Coffee tree nursery at La Frontera, Cajamarca, Peru. La Frontera has been a Root Capital client since 2004 and provides sustainable incomes for 328 smallholder coffee farmers.

Performance Report

Q4 2016

root capital

OVERVIEW

Root Capital's supporters know that 2016 was a year that tested the resilience of our clients as well as the resilience of our organization, as we faced a confluence of continued and widespread challenges related to climate, market and currency.

In the face of these challenges, 2016 was a year of careful investment to strengthen the organization and grow our impact in the years to come. Based on ongoing analysis of the historic performance of our work over the past 17 years, we deepened our understanding of the risks across our portfolio and implemented many new policies and processes. These changes, while positive steps towards a stronger 2017 and beyond, did result in a large, though expected, one-time impact to our balance sheet in 2016. You will see this reflected as previously forecasted in the pages that follow.

Throughout 2016, we distilled and applied learnings from our now-complete Risk Appetite Project in a number of areas that will set us on a more sustainable path forward. In addition, we implemented an initial set of cost control measures in 2016 and have just recently proposed a larger set of changes for 2017. Given the constraints of our own balance sheet, we have been focused on building partnerships that mobilize off-balance-sheet capital and, in so doing, allow us to continue to meet the needs of our clients. Our partnership program now includes participations (sales of portions of existing loans to partners), syndications and agency services for aligned partners like Heifer International and Catholic Relief Services. These are in addition to Lending for African Farming Company (LAFCo), which is a separately capitalized vehicle managed by Root Capital in partnership with KfW and AgDevCo.

For example, together with LAFCo and other lenders, we provided Gulu Agricultural Development Company (GADC), a long-time Root Capital client that sources cotton, sesame, chilies and sunflower from over 80,000 smallholder farmers, with $6 million in credit in 2016. The business provides a stable, premium market for smallholder farmers across northern Uganda, a region recovering from nearly 25 years of armed conflict and civil strife that left the region the poorest in the country.

We are convinced that we start 2017 on a strong footing, with the ability to be more selective in the investments we make to optimize both profitability and impact and with an expanded business model that allows us to collaborate with a variety of partners and peers to channel capital to hard-to-serve markets.

Portfolio Performance and Impact

In 2016, Root Capital reached 288 agricultural businesses. Together, these businesses generated $1.23 billion in revenue, 82 percent of which was paid directly to 612,000 farmers (239,000 of them women).

Root Capital's average outstanding balance and disbursements for the quarter were below expectations, at $83.7 million and $28.2 million respectively, driven in large part by a delayed coffee harvest season in Central America and a lack of purchase contracts, and quality problems stemming from El Niño rains for our coffee clients in South America.

Overall for the year, we disbursed $117 million, compared to $154 million in 2015. In addition, our outstanding balance was 16 percent lower year-over-year. The drivers of this decrease include several geography-specific factors (e.g. a smaller-than-normal West African cocoa harvest in Q1, new regulations in Rwanda and a widespread transportation strike in Colombia in Q2), and, importantly, a conscious decision to be more selective in credit decisions.

Portfolio Quality

At the end of 2016, 14.9 percent ($12.4 million) of Root Capital's lending portfolio was classified as Portfolio-at-Risk (PAR) greater than 90 days. In Q4, $2.8 million was downgraded into PAR over 90 days, with more than 50 percent of that amount coming from under-performing loans to businesses in West Africa, with a cashew client being the largest driver. Despite these downgrades, the balance in PAR over 90 days increased by only $355,000, mainly due to a number of write-offs during Q4. While write-offs for the year totaled $6.1 million, our team recovered a total of $2.1 million throughout the year, our highest annual recovery amount to date. The vast majority ($1.2 million) of the year's recoveries came from collections; the rest, $954,000, came from guarantee payments. The resulting net write-off ratio in 2016 was 4.4 percent.

We expect to see a continued high PAR level in 2017 as we work together with a number of clients to restructure their loans. We have reported previously that Root Capital is not alone in facing portfolio quality challenges. At the November meeting for the Council on Smallholder Agriculture (CSAF), an industry alliance between Root Capital and eight other social lenders, members shared information about the increase in non-performing loans in their portfolios and the challenges of aligning risk, return and impact objectives in agricultural lending.

Advisory Services

With the end of 2016 came the successful completion of the Coffee Farmer Resilience Initiative (CFRI), a partnership led by Root Capital that brought together the private sector, public sector, foundations and impact investors to stabilize and support coffee production in Latin America in light of coffee leaf rust, a disease that devastated coffee yields across the Americas. As part of this initiative, Root Capital's Advisory Services team supported 117 businesses – representing 58,000 farmers – in building their financial management and planning capacity.

Reflecting on Root Capital's partnership through the CFRI, the manager of one of our client businesses in Guatemala told us, "Root Capital is our main ally… it is not the money that we value most but what we seek is wisdom, because in the end human resources are the most valuable asset of an organization and if the personnel are well-trained, things will endure."

The Advisory Services team closed 2016 having delivered the equivalent of 2,622 days of training to 236 current and potential Root Capital clients across Latin America and Africa.

Financial Results

The cumulative result of our activities through year-end 2016 was a deficit of $10.5 million. Loan interest and fee revenue declined by 28 percent year over year and the net provisioning expense was $9.3 million, driven by our decision to implement an enhanced and more conservative provisioning policy. At $2.1 million, our record-high recoveries in 2016 were an important offset to the high provisioning expense. Careful cost control in 2016 enabled us to reduce overall operating expenses by $465,000 year over year. At year end, our balance sheet had $10.8 million in net assets for lending and $8.9 million in long-term subordinated debt as we drew a remaining $2.7 million in subordinated debt commitments in Q4 to support a year-end loan portfolio of $83.7 million.

During 2016, we raised $13.8 million in philanthropic contributions to support our work in 2016 and future years, which is a 43 percent increase over the total amount raised in 2015. At year end, the balance for net assets that are temporarily restricted either for purpose or time and the amount of conditional grants was $14.1 million, which is the highest total temporarily restricted net asset balance since 2012. However, while we had significant success raising funds particularly for work in future years, we did not meet our contribution release target in 2016, which also contributed to the year-end deficit.

Given 2016 results, we are focused on fiscal responsibility and achieving a breakeven budget in 2017 while continuing to meet the needs of our clients as best as we can. Therefore, we have taken a number of measures to reduce operating expenses for this coming year by $1.8 million, including the difficult choice to eliminate 15 positions across US and Latin America operations. These layoffs are in addition to 12 transitions that have taken place in recent months, which include the transition of our Haiti program to a stand-alone entity and the end of the first phase of the Coffee Farmer Resilience Initiative mentioned above.

Conclusion

With every passing year, Root Capital becomes a more resilient organization. We close the books on 2016 sharply focused on the road ahead. In 2016, we took a major step forward with the implementation of new and improved underwriting tools and provisioning policies and processes and with the growth of a partnership program that helps us pursue impact by catalyzing capital from other sources. We are confident that these changes will result in improved portfolio quality and financial health as well as an increase in the overall level of resources that flow to our clients.

We are enormously grateful for the community of supporters who have shown their solidarity with us and with our clients over these past two years and throughout our history. We know that together, we can create a more prosperous, peaceful and sustainable planet and we look forward to creating that future together.

Q4 2016 DASHBOARD

Metric	Result	Full Year Target (unless otherwise noted)	Results as % of Target
Social and Environmental Metrics			
Number of Producers Reached	744K	760K	98%
Producers supplying business	612K	601K	102%
Producers buying inputs	132K	159K	83%
Purchases from Producers	$1.0B	$1.0B	97%
Total Revenue of businesses	$1.2B	$1.3B	96%
Sustainable Hectares under Management	639K	669K	96%
Lending Program			
Loan Disbursements	$117.5M	$137.9M	85%
Average Outstanding Portfolio Balance [1]	$83.7M	$104.8M	80%
Average Outstanding Balance per Active Loan	$339K	$397K	85%
Number of Clients Reached [2]	288	323	89%
Clients Reached, Current	242	247	98%
Portfolio-at-Risk Over 90 Days *	14.9%	< 7.0%	
Net Write-off Ratio *	4.4%	< 6.0%	
Advisory Services			
Number of Businesses Served	236	282	84%
Days of Training Delivered	2622	2107	124%
Operating Results			
Total Operating Expense	$15.4M	$15.8M	97%
Debt to Equity Ratio*	4.04	< 5.00	
Capital Utilization *	97%	90%	108%

[1] Average Outstanding Balance figures are for Q4 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.

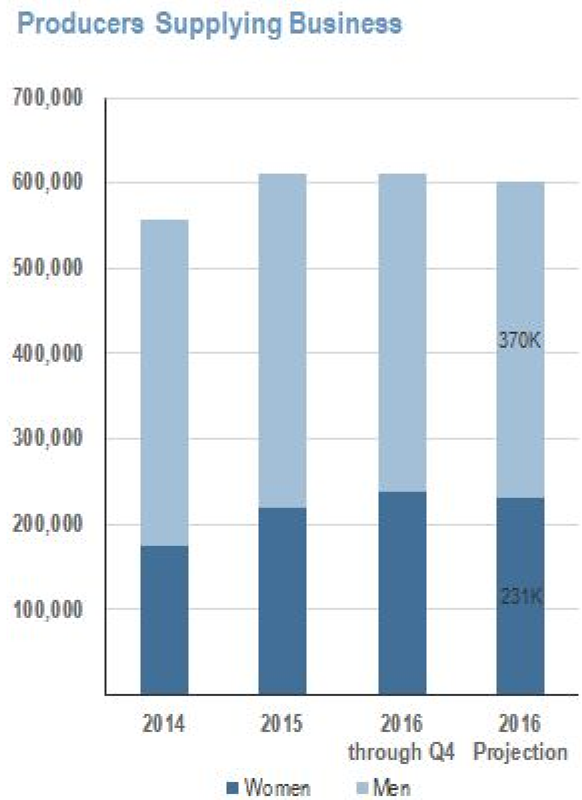
Debt to Equity: Notes payable and other debt, divided by lending net assets. Our calculation treats long-term subordinated debt as equity, reflecting its equity-like characteristics.

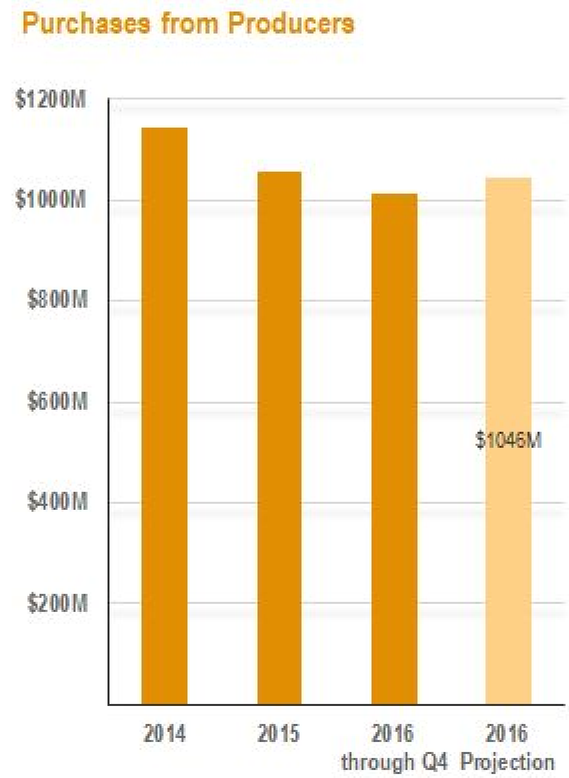
Capital Utilization: Capital utilization measures the proportion of available capital that is deployed in our lending portfolio at a point in time, calculated as: (Gross loans outstanding) / (Notes payable + lending net assets).

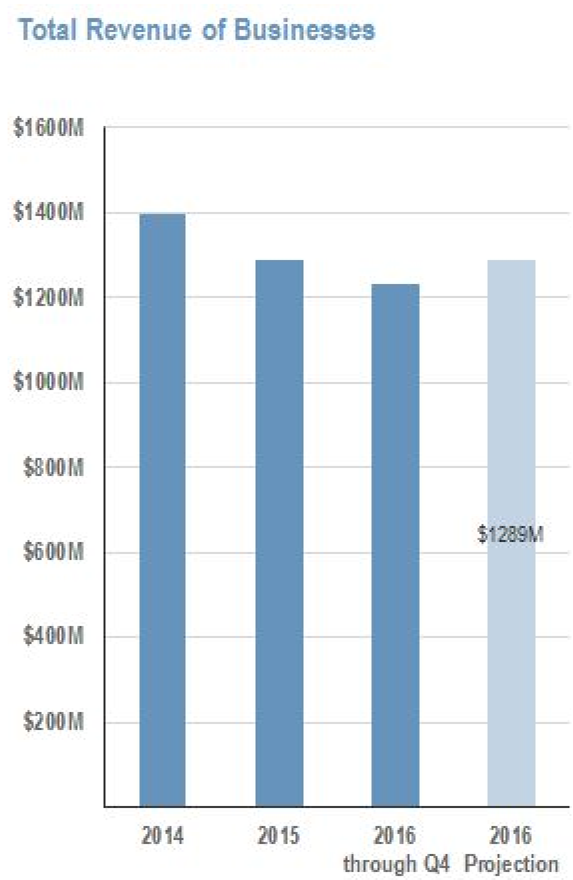
Region Acronyms: MAC (Meso America & Caribbean), SAM (South America), EAF (East Africa), WAF (West Africa), ASI (Asia [currently Indonesia only]).

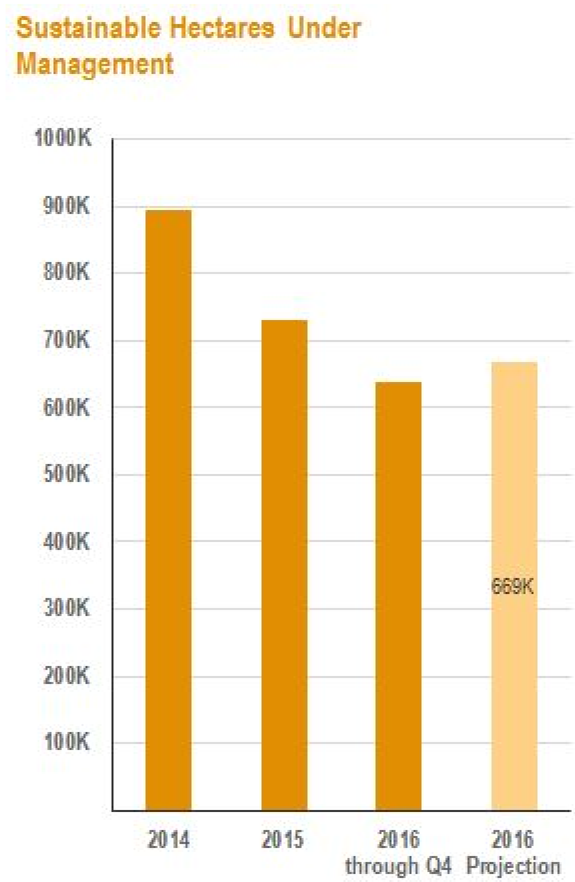
PORTFOLIO PERFORMANCE

Social and Environmental Metrics

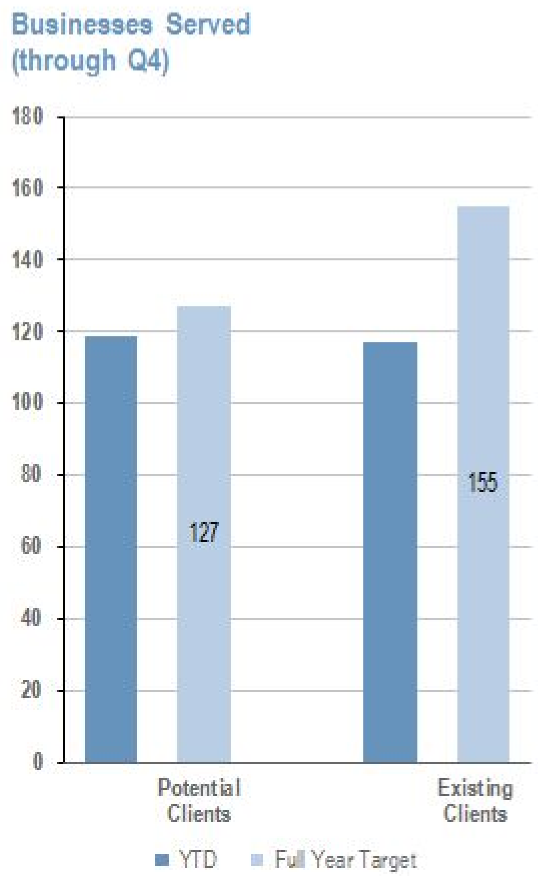


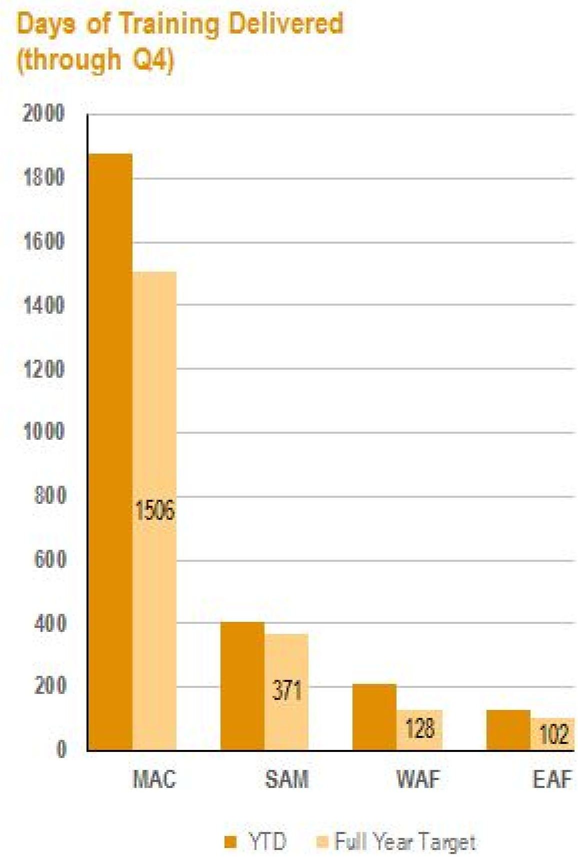




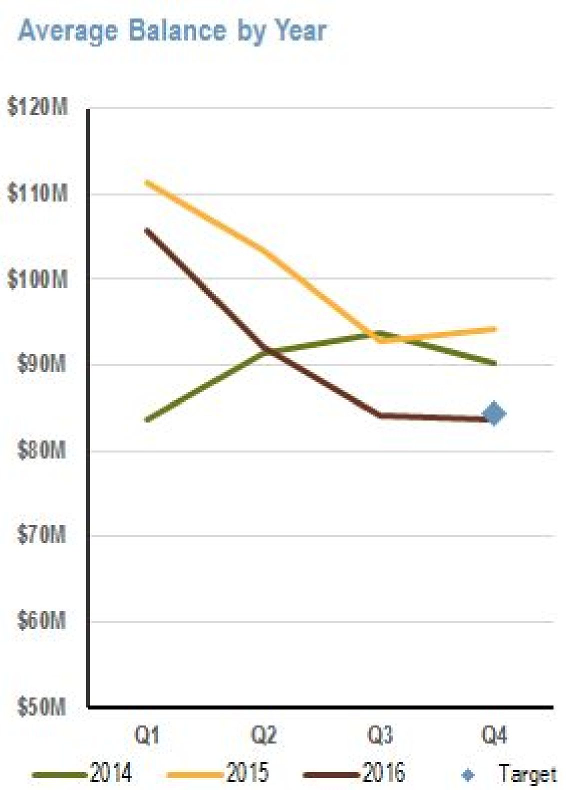


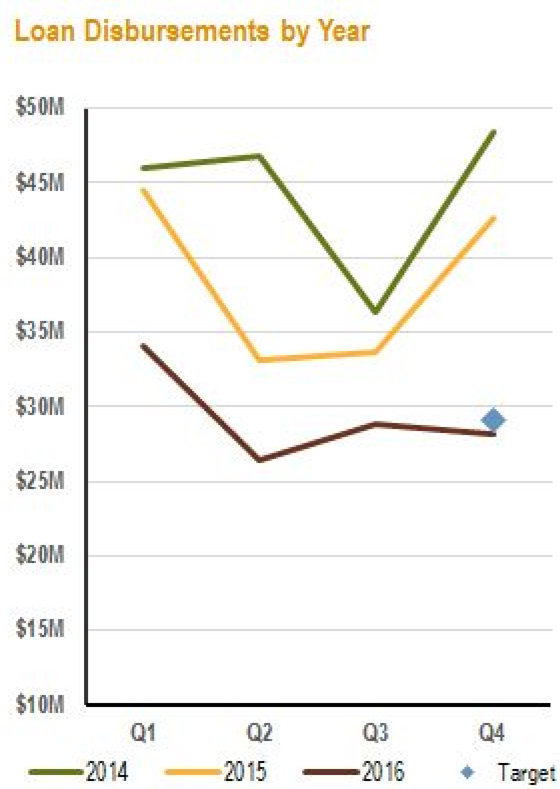
Advisory Services



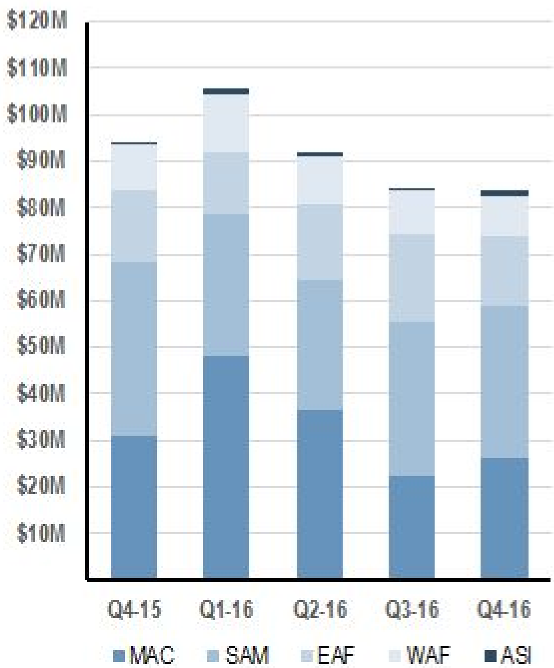


Lending Performance

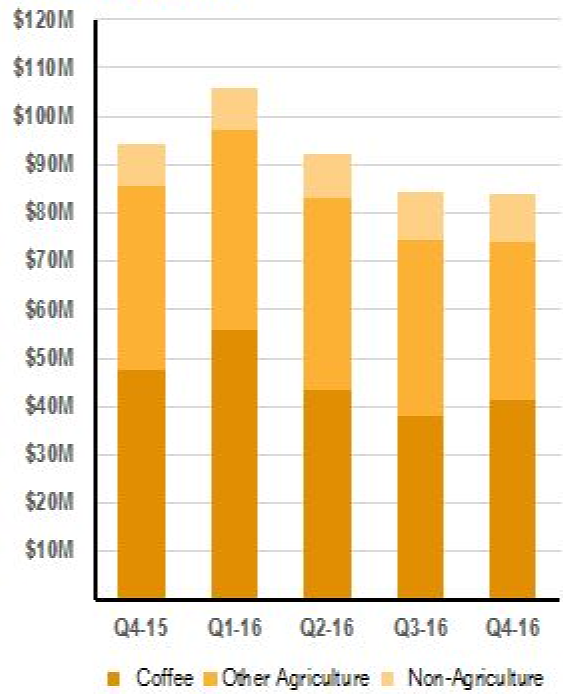




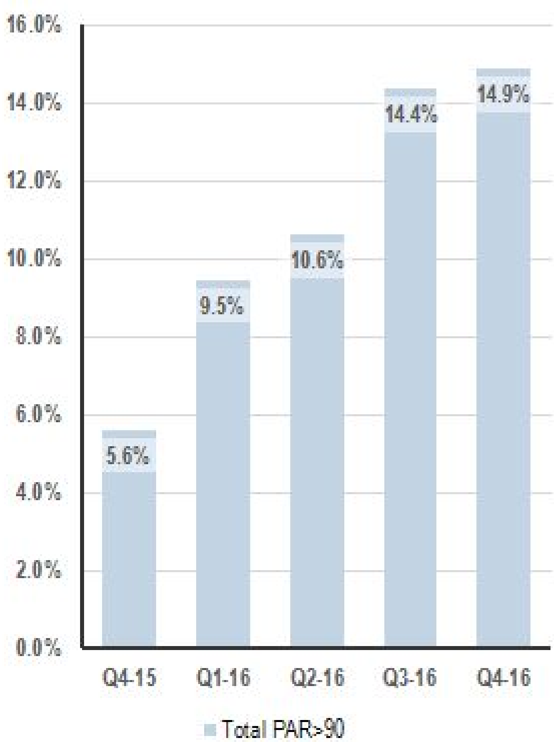
Average Balance by Region (Trailing 5 Quarters)



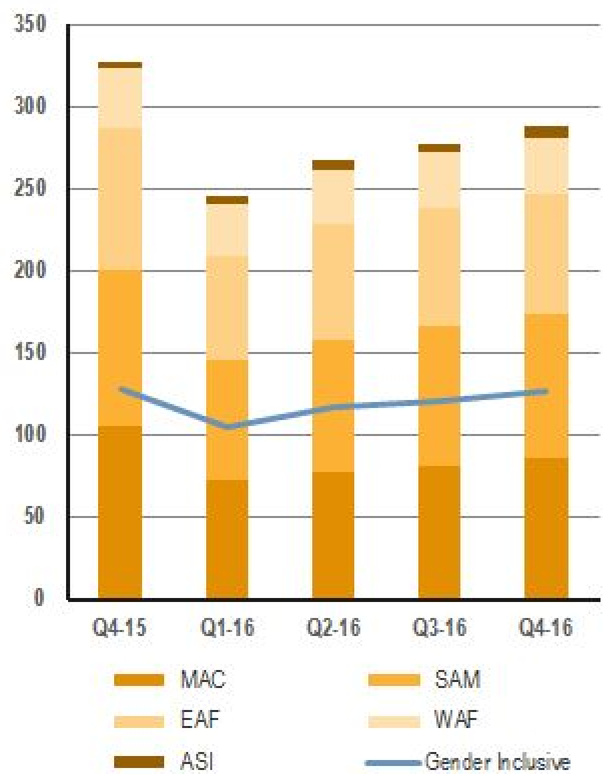
Average Balance by Industry (Trailing 5 Quarters)



Portfolio at Risk > 90 Days



Number of Clients Reached by Region



FINANCIAL RESULTS

Balance Sheet

Balance Sheet Highlights			
Thousands of USD	2015	2016	Yr/Yr Growth
Cash and Short-Term Investments	25,462	26,432	4%
Total Loans Receivable	100,673	83,651	-17%
Less: Allowance for Credit Losses	(5,408)	(10,742)	99%
Loans Receivable (net)	95,265	72,909	-23%
Other Assets	10,199	6,850	-33%
Total Assets	**130,927**	**106,191**	**-19%**
Senior Debt	96,474	79,662	-17%
Subordinated Debt	3,300	8,880	169%
Other Liabilities	5,341	2,465	-54%
Total Liabilities	**105,115**	**91,007**	**-13%**
Lending Net Assets & Op Reserve	21,306	10,817	-49%
T/R Net Assets (Purpose & Time)	4,506	4,367	-3%
Total Net Assets	**25,812**	**15,184**	**-41%**
Total Liabilities & Net Assets	**130,927**	**106,191**	**-19%**

Key Financial Metrics			
	2015	2016	Yr/Yr Growth
Grant Net Assets* ($000)	9,190	14,573	59%
Debt-to-Equity Ratio**	3.92	4.04	0.12 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	2015	2016	Yr/Yr Growth
Loan Interest and Fees	11,573	7,823	-32%
Gain / (Loss) on FX Lending	(1,476)	(600)	-59%
Interest & Fee Revenue	**10,097**	**7,223**	**-28%**
Net Interest Expense	(2,457)	(2,198)	-11%
Net Interest & Fee Revenue	**7,640**	**5,025**	**-34%**
Net Provisioning Expense	(5,842)	(9,314)	59%
Net Lending Revenue	**1,798**	**(4,288)**	**-339%**
LAFCo & Agency Services Fees	394	693	76%
Net Operating Revenue	**2,192**	**(3,595)**	**-264%**
Operating Expenses	(15,855)	(15,389)	-3%
Operating Need	**(13,663)**	**(18,984)**	**39%**
Contributions for Operations	10,402	8,442	-19%
Fee for Service Revenue	282	472	67%
Operating Surplus / (Deficit)	**(2,979)**	**(10,070)**	**238%**
Non-Operating Item	0	(466)	N/A
Surplus / (Deficit)	**(2,979)**	**(10,536)**	**254%**

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.