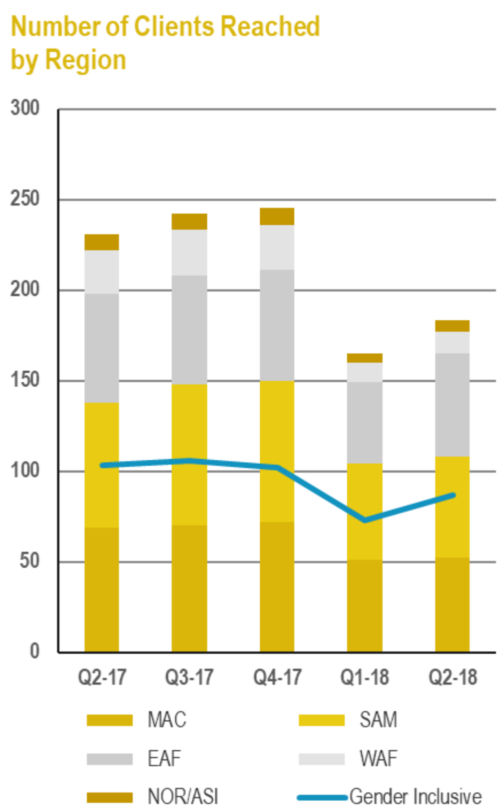


# Lending Performance



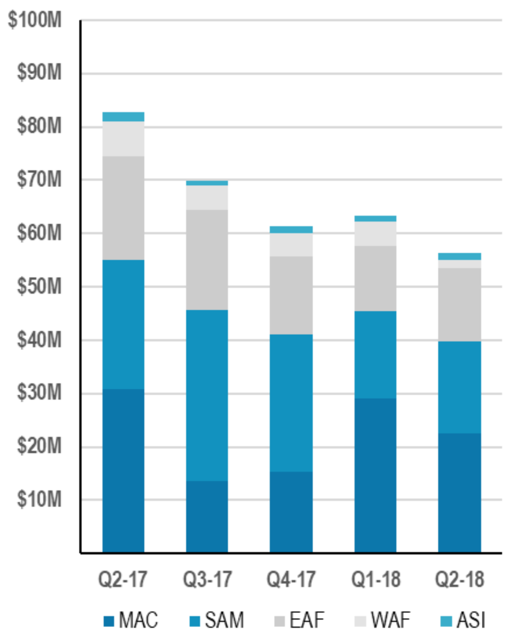



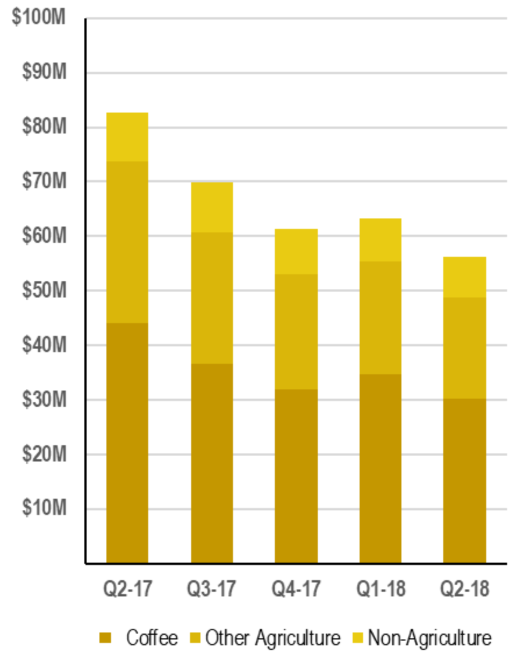




* As of December 31, 2017, we have segregated and removed a segment “other collateralized assets” from the PAR greater than 90 days and total portfolio balances and restated results for previous quarters. At quarter-end, we held $5.0 million in other collateralized assets.

### Average Balance by Region

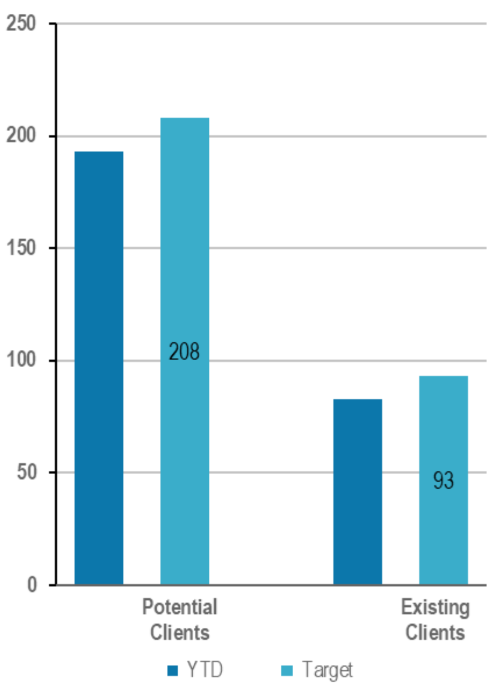



### Average Balance by Industry

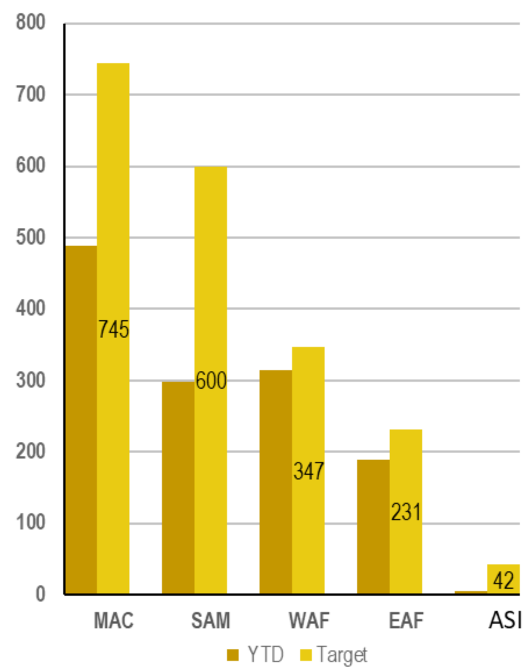



## Advisory Services

### Businesses Served (through Q2)




### Days of Training Delivered (through Q2)



# Balance Sheet

***As of June 30, 2018***

| Balance Sheet Highlights | | | |
|---|---|---|---|
| *Millions of USD* | Q2 2018 | Q2 2017 | Yr/Yr Growth |
| Cash and Short-Term Investments | 26.8 | 30.8 | -13% |
| Total Loans Receivable | 57.2 | 72.0 | -20% |
| Allowance for Credit Losses | (7.0) | (7.8) | -10% |
| Loans Receivable (net) | 50.3 | 64.2 | -22% |
| Other Collateralized Assets (net) (1) | 3.1 | 3.4 | -9% |
| Other Assets | 15.5 | 16.1 | -4% |
| **Total Assets** | **95.6** | **114.5** | **-16%** |
| Senior Debt | 64.9 | 82.0 | -21% |
| Subordinated Debt | 8.5 | 9.5 | -11% |
| Other Liabilities | 8.3 | 8.9 | -7% |
| **Total Liabilities** | **81.7** | **100.4** | **-19%** |
| Lending Net Assets | 9.5 | 10.4 | -8% |
| T/R Net Assets (Purpose & Time) | 4.4 | 3.7 | 21% |
| **Total Net Assets** | 14.0 | 14.0 | **-1%** |
| **Total Liabilities & Net Assets** | **95.6** | **114.5** | **-16%** |

| Key Financial Metrics | | | |
|---|---|---|---|
| | Q2 2018 | Q2 2017 | Yr/Yr Growth |
| Grant Net Assets (2) | 19.3 | 18.1 | 7% |
| Debt-to-Equity Ratio (3) | 3.6 | 4.1 | -0.5 pts |

*(1) Includes gross balance of Other Collateralized Assets ($5.0M in Q2 2018 and $4.3M in Q2 2017), net of allowance for losses ($1.9M in Q2 2018 and $0.9M in Q2 2017)*
*(2)Grant Net Assets include $4.4M of Temporarily Restricted Net Assets, held on the balance sheet, as well as $12.8M of conditional grants, held off of our balance sheet, $1.6M of subordinated debt pledged to convert to net assets through 2020, and $0.5M of receipts for grants included in other liabilities. As grant conditions are met in future periods, we will add the off-balance sheet conditional grants to Temporarily Restricted Net Assets (Purpose & Time) and the other liabilities will be transferred to donor-restricted net assets for lending.*
*(3) Debt to equity includes long-term subordinated debt as equity, reflecting its equity-like characteristics.*

# Statement of Activities

***Year-to-date results as of June 30, 2018***

| *Millions of USD* | Q2 2018 | Q2 2017 | Yr/Yr Growth |
|---|---|---|---|
| **Interest & Fee Revenue** | **3.0** | **4.2** | **-28%** |
| Net Interest Expense | (0.9) | (1.0) | -10% |
| **Net Interest & Fee Revenue** | **2.2** | **3.3** | **-34%** |
| Net Provisioning Expense | (2.4) | (2.6) | -7% |
| **Net Lending Revenue** | **(0.3)** | **0.6** | **-146%** |
| LAFCo & Agency Services Fees | 0.2 | 0.3 | -41% |
| **Net Operating Revenue** | **(0.1)** | **1.0** | **-109%** |
| Operating Expenses | (7.3) | (6.5) | 12% |
| **Operating Surplus / (Deficit)** | **(7.4)** | **(5.6)** | **33%** |
| Contributions for Operations | 6.2 | 5.0 | 25% |
| Fee for Service Revenue | 0.1 | 0.3 | -63% |
| **Net Surplus / (Deficit)** | **(1.1)** | **(0.3)** | **253%** |

**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.

## Client Profile

# ANEI

Location: Valledupar, Colombia

Every day, the ANEI cooperative navigates the tension between maintaining their indigenous heritage and engaging with the outside world. Top-quality coffee and cocoa offers the business a tool to preserve the cultures of its 700 indigenous farmer-members, while simultaneously improving their livelihoods.

Located high in the Sierra Nevada de Santa Marta, one of the highest coastal mountain ranges in the world, ANEI unites farmers from four of Colombia's main indigenous groups: the Arhuacos, Koguis, Wiwas, and Kankuamos. Since it was founded in 1995, the cooperative has used agriculture to create opportunities for indigenous farmers who have endured decades of poverty, violence, and marginalization. It has earned both Fair Trade and organic certifications, ensuring that the cooperative can sell its products at a premium and pay its farmers higher wages.

The cooperative stands by its members when outside forces threaten their livelihoods. As a changing climate pushes temperatures skyward, many regions where coffee has thrived for generations are becoming too warm for the crop to succeed. ANEI has supported many of its members in switching from coffee to cocoa, which grows more easily in warmer climates—enabling them to continue farming their ancestral lands.

Since we began funding the cooperative in 2012, Root Capital has loaned ANEI more than $1.5 million and provided training on financial planning and analysis, harvest forecasting, and internal inspections. Most recently, we awarded ANEI a $20,000 grant, which will be used to train 400 of their farmer-members on improved agricultural techniques and new technologies. These investments are designed to boost both farm productivity and coffee quality, enabling the farming families of ANEI to improve their incomes for years to come.