

Agrofinanzas S.A. de C.V. (now Bankaool S.A.)

COMPANY BACKGROUND

Agrofinanzas S.A. de C.V. (Agrofinanzas) is a specialized, non-deposit taking financial institution called a Sociedad Financiera de Objeto Limitado, or sofol, on-lending to farmers and rural companies in Mexico. As a sofol, Agrofinanzas is regulated and supervised by the Mexican Banking and Securities Commission. The company was created in 2005 when the Esteve family, majority shareholders in the international soft commodity trader ECOM, decided to spin off the supplier financing division of ECOM's Mexican subsidiary, Agroindustrias Unidas de Mexico S.A. de C.V. (AMSA), a major trader of coffee, cotton, cocoa, and grain. Agrofinanzas is 76.3% owned by the

Country: Mexico

Sector: Finance

IFC's Investment: MXN 60 million in equity
(US\$4.93 million)

Esteve family, 8.4% by management, and 15.2% by IFC. It has 35 employees – a lean structure made possible by the nature of its business model.

DRIVERS FOR AGROFINANZAS' INCLUSIVE BUSINESS MODEL

- Market need for agribusiness finance in Mexico, especially among small producers
- Government incentives for providers targeting this need

Agriculture is a risky sector to invest in, because success depends on a wide variety of factors that are hard to control or even predict – such as local and foreign weather conditions, tariff and subsidy regimes, freight costs, and pest infestations. It is particularly hard for small-scale producers to obtain the financing they need because – in addition to the risk factors above – they tend to have limited credit history and collateral, and the transaction costs of servicing small loans are high. Most banks have traditionally prioritized consumer, housing, and corporate lending over agricultural production and other agribusiness-related sectors. As a result, lending from Mexico's banking sector in primary agriculture production is lower than in most other sectors (as a percentage of financing to the sector's respective GDP).

Most of the funding for on-lending to agricultural producers and other rural enterprises in Mexico comes from a set of four trust funds set up in 1954 by the central bank, the

Fideicomisos Instituidos en Relacion con la Agricultura (FIRA). In addition to funding, the Mexican government also provides guarantees and subsidies to banks, sofoles, and sofomes. Subsidies are available for all loans made to small producers borrowing for the first and second times.

Against this backdrop of unmet need and government support, the Esteve family made a strategic decision to separate AMSA's supplier financing business from its core trading business, and to professionalize and scale it up to be able to serve more borrowers. Inheriting AMSA's existing portfolio, platform, and network of borrowers gave Agrofinanzas a critical mass right from the start, allowing it to avoid the losses a brand-new company would ordinarily face in the ramp-up stage. FIRA has provided a source of competitive cost capital and guarantees, currently funding 80% of the company's loan portfolio and guaranteeing close to 100% (up to 50% of losses for peso-denominated loans, and 40% for dollar-denominated loans).

AGROFINANZAS' INCLUSIVE BUSINESS MODEL

Agrofinanzas serves Mexican producers of coffee, cocoa, cotton, sugar, rice, grains, fruits, pork, and shrimp, including small producers who have traditionally had difficulty obtaining formal financial services as a result of high transaction costs, limited credit histories and forms of collateral.

99% of Agrofinanzas' clients have monthly incomes less than \$1,200, and 80% had no access to formal financial services prior to engaging with Agrofinanzas.

The company offers two primary products: short-term working capital loans and medium-term loans for capital expenditures.

Short-term working capital loans are intended to finance a single crop cycle from input to harvest. These loans range in size from less than MXN 20,000 (approximately US\$1,500) to as much as MXN 5.5 million (approximately US\$413,000). The average loan is MXN 50,000 (approximately US\$3,750). Loans are limited to 80% of input costs. Depending on the crop cycle, tenors are generally 6-18 months. Rates run from 12-13% up to 36% for very small loans under MXN 20,000, depending on the crop. These rates are lower than those offered by off-takers who finance their value chains directly, and much lower than those of most microfinance institutions.

Medium-term loans are intended to finance capital expenditures like vehicles and processing equipment. These loans range in size from MXN 74,000 to 5.4 million (approximately US\$5,500 to 405,000). Loans are limited to 75% of the value of new assets, and 50% of the value of used assets. Tenors run from three to five years, with monthly interest payments during the first year and annual amortization payments thereafter. Interest rates run from 12-14%.

Agrofinanzas' inclusive business model is based on relationships with off-takers. In its program with off-takers, it lends exclusively to producers that have supply relationships with off-takers i.e. traders, crop consolidators, or processors who buy their crops. These off-takers agree to help Agrofinanzas identify reliable producers who are

likely to present good credit risk. Off-takers also help Agrofinanzas compile information and documentation for credit files on borrowers, which comply with banking regulations. They also agree to retain the borrowers' debt service on Agrofinanzas' behalf from the proceeds they pay at harvest. Agrofinanzas pays a success fee to off-takers as compensation for their services. The fee is a fraction of the interest spread obtained from the loans to the producers who supply the off-taker, after deducting any loan losses not covered by the first loss guarantee provided by the off-taker.



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Agrofinanzas requires producers to provide cash flow projections in order to assess their payment ability. It also requires collateral, such as producers' inputs, crops, and proceeds from the sale of crops. Loans larger than MXN 3 million also require additional collateral, in the form of mortgage on the land or pledge of movable assets, such as equipment and machinery.

Once a loan agreement is signed, the loan is disbursed directly to the borrower, using the off-taker as a logistical agent for the delivery of money. Disbursement happens in up to three installments according to crop progression and input needs in the field. Each disbursement requires an agronomist field visit to validate progression and cash flow requirements. The off-taker then makes a single principal and interest payment for the working capital loan shortly after harvest on the borrower's behalf.



The off-taker based model allows Agrofinanzas to finance large numbers of small producers who would be difficult to reach and serve otherwise

The off-taker based model allows Agrofinanzas to finance large numbers of small producers who would be difficult to reach and serve otherwise. First, it aggregates and reduces the administrative requirements of dealing with many small clients. Second, it allows the company to enhance the credit quality of its portfolio in two ways: profit- and risk-sharing with the off-taker, and linking the producer's relationship

with Agrofinanzas to his relationship with his main buyer. If the producer defaults on Agrofinanzas by selling his crop to another company, or uses the money for purposes other than those agreed with Agrofinanzas, he will damage his relationship with that buyer.

Agrofinanzas' first off-taker relationship was with AMSA, whose loan portfolio Agrofinanzas inherited when it spun off. At the same time Agrofinanzas has been building relationships with other off-takers, acquiring their suppliers as borrowers. The company has developed a total of 15 off-taker relationships to date. The loan portfolio under the off-taker program exceeds MXN 500 million and includes more than 25,000 loans.

RESULTS OF AGROFINANZAS' INCLUSIVE BUSINESS MODEL

- More than 4,882 clients and 23,545 active loans as of December 2011
- Nearly 5,000 clients with access to formal financial services for the first time
- Total loan portfolio of \$96.7 million, with a non-performing loan ratio of 3.5%
- Profits of \$2.6 million and 20% return on equity in 2011

Approximately 25% of the Mexican population lives in rural areas and depends directly or indirectly on agriculture. Agricultural development is critical to increasing standards of living in rural areas and managing the outflow of labor and talent to the cities and abroad. Financing is a critical ingredient in agricultural development, but the rural agribusiness sector has suffered from a chronic lack of interest from traditional lenders.

Agrofinanzas is helping to fill the gap. 80% of its clients had not had access to formal financial services before. Borrowing from Agrofinanzas, they start building credit histories, which open up access to additional financial services such as checking and savings accounts, personal loans, and insurance. Furthermore, the company's interest rates are lower than those offered by off-takers who finance their value chains directly, and much lower than those of most microfinance institutions.

As of December 31, 2011, Agrofinanzas had 4,882 clients, 99% of whom earn less than \$1,200 a month, and 23,545 active loans. 53% of these were short-term working capital loans; another 47% were medium to long-term loans for capital expenditures. The company's total loan portfolio stood at MXN 1,257 million (US\$96.7 million), with non-performing loans accounting for only 3.5%.

Agrofinanzas became profitable in 2006. In 2011, the company posted a profit of MXN 33.9 million (US\$2.6 million) and earned a 20% return on equity.

In 2011, Agrofinanzas obtained investment grade in Mexico from Fitch Ratings, and in 2012 was the first agribusiness sofol or sofom to gain access to capital markets by listing a short-term commercial paper program in the Mexican Stock Exchange.

IFC'S ROLE AND VALUE-ADD

IFC's Investment: MXN 60 million in equity (US\$4.93 million)

Investment Year: 2008 to 2014

- Support Agrofinanzas in making the transition from FIRA funding to commercial financing and success in a non-subsidized environment.
- Strengthen Agrofinanzas' capital base through an equity investment and improve social and environmental standards.
- Enhance the company's credibility and ability to attract financing from other investors such as Inter-American Investment Corporation, Scotiabank, and Monex, as well as through a short-term bond issue in the local capital market.

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For more information, visit ifc.org/inclusivebusiness and bankaool.com