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

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 ECOM, an international soft commodity trader, decided to spin off the supplier financing division of ECOM's Mexican subsidiary, Agroindustrias Unidas de Mexico S.A. de C.V. (AMSA). AMSA, a major trader of coffee, cotton, cocoa, and grain, had been providing supplier financing for more than 50 years.

Agrofinanzas is run by Chief Executive Officer Francisco Mere and Chief Operating Officer Carlos Budar, who are well-respected because of their long career in the financial sector and their previous work at the government agricultural financing agency Fideicomisos Instituidos en Relación con la Agricultura (FIRA). Mere was head of FIRA from 1998 to 2007. The company is 76.3% owned by the Esteve family, 8.4% by management, and 15.2% by IFC.

Agrofinanzas is one of nine agribusiness sofoles and sofomes[1], and serves approximately 20% of their market in terms of loan portfolio amount. As of December 31, 2011, the company had US$96.4 million in total assets and US$81.8 in loans outstanding. It has 35 employees – a lean structure made possible by the nature of its business model.

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 not had access to formal financial services before.

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 less than 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 with compiling 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.

Agrofinanzas requires producers to provide cash flow projections in order to assess their payment ability. It also requires collateral. All loans have as collateral the inputs, the crop, and the proceeds from the sale of the crop. 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 requirement. 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. 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 it 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 more than 25,000 loans.

1. All Sofoles are required to become non-regulated non-bank financial institutions known as Sofomes or Sociedad Financiera de Objeto Multiple by July 2013.

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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, in Mexico, lending from the 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 onlending to agricultural producers and other rural enterprises in Mexico comes from a set of four trust funds set up by the central bank in 1954, 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. And 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 ones).

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 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

FIRA funding is intended to be catalytic, and sofoles like Agrofinanzas are expected to transition to market-based financing within three years of their first loan. However, the Mexican financial market has historically shown little interest, given the added risk generally associated with agribusiness finance. As a result, Agrofinanzas' shareholders – both existing IFC clients – turned to IFC for support making the transition to commercial financing and success in a non-subsidized environment.

IFC has supported Agrofinanzas in two ways: strengthening its capital and improving social and environmental standards. In 2010, IFC invested MXN 22 million in equity (US$1.714 million). At the same time, IFC is helping Agrofinanzas on compliance with social and environmental standards.

Taken together, these measures are helping to enhance the company's credibility and ability to attract financing from other prospective investors. Indeed, while FIRA is still Agrofinanzas' main source of funding – because it offers the lowest cost and government guarantees – in 2011 the company obtained additional funding from the Inter-American Investment Corporation, Scotiabank, and Monex. In 2012, the company has also issued MXN 200 million (US$14.50 million) in short-term bonds in the local capital market, the first tranche of a total of MXN 500 million (US$36.26 million) planned for the next two years.

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IFC's Investment:

MXN 22 million in equity (US$1.714 million)