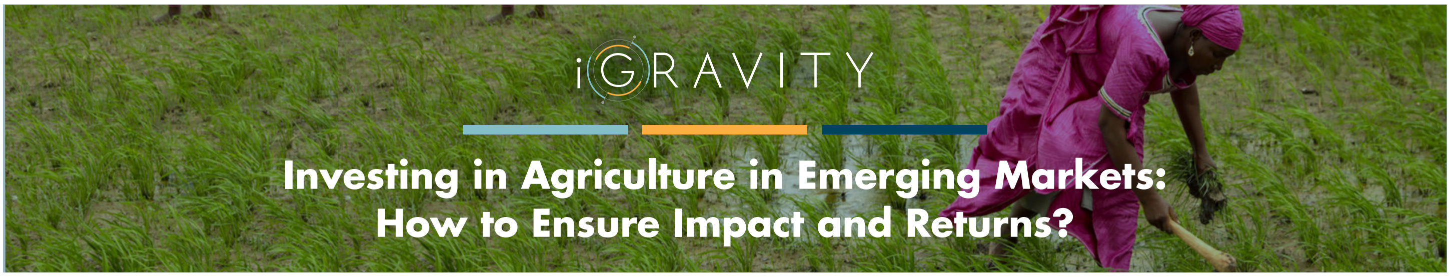


Investing in Agriculture in Emerging Markets: How to Ensure Impact and Returns?

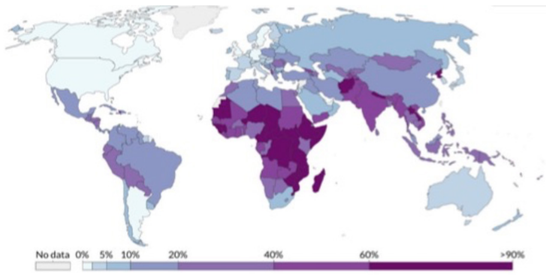
Abstract

Investing in sustainable and inclusive agriculture in emerging markets can have the triple benefits of alleviating poverty, mitigating climate change, and providing attractive returns for investors. However, ensuring impact and returns can be tricky, as investors traditionally see this sector as high risk and find it difficult to avoid "impact-washing". In this executive summary, we will share the key takeaways from our research and conversation with Agriculture and Commodity Structured Trade Finance expert Nabil Marc Abdul-Massih, CEO of INOKS Capital. Particularly, we'll address how investors can:

- Finance the different actors across the agricultural value chain
- Mitigate the risks linked to Emerging Market Agriculture investments
- Find attractive opportunities both from an impact and financial perspective.

The market

Share of the world labour force employed in agriculture



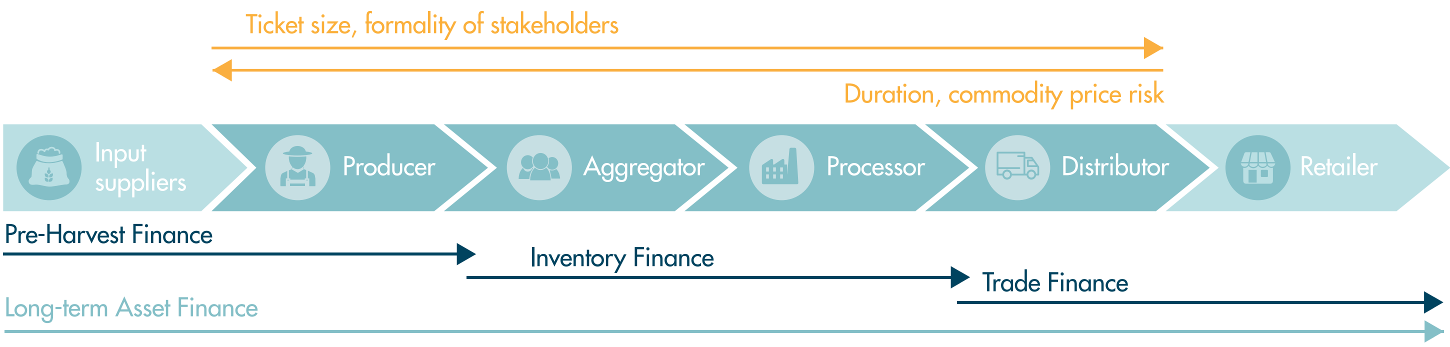
Agriculture is a major source of employment in emerging markets. Indeed, this sector represents around 14% of the labor force in Latin America, 42% in South Asia and 53% in Sub-Saharan Africa[1]. Furthermore, some studies show that investments in agriculture are 2 to 4 times more effective in reducing poverty than investments in other sectors[2]. Yet, the industry is highly underfunded, with Africa representing the extreme case where agriculture generates 32% of GDP, yet represents less than 10% of commercial lending. This, along with our need to transition towards more environmentally sustainable farming techniques, improve local food security, and decrease food waste, creates huge opportunities for investors to generate both impact, as well as attractive financial returns.

Financing needs across the value chain

The agricultural value chain is characterized by its fragmentation and stakeholders' diversity: indeed, it is typically comprised of many different actors, who have specific financing needs at different times. The main differentiators are:

- **Ticket size:** smallholder farmers require little financing, a few thousand dollars, to purchase inputs and get by until harvest. On the other end of the spectrum, distributors usually are relatively large companies that need $1M+ in order to finance their operations. Aggregators and processors typically fall in between.
- **Formality:** most aggregators and processors are SMEs on the smaller end of the spectrum, characterized by a high level of informality, making due diligence processes fairly long and costly. This differs from larger distributors that are more organized and used to dealing with professional investors.
- **Duration:** regarding working capital needs, producers require financing for 3-9 months during the growing season depending on the type of crops that they produce. Aggregators on the other hand have peaks in their funding needs, as they need to buy inventory during harvest, and ideally sell it over a few months in order to avoid selling all their stock when prices are at the lowest. Finally, processing and distribution companies typically sell their products on credit to their own clients, so they have to wait weeks or months before getting paid by their clients.
- **Risk and collateral:** the risk is at its highest during the growing season, as there is a lot of uncertainty regarding not only internal operational risks of the borrower, but also external risks such as future commodity prices and weather events. As we move down the value chain, external risks decrease substantially and change as prices get set and production is secured, and lenders can focus on assessing internal risks of the borrower and the transformation chain. Similarly, farmers are typically the ones having the lowest levels of quality collateral, compared to actors further down the chain who can use their inventory or hard assets as collateral.

[1] Source: World Bank (2019) [2] Source: FAO (2018)



iGravity's view: At iGravity, we believe that in order to ensure both environmental and social sustainability across the agricultural value chain, each actor must play their part: producers have to use farming techniques that are respectful to the environment, and aggregators and processors have to minimize food waste and provide farmers with fair prices for their products. Finally, distributors have to ensure transparency on the origin of their supply, and set high sustainability standards for their suppliers.
In order to achieve these objectives, investors have a key role to play in providing appropriate financing to the different stakeholders in the value chain.

Investment strategies for investors

The variety of financing needs in the agricultural sector provide investors with different investment strategies. Those have different risk, return and liquidity profiles, as illustrated in the table below.

Target beneficiary	**Smallholder farmers**	**Aggregators (small SMEs, cooperatives)**	**Larger SMEs**
Investment strategy	Microfinance (typically semi-liquid)	Specialized private debt (typically illiquid)	Specialized private debt (semi-liquid or illiquid)
Specifics	• Stable returns achieved through high level of diversification • Indirect financing through financial institutions • Only a few specialized on rural areas	• Return profile depends on stage of development of the company, formality of the sector, etc. • More costly to serve • Arguably the highest impact potential with regards to economic development	• Stable returns achieved thanks to robustness of borrower • Impact mostly through the standards that it sets upward in the value chain (sustainable farming, fairtrade, etc)

iGravity's view: There are attractive opportunities to invest in impactful companies in the agricultural sector, through a diversified portfolio of assets that finance the different stakeholders along the value chain.
While there doesn't seem to be any trade-off between impact and returns when investing in smallholder farmers and larger SMEs, we do see some tension when venturing into small SMEs and cooperatives, often referred to as the "missing middle". Indeed, while they arguably represent the highest impact potential, they are quite expensive to serve and often require additional support in the form of technical assistance. This makes them a perfect case for blended finance strategies and more patient capital.

In this section, we have focused on working capital needs in the agricultural sector. However, farmers and companies also have a large need for long-term financing to transition their operations to a more sustainable model, invest in storage and machinery that would allow to decrease food waste, among others. Obviously, long-term financing needs imply longer duration and lower liquidity for investors.

INOKS CAPITAL

INOKS Capital is a FINMA prudentially regulated asset manager of collective investment schemes. The Funds managed by INOKS Capital provide short term customized alternative credit solutions to non-speculative corporates that are active predominantly in the Agri/Food sector covering the entire value chain from i.e. funding of input factors like seeds, harvesting, processing and distribution to ultimately the "plate" of the consumer.

For example, one of the investees is a corporate in Eastern Europe where the financing spans the purchase of seeds, crushing, storage and shipment of sunflower and rapeseed oil to the final destination (port). Another example is the production of groundnuts in South Africa which are used to providing food inputs for school canteens, and which help to create employment opportunities in local communities.

Nabil Marc Abdul-Massih, CEO of INOKS, explains the specific characteristics of financing along extended parts of the value chain which include ensuring added value of the various steps, controlling ESG aspects, as well as measuring concrete positive impact.

Transactions in Emerging Markets are often perceived as higher risk, even if the underlying goods produced are the same as in developed markets. The risk aspects need to be measured carefully already when conducting due diligence for each transaction. INOKS ensures a constant monitoring of the risk through the various steps of the value chain exposed in each transaction and provides also technical assistance when necessary.

These risk mitigation practices need to be carefully applied in order to generate attractive returns, which has been the case for INOKS over the past 15 years since the inception of the strategy.

iGravity's view: INOKS' strategy provides financing in a sector and across geographies that are typically underserved, and does so by integrating a thorough impact assessment to its comprehensive risk management practices. This, coupled with the strategy's return and liquidity profile, represents an attractive investment opportunity for our impact investment solutions.

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