Hillside coffee gardens in the eastern region of the Democratic Republic of the Congo where Root Capital has several coffee clients.

# Performance Report

## Q3 2016

root capital

# OVERVIEW

Root Capital supported the growth and impact of well over 300 agricultural businesses through Q3 2016, enterprises that are improving livelihoods and transforming rural communities in remote stretches of Africa, Asia, and Latin America. Together, our clients are providing higher, more reliable incomes for 596,000 farmers — farmers who would otherwise be disconnected from the formal economy and its many networks of opportunity.

Many of our clients are located in vulnerable, post-conflict regions, for example in countries like Colombia, Indonesia, and the Democratic Republic of the Congo (DRC). Speaking recently about one client in the DRC, Richard Tugume, portfolio manager for East Africa, summarized the enormous challenges these businesses encounter: "They have no address and face security issues, their country's legal system is nonfunctional, their Internet connection and their roads are very poor, and extortion from outlaws is high."

Our clients in post-conflict zones like the DRC are not alone in facing a wide range of challenges. Indeed, the issues we have detailed in previous reports (commodity and currency volatility, compounded by ongoing effects of coffee leaf rust and others symptoms of a changing climate) continued to affect our clients, and consequently, our portfolio performance (detailed below). These challenges are not likely to change in a quarter or even a year's time, and although there are some signs of a rebound in the coffee market, we expect to see a continued elevated level of risk and volatile demand for the foreseeable future.

As discussed in previous communications, in response to heightened risk, we have been leveraging our 17-year track record to improve our lending tools and systems. In the second half of last year, we collected more than 100 different metrics for over 1,300 of our loans dating back to 2008, and then analyzed that data to refine and enhance our ability to project risk across different segments of the portfolio. Throughout 2016 we have been using what we have learned to enhance and expand our underwriting and credit allocation tools.

Some of the modifications are to our risk rating system, pricing and provisioning methodologies, and portfolio limits. Our Expected Impact Rating is a new rating methodology that allows us to score and evaluate the relative level of potential impact of each loan we make and therefore allows us to direct the contributions we receive towards greatest impact. While the updates we are making to our provisioning methodology will result in a more conservative treatment of certain loans and will actually lead to an additional increase in provisioning expense by year-end, over time the modifications to the risk rating system and pricing policy will result in improved performance.

An important staff announcement is that we are pleased to announce the hire of our new Chief Financial Officer, Jared Chase. Jared joins Root Capital with extensive experience in investment and treasury management, most recently as the Chairman of the State Street Global Alliance. During his career at State Street, Jared also held roles that included Head of Global Treasury, Liability Management, Money Markets & Derivatives, and Managing Director of Fiduciary Services. Jared currently serves as Chairman of the Board of Directors of the Massachusetts Audubon Society and has spent 18 years as a Director of this well regarded conservation organization.

### Portfolio Performance and Impact

The 277 businesses we loaned to through Q3 2016 are on track to generate $1.18 billion in revenue this year, about $958 million of which will be paid directly to the 596,000 smallholder producers they connect to formal markets. Notably, 233,800 of those producers (39 percent) are women.

In Q3, Root Capital had an average outstanding balance of $84.2 million, a 9.4 percent decline from the same period last year, as clients struggled with the same adverse market conditions reported above and in previous quarters. Against the backdrop of a weak global coffee market, many of our coffee clients in South America, Central America, and Rwanda struggled to secure purchase contracts for this year's harvest. In Colombia in particular, a lack of purchasing contracts was compounded by a major drought that affected the quality and volume of the coffee harvest in Q3. Although disbursements for the quarter, $28.9 million, were also down 14 percent from last year, our pipeline indicates that we can expect to see an uptick in credit demand in Q4 with the onset of the coffee harvest in Central America.

Notably, Root Capital's average outstanding balance to coffee cooperatives in the DRC nearly doubled, growing from $1.3 million in Q3 2015 to $2.5 million in Q3 2016. Through the first three quarters of 2016, we disbursed $4 million to clients in the DRC compared to $1.7 million through the same period last year. As this recent Wall Street Journal article explores in detail, the Democratic Republic of the Congo is an extremely complicated, challenging, and sometimes dangerous place to work. Root Capital is committed to supporting the country's specialty coffee businesses as they build peace, hope, and better livelihoods for farmers.

Forty-five percent of Root Capital's loans in Q3 were to coffee businesses, down from 47 percent last quarter. Outside of coffee, cashews and cocoa were our next largest industries, comprising 6.7 percent and 6.0 percent of the quarter's average outstanding balance, respectively. Collectively, loans to non-coffee businesses such as cocoa, nuts, grains, and seed businesses (classified as "other agriculture" on page 7), made up 43 percent of the the Q3 average outstanding balance. Loans to clients classified as "non-agriculture" industries such as handcrafts and textiles accounted for 10 percent of the Q3 average outstanding balance.

**Portfolio Quality**

At the end of Q3, 14.4 percent of our lending portfolio was classified as Portfolio-at-Risk (PAR) greater than 90 days, up from 5.9 percent at the same time last year and 10.6 percent last quarter. The balance in PAR over 90 days at quarter end was $12.1 million, up from $8.8 million in Q2. We are actively working to restructure many of the loans currently at risk and are committed to standing by these clients during these hard times.

In Q3, we wrote off $298,000 and recovered $554,000 and the 12-month trailing net write off rate was 4.2 percent. Throughout the first three quarters of 2016, recoveries, including for guaranteed loans, were $830,000, the most successful first three quarters of any year in our history.

**Advisory Services**

The priority for our advisory services is to invest in our clients' capacity and resilience. To that end, we provide financial management training, agronomic planning, and mobile technology interventions that strengthen management and operations for the businesses. During Q3, Root Capital's Advisory Services team delivered 817 days of training to 146 businesses, representing an 11 percent increase over Q3 activity in 2015. Through Q3, we have provided 1,886 days of training for 210 groups.

Over the past year, we have launched important partnerships with the IKEA Foundation and the Mastercard Foundation to accelerate the growth of agricultural businesses in Africa through an integrated combination of capital and technical support. Through these partnerships, we are looking to have the same impact on other businesses that we have had with businesses like ACASEN, an early-stage, mother-daughter-led cashew business in Senegal. While attending one of our financial training sessions in early 2014, the mother-daughter team realized that their business was not yet ready to take on a loan. Root Capital's Advisory Services team began working with them in 2014 to strengthen the business's financial management processes and ready them to access a loan at the right moment. In the years since, ACASEN has been approved for $230,000 in loans, helping the business strengthen relationships with suppliers, invest in equipment, and expand its product line.

**Financial Results**

In Q3, loan interest and fee revenue declined by 28 percent year over year. While year-to-date net provisioning expense of $4.9 million remained elevated relative to our target, the significant recoveries made during Q3 helped offset this expense. Careful cost control has allowed us to add staff in expansion regions such as Colombia, Côte d'Ivoire, and Ghana, while keeping overall operating expenses flat year over year. The cumulative result of our activities through Q3 was a deficit of $4.5 million, and we are expecting a full-year deficit of $9 to $12 million.

At quarter-end, our balance sheet had $16.9 million in net assets for lending and $6.2 million in long-term subordinated debt, easily supporting a loan portfolio of $84 million. We project having $11 million in grant funded net assets and $8.5 million in long-term subordinated debt by the end of the year. In that context, we will need to continue to make careful credit and growth choices in 2017 and beyond until we can replenish our reserves. We are currently in conversation with several close partners about opportunities to grow our net assets and we look forward to sharing news of those negotiations in the coming quarters.

At quarter end, the balance for net assets that are temporarily restricted either for purpose or time was $4.2 million and the amount of conditional grants was $7.9 million, for a total of $12.1 million. This is a 57 percent increase compared to Q3 2015. Conditional grants are milestone-based donor funds that are temporarily kept off the balance sheet, and are anticipated to be available for release in future periods after meeting grant requirements. A highlight in Q3 was the launch of a three-year, $1.2 million partnership with the U.S. Global Development Lab's Partnering to Accelerate Entrepreneurship (PACE) Initiative.

**Conclusion**

After a challenging few years, we remain committed to serving our clients and pioneering ways to accelerate the growth and stability of agricultural businesses that promote peace, prosperity, and the environment. To quote Richard Tugume, "all [these businesses] need is to be given an opportunity to prove themselves, to prove that they can compete on the global stage and not ask for handouts." Root Capital is proud to provide that opportunity. We are grateful for your partnership and look forward to continuing this journey together.

# Q3 2016 DASHBOARD

| Metric | Result | Full Year Target (unless otherwise noted) | Results as % of Target |
|---|---|---|---|
| **Social and Environmental Metrics** | | | |
| Number of Producers Reached | 728K | 760K | 96% |
| *Producers supplying business* | 596K | 601K | 99% |
| *Producers buying inputs* | 132K | 159K | 83% |
| Purchases from Producers | $958.4M | $1.0B | 92% |
| Total Revenue of businesses | $1.2B | $1.3B | 91% |
| Sustainable Hectares under Management | 585K | 669K | 87% |
| **Lending Program** | | | |
| Loan Disbursements | $89.3M | $137.9M | 65% |
| Average Outstanding Portfolio Balance [1] | $84.2M | $104.8M | 80% |
| Average Outstanding Balance per Active Loan | $318K | $397K | 80% |
| Number of Clients Reached [2] | 277 | 323 | 86% |
| *Clients Reached, Current* | 245 | 247 | 99% |
| Portfolio-at-Risk Over 90 Days * | 14.4% | < 7.0% | |
| Net Write-off Ratio * | 4.2% | < 6.0% | |
| **Advisory Services** | | | |
| Number of Businesses Served | 210 | 282 | 74% |
| Days of Training Delivered | 1887 | 2107 | 90% |
| **Operating Results** | | | |
| Total Operating Expense | $11.1M | $15.8M | 70% |
| Debt to Equity Ratio* | 3.68 | < 5.00 | |
| Capital Utilization * | 89% | 90% | 99% |

*[1] Average Outstanding Balance figures are for Q3 only. In 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**: A gender-inclusive business either has a supplier and nonmanagerial 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.

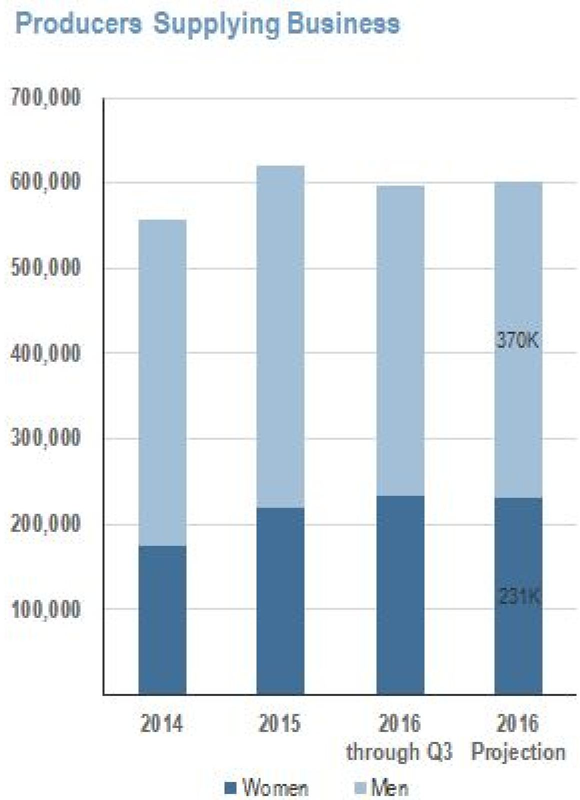
**Debt to Equity**: Notes payable and other debt, divided by lending net assets. Our calculation treats long-term subordinated debt as equity, reflecting its equity-like characteristics.

**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).

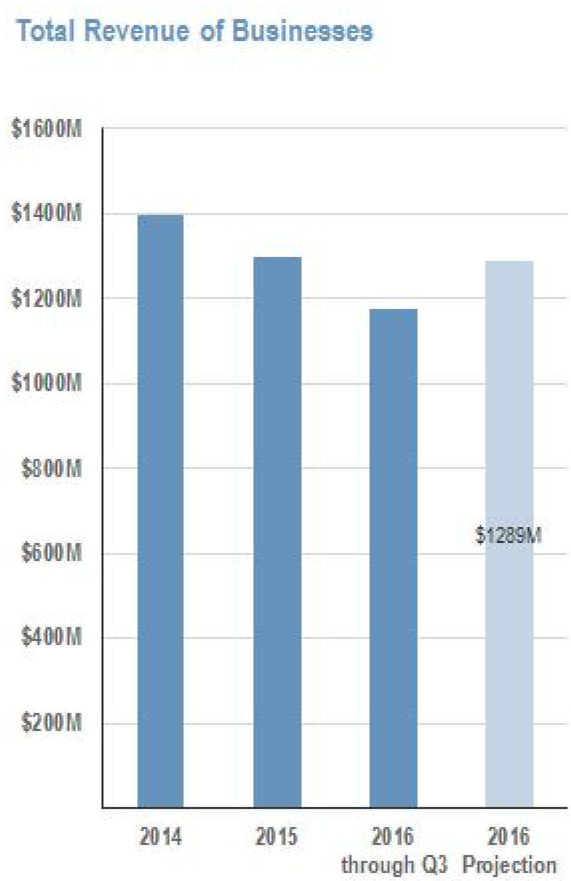
**Region Acronyms**: MAC (Meso America & Caribbean), SAM (South America), EAF (East Africa), WAF (West Africa), ASI (Asia [currently Indonesia only]).

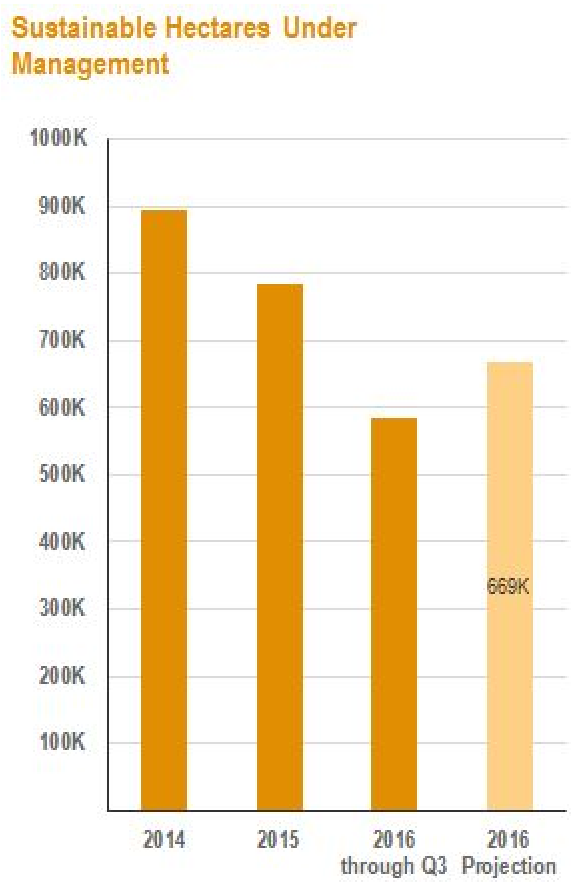
# PORTFOLIO PERFORMANCE

## Social and Environmental Metrics

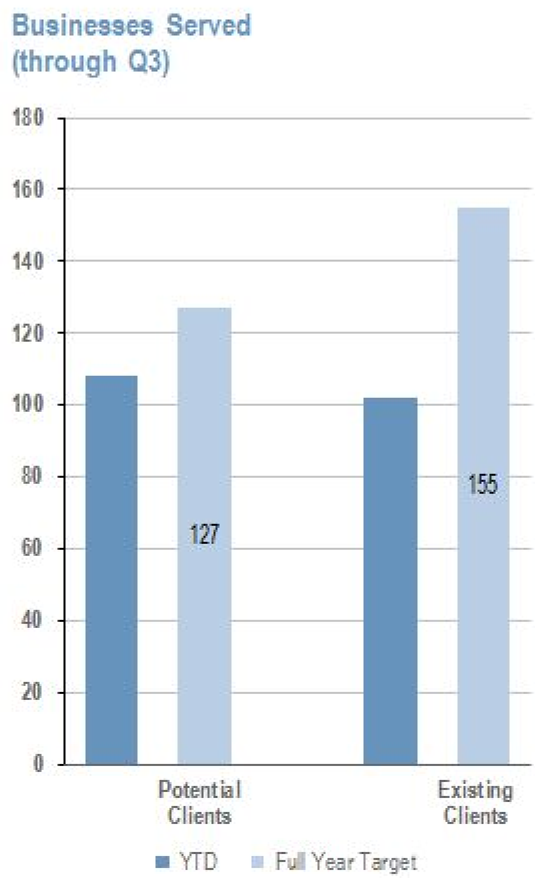


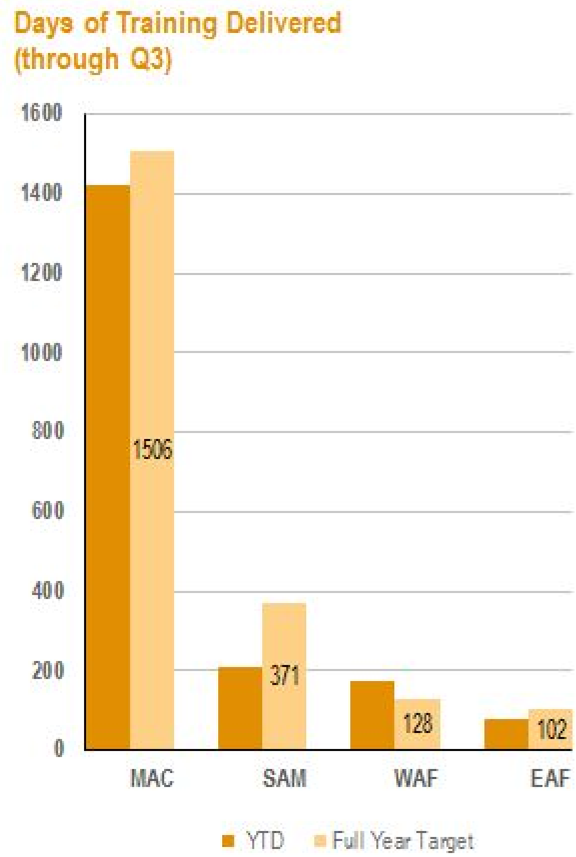




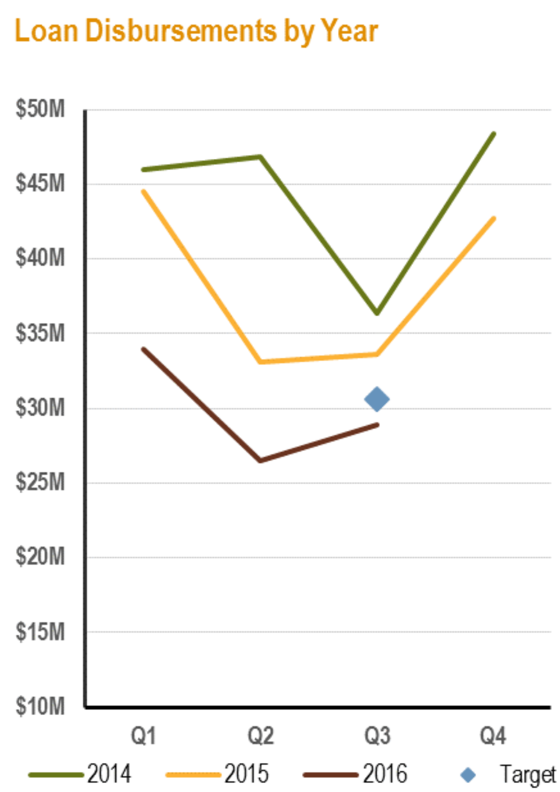



## Advisory Services

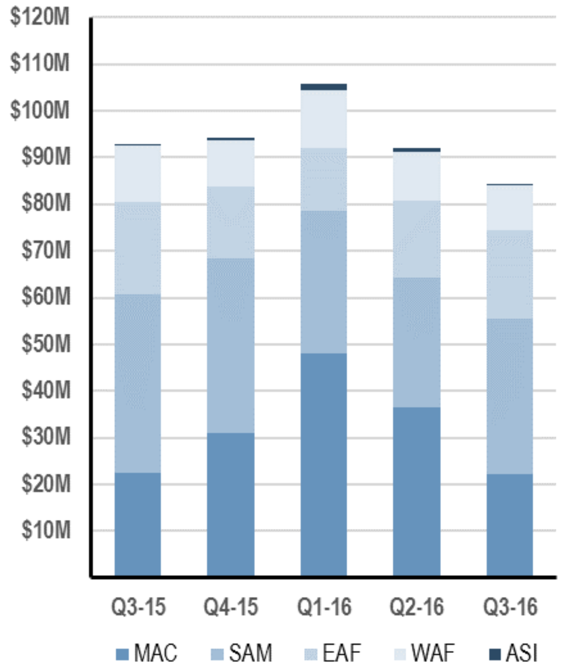


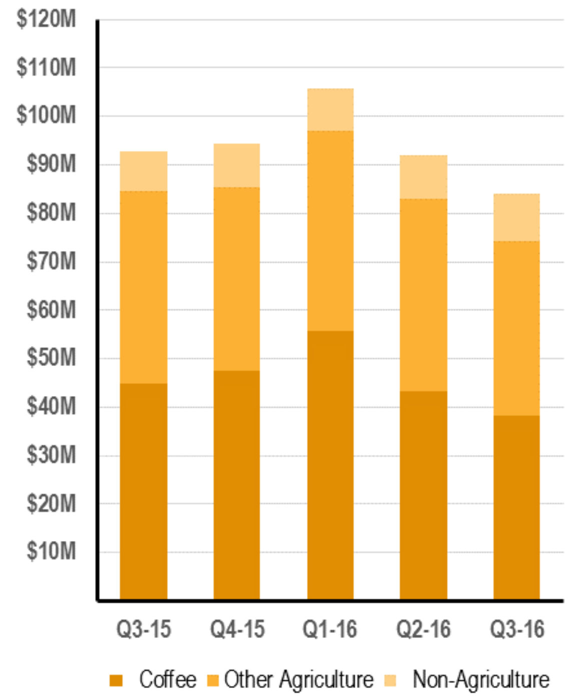

## Lending Performance

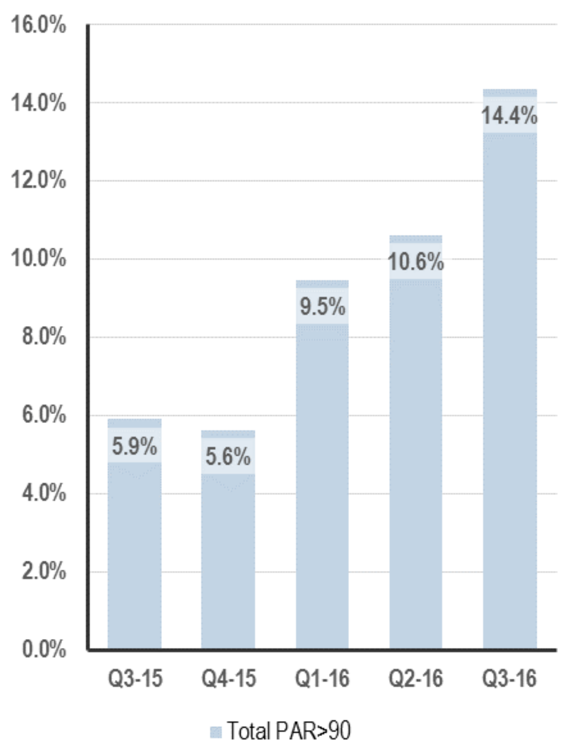
## Average Balance by Region (Trailing 5 Quarters)



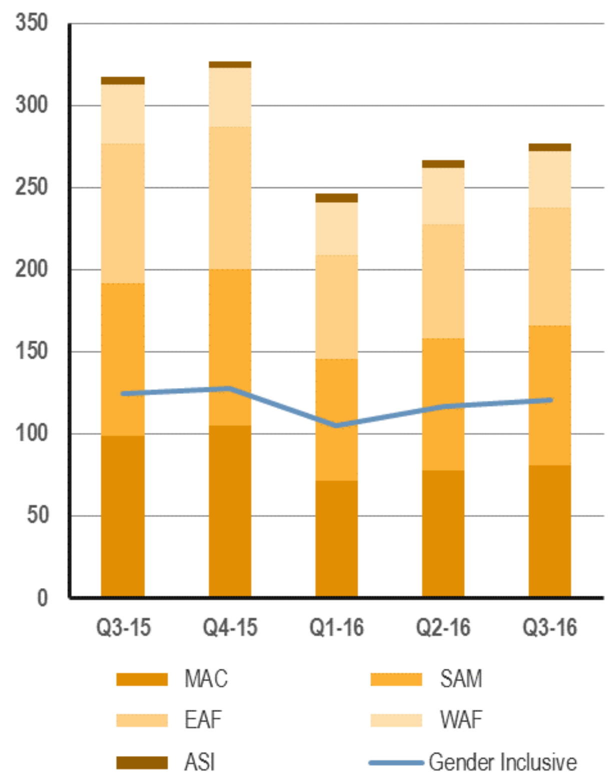

## Average Balance by Industry (Trailing 5 Quarters)




## Portfolio at Risk > 90 Days




## Number of Clients Reached by Region



# FINANCIAL RESULTS

## Balance Sheet

| Balance Sheet Highlights | | | |
|---|---|---|---|
| *Thousands of USD* | 09/30/16 Results | 09/30/15 Results | Yr/Yr Growth |
| Cash and Short-Term Investments | 32,054 | 31,331 | 2% |
| Total Loans Receivable | 84,163 | 91,109 | -8% |
| Less: Allowance for Credit Losses | (7,680) | (4,867) | 58% |
| Loans Receivable (net) | 76,476 | 86,241 | -11% |
| Grants Receivable | 2,731 | 5,710 | -52% |
| Other Assets | 6,353 | 5,648 | 12% |
| **Total Assets** | **117,614** | **128,931** | **-9%** |
| Senior Debt | 84,825 | 96,233 | -12% |
| Subordinated Debt | 6,200 | 900 | 589% |
| Other Liabilities | 5,532 | 3,956 | 40% |
| **Total Liabilities** | **96,557** | **101,089** | **-4%** |
| Lending Net Assets & Op Reserve | 16,862 | 23,046 | -27% |
| T/R Net Assets (Purpose & Time) | 4,195 | 4,795 | -13% |
| **Total Net Assets** | **21,057** | **27,842** | **-24%** |
| **Total Liabilities & Net Assets** | **117,614** | **128,931** | **-9%** |

| Key Financial Metrics | | | |
|---|---|---|---|
| | 09/30/16 Actual | 09/30/15 Results | Yr/Yr Growth |
| Grant Net Assets* | 12,105 | 7,691 | 57% |
| Debt-to-Equity Ratio** | 3.68 | 4.13 | -45 bps |
| Capital Utilization | 89% | 86% | +365 bps |

** Grant Net Assets include Temporarily Restricted Net Assets (Purpose & Time), held on the Balance Sheet, as well as $7.9M of conditional grants, held off-Balance Sheet as required by US GAAP. As grant conditions are met in future periods, we will add the off-Balance Sheet Contingent Net Assets to the T/R Net Asset balance. ** Debt-to-equity treats long-term subordinated debt ($6.2M) as equity, reflecting its equity-like characteristics.*

## Statement of Activities

| Statement of Activities | | | |
|---|---|---|---|
| *Thousands of USD* | YTD Results | 2015 YTD | Yr/Yr Growth |
| Loan Interest and Fees | 6,566 | 9,172 | -28% |
| Gain (loss) on FX Lending | (502) | (1,207) | -58% |
| **Interest & Fee Revenue** | **6,064** | **7,964** | **-24%** |
| Net Interest Expense | 1,726 | 1,882 | -8% |
| **Net Interest & Fee Revenue** | **4,338** | **6,083** | **-29%** |
| Provisioning Expense | 4,884 | 3,986 | 23% |
| **Net Revenue after Provisioning** | **(546)** | **2,097** | **-126%** |
| Operating Expenses | 11,097 | 11,449 | -3% |
| Contributions for Operations | 6,295 | 7,750 | -19% |
| Other Income | 831 | 402 | 106% |
| **Operating Surplus / (Deficit)** | **(4,517)** | **(1,200)** | **276%** |

**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.