LAFCo Lending for African Farming

Disclosure Statement

Operating Principles for Impact Management

Lending for African Farming Company (LAFCo)

1 February 2022

Lending for African Farming Company (LAFCo) hereby affirms its status as a Signatory to the Operating Principles for Impact Management (the "Impact Principles").

In February 2021 the Company became the 112th Signatory to the Impact Principles and hereby attests that the Impact Principles are incorporated into LAFCo's current and future investment activities. The Impact Principles provide a reference point against which the impact management systems of funds and institutions may be assessed. They draw on emerging best practices from a range of asset managers, asset owners, asset allocators, and development finance institutions.

Total assets under management in alignment with the Impact Principles are USD19.6 million as of 31 December 2021.

Kevindren Ramsamy
Director
Lending for African Farming Company

Principle 1: Define strategic impact objective(s), consistent with the investment strategy

The Manager shall define strategic impact objectives for the portfolio or fund to achieve positive and measurable social or environmental effects, which are aligned with the Sustainable Development Goals (SDGs), or other widely accepted goals. The impact intent does not need to be shared by the investee. The Manager shall seek to ensure that the impact objectives and investment strategy are consistent; that there is a credible basis for achieving the impact objectives through the investment strategy; and that the scale and/or intensity of the intended portfolio impact is proportionate to the size of the investment portfolio.

- Our investment strategy, in addition to the delivering targeted returns to investors, is to stimulate economic growth in the African agriculture sector by investing in agricultural small and medium-sized enterprises (agri-SMEs) that are linked to smallholder farmers, thereby reducing poverty and enhancing food security in rural poor areas.
- This is contractually reflected in the LAFCo's investment management agreement.
- LAFCo works to strengthen the inclusive business models of its portfolio companies so that these are able to ensure income and development gains for employees and smallholders in line with SDG 1: No Poverty; SDG 2: Zero Hunger; and SDG 8: Decent Work and Economic Growth, while remaining commercially profitable.
- LAFCo's theory of change (ToC) describes how our provision of funding and the implementation of our investment strategy aims to promote sustainable agri-SMEs, enhance smallholder incomes, and ultimately contribute towards a positive impact on African food security.
- To achieve our vision and mission, LAFCo focuses on the following:
  - <u>Providing Credit</u>
    LAFCo provides short term loans and flexible lines of credit to enable agricultural enterprises that work with smallholder farmers to grow and source higher volumes of product from farmers. This in turn creates income generation opportunities for smallholder farmers and actors across the value chain.
  - <u>Social and Economic Impact</u>
    LAFCo will generate social and economic impact for the African agricultural sector, including direct impacts on increased employment and revenue for SMEs as well as indirect impact on smallholder farmers through higher, more stable incomes, improved productivity, reliable markets and increased food security.
  - <u>Demonstrating Viability</u>
    LAFCo aims to demonstrate the viability of agricultural finance in Africa by generating positive returns for the facility and its shareholders by servicing a blend of impact and commercial debt and attracting additional finance to the sector.

Principle 2: Manage strategic impact on a portfolio basis

The Manager shall have a process to manage impact achievement on a portfolio basis. The objective of the process is to establish and monitor impact performance for the whole portfolio, while recognising that impact may vary across individual investments in the portfolio. As part of the process, the Manager shall consider aligning staff incentive systems with the achievement of impact, as well as with financial performance.

- LAFCo has in-house impact capacity and has partnered with an external and independent ESG and impact modelling consultancy to assist with impact data collection, reporting and verification.
- As part of the pre-investment due diligence process, the impact of LAFCo's prospective investments is evaluated prior to presenting the deal to the credit committee. A dedicated impact report for each potential investee accompanies the credit application, and assesses impact based on the Impact Management Project (IMP) framework. This is where the five dimensions of impact are assessed: What, Who, How Much, Contribution and Risk. Further, both the direct impact on the investee and the indirect impact on beneficiaries within the value chain is evaluated. In some instances, LAFCo assigns specific pledges or targets around impact, depending on the client and context.
- LAFCo has predefined impact metrics which are used to assess each prospective investee. This forms the baseline data, against which investees are re-evaluated on an annual basis. Portfolio companies are contractually required to supply impact data and meet LAFCo's impact reporting requirements. These metrics span a wide range of indicators that include sex-disaggregated data for employees, smallholder farmers linked to SMEs and farmers using extension services and/or receiving improved inputs, as well as units sold, agricultural yields, and payments to farmers.
- Looking ahead, we will formalise LAFCo's impact measurement and management system, to clearly outline all the processes necessary to achieve the impact goals.
- As the investment manager of LAFCo, Barak Fund Management Limited's fee structure pays out at different levels depending on the achievement of impact data collection and impact reporting targets.

Principle 3: Establish the Manager's contribution to the achievement of impact

The Manager shall seek to establish and document a credible narrative on its contribution to the achievement of impact for each investment. Contributions can be made through one or more financial and/or non-financial channels.[1] The narrative should be stated in clear terms and supported, as much as possible, by evidence.

- A key consideration when assessing a potential investment opportunity for LAFCo is ensuring we are playing an additive role in the markets in which we operate. LAFCo looks to serve SMEs that are under-served by the local financial sector for a number of reasons that LAFCo can address, including stringent security requirements, cumbersome and lengthy loan approval documents and disbursement processes, and prohibitive and opaque pricing. Innovative loan

[1] For example, this may include: improving the cost of capital, active shareholder engagement, specific financial structuring, offering innovative financing instruments, assisting with further resource mobilization, creating long-term trusted partnerships, providing technical/ market advice or capacity building to the investee, and/or helping the investee to meet higher operational standards.

structures and collateral requirements, flexible lines of credit, as well as the option of risk sharing with industry partners are forms of additionality deployed. LAFCo also ensures that the loan sizes and rates offered are sustainable for the business.
- LAFCo also seeks to achieve impact via non-financial channels, by supporting portfolio companies with technical assistance (TA) via technical assistance partners, and in the future, via LAFCo's own TA facility. With the help of our TA partners, we seek to deploy inclusive technical mechanisms that strengthen supply chain, with specific emphasis on smallholder farmer engagement, and promote commercial returns, impact and resilience.

Principle 4: Assess the expected impact of each investment, based on a systematic approach

For each investment the Manager shall assess, in advance and, where possible, quantify the concrete, positive impact[2] potential deriving from the investment. The assessment should use a suitable results measurement framework that aims to answer these fundamental questions: (1) What is the intended impact? (2) Who experiences the intended impact? (3) How significant is the intended impact?[3] The Manager shall also seek to assess the likelihood of achieving the investment's expected impact. In assessing the likelihood, the Manager shall identify the significant risk factors that could result in the impact varying from ex-ante expectations.

In assessing the impact potential, the Manager shall seek evidence to assess the relative size of the challenge addressed within the targeted geographical context. The Manager shall also consider opportunities to increase the impact of the investment. Where possible and relevant for the Manager's strategic intent, the Manager may also consider indirect and systemic impacts. Indicators shall, to the extent possible, be aligned with industry standards[4] and follow best practice.[5]

- Due to predominantly providing short term trade finance, the most direct expected impact is linked to financial projections. Increased sales and revenues drive greater impact by sourcing larger quantities from smallholders and benefitting the supply chain.
- LAFCo assesses impact according to the following framework: impact data is collected prior to investment, forming baseline data, and is updated annually. In the future, LAFCo seeks to collect impact data on a quarterly basis to track changes according to seasonality and loan disbursement frequency. The data is verified using country and commodity-specific assumptions regarding the quantities procured, sold and the number of suppliers engaged. The impact data is complemented with financial data provided by investees and cross-checked by the LAFCo team.
- Looking ahead, LAFCo will seek to enhance the approach to impact management and measurement by tracking actual impact against our expected impact for the portfolio company.

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[2] Focus shall be on the material social and environmental impacts resulting from the investment. Impacts assessed under Principle 4 may also include positive ESG effects derived from the investment.

[3] Adapted from the Impact Management Project (www.impactmanagementproject.com)

[4] Industry indicator standards include HIPSO (https://indicators.ifipartnership.org/about/); IRIS (iris.thegiin.org); GIIRS (http://b-analytics.net/giirs-funds); GRI (www.globalreporting.org/Pages/default.aspx); and SASB (www.sasb.org), among others.

[5] International best practice indicators include SMART (Specific, Measurable, Attainable, Relevant, and Timely), and SPICED (Subjective, Participatory, Interpreted & Communicable, Cross-checked, Empowering, and Diverse & disaggregated), among others.

Principle 5: Assess, address, monitor and manage the potential risks of negative effects of each investment

For each investment the Manager shall seek, as part of a systematic and documented process, to identify and avoid, and if avoidance is not possible, mitigate and manage Environmental, Social and Governance (ESG)[6] risks. Where appropriate, the Manager shall engage with the investee to seek its commitment to take action to address potential gaps in current investee systems, processes, and standards, using an approach aligned with good international industry practice.[7] As part of portfolio management, the Manager shall monitor investees' ESG risk and performance, and where appropriate, engage with the investee to address gaps and unexpected events.

- LAFCo uses screening tools such as questionnaires to determine house views on sectors/commodities & countries; as well as to provide direction on where specific ESG risks need to be addressed for those selected sectors/commodities & countries. This framework enables us to evaluate potential negative effects during the due diligence process and post-investment.
- Should specific ESG risks be identified/highlighted, an enhanced due diligence would be performed and an action plan would be discussed with the investee company around how to address and mitigate those risks.
- Monitor the progress of the investee company's ESG operations and engage accordingly; with annual reviews and re-certifications on ESG compliance.
- As LAFCo is an impact-focussed fund, we screen all potential investees against the IFC Exclusion List, which filters out companies that are at a higher risk of having negative impact on the communities and environment.
- We are looking to incorporate a quantitative tool to objectively classify and categorize ESG risks for specific commodities and countries, and apply this to each borrower in the portfolio. Scorecards would provide a benchmark system as well as better define specific questions and action plans if necessary, and allow more transparent reporting for investors on both overall and aggregated ESG risks. In the event that a borrower does not meet the required threshold as per the benchmark, or the risk identified is too great without applicable corrective action, then the borrower would not be onboarded to the platform.

[6] The application of good ESG management will potentially have positive impacts that may or may not be the principal targeted impacts of the Manager. Positive impacts resulting from ESG matters shall be measured and managed alongside with, or directly embedded in, the impact management system referenced in Impact Principles 4 and 6.

[7] Examples of good international industry practice include: IFC Performance Standards (www.ifc.org/performancestandards) and the associated Environmental, Health and Safety Sector Guidelines (Guide for Preparation of Draft Industry Sector EHS Guidelines (ifc.org)); IFC Corporate Governance Methodology (www.ifc.org/cgmethodology), the United Nations Guiding Principles for Business and Human Rights (www.unglobalcompact.org/library/2); and the OECD Guidelines for Multinational Enterprises (http://mneguidelines.oecd.org/themes/human-rights.htm).

Principle 6: Monitor the progress of each investment in achieving impact against expectations and respond accordingly

The Manager shall use the results framework (referenced in Principle 4) to monitor progress toward the achievement of positive impacts in comparison to the expected impact for each investment. Progress shall be monitored using a predefined process for sharing performance data with the investee. To the best extent possible, this shall outline how often data will be collected; the method for data collection; data sources; responsibilities for data collection; and how, and to whom, data will be reported. When monitoring indicates that the investment is no longer expected to achieve its intended impacts, the Manager shall seek to pursue appropriate action.[8] The Manager shall also seek to use the results framework to capture investment outcomes.[9]

- Principle 2 outlines LAFCo impact measurement and management system. The impact data is self-reported by the portfolio companies; however, the data is cross-checked using industry and country standards. The LAFCo team also validates the data during site visits and through the use of external consultants. Our first annual impact report[10] will be published for 2020 in February 2022, which aims to showcase the impact of our funding on SMEs and their value chains. Looking ahead, LAFCo seeks to report on impact on a quarterly basis, beginning with the fourth quarter of 2021.
- In the event that a portfolio client fails to achieve intended impact or that there has been a fundamental change to the business model of the company, LAFCo may opt to stop funding the client and demand repayment of the loan. However, the first line of action would be to engage the company to assess potential alternatives and identify whether additional support is required to achieve the desired impact.

Principle 7: Conduct exits, considering the effect of sustained impact

When conducting an exit,[11] the Manager shall, in good faith and consistent with its fiduciary concerns, consider the effect which the timing, structure, and process of its exit will have on the sustainability of the impact.

- LAFCo's investments are revolving debt, and as such do not involve exits unless necessitated by an increase in risk.
- LAFCo's investments are on the back of agricultural trades, and the client's facility is renewed or discontinued dependent on the historical performance. The client draws down and repays the interest and capital amounts as they become due, always remaining within the facility limit. Once repayments have been made and the company has performed well, the LAFCo team will conduct additional due diligence before taking the client back to the Credit Committee to have the facility renewed.

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[8] Actions could include active engagement with the investee; early divestment; adjusting indicators/expectations due to significant, unforeseen, and changing circumstances; or other appropriate measures to improve the portfolio's expected impact performance.

[9] Outcomes are the short-term and medium-term effects of an investment's outputs, while the outputs are the products, capital goods, and services resulting from the investment. Adopted from OECD-DAC (www.oecd.org/dac/).

[10] https://www.lendingforafricanfarming.com/press/lafco-annual-impact-report-2020/8/

[11] This may include debt, equity, or bond sales, and excludes self-liquidating or maturing instruments.

Principle 8: Review, document and improve decisions and processes based on the achievement of impact and lessons learned

The Manager shall review and document the impact performance of each investment, compare the expected and actual impact, and other positive and negative impacts, and use these findings to improve operational and strategic investment decisions, as well as management processes.

- The LAFCo team reviews the portfolio on a quarterly basis and the first annual impact report will summarise the impact achievements thus far by shedding light on.
- LAFCo's impact measurement and management process continues evolves based internal reviews and lessons learnt.
- As Barak Fund Management Limited won the sole mandate for LAFCo in mid-2019, the learning discussed under Principle 9 are only beginning to manifest.

Principle 9: Publicly disclose alignment with the Impact Principles and provide regular independent verification[12] of the extent of alignment

The Manager shall publicly disclose, on an annual basis, the alignment of its impact management systems with the Impact Principles and, at regular intervals, arrange for independent verification of this alignment. The conclusions of this verification report shall also be publicly disclosed. These disclosures are subject to fiduciary and regulatory concerns.

- This Disclosure Note affirms the alignment of LAFCo's procedures with the Impact Principles and will be updated annually.
- The independent external verification of LAFCo's alignment will be done by Kongiwe Environmental (Pty) Ltd, contemporary problem-solving consultancy specialising in solving real-world environmental challenges. Kongiwe Environmental specialises in environmental and social impact assessments and run a process compliant with the overarching International Finance Corporation (IFC) principles – ending extreme poverty by 2030 and boosting shared prosperity. The Company has experience in assisting Clients with Environmental Auditing and compliance assessments in light of their legal and/or corporate commitments.
- The independent verification of this disclosure statement will be completed in the 2nd quarter of 2022.

[12] The independent verification may be conducted in different ways, i.e., as part of a financial audit, by an independent internal impact assessment committee, or through a portfolio/fund performance evaluation. The frequency and complexity of the verification process should consider its cost, relative to the size of the fund or institution concerned, and appropriate confidentiality.