Income for small coffee producers

CAFENOR

Anticipated transaction impact
Improve the livelihood of small coffee farmers in El Salvador by increasing the coffee processing capacity.

Impact score	Pass (7.2/10.2)
Credit score	Pass (12/15)

Loan Overview

Commitment limit	USD 74,000
Tenor and structure	48 months. Monthly interest payments and quarterly interest and principal payments,.
Interest rate	8% p.a.

Financial Overview

Revenue 2023	USD 1.1M
Net profit 2023	USD 13.2k
Financial liabilities 2023	USD 375k
Net assets 2023	USD 493k

Company Information

Legal name	CAFETALERA DEL NORTE, S.A. de C.V.
Incorporation date	2018
Corporate address	Canton Montenegro Caserio El Pinar, Metapan, Santa Ana, El Salvador
Nature of business	Coffee production and commercialization
Website	N/A

Shareholders

Name	Share (%)
Alejandro Valiente	45,4%
Monica Cerezo	27,3%
Valeria Valiente	27,3%

Company management

Name	Nationality	Position
Alejandro Valiente	El Salvador	General Manager
Monica Cerezo	El Salvador	Export Manager
Valeria Valiente	El Salvador	Sustainability Manager

Recommendation
Extend a USD 74,000 loan to Cafenor to increase coffee processing productivity and improve efficiency.

Beneficial Returns

Business overview

Cafetalera del Norte (Cafenor) is a six-year old company that processes and exports premium green coffee beans from 74 small farmers in El Salvador. The company sells the product to specialty roasters in the US, Europe and Asia. The farmers that supply Cafenor are from four regions in the country: Palma, Chalatenango, Metapan, and Santa Ana. Cafenor also purchases coffee from five other regions occasionally.

Cafenor is focused on elevating farmer income by increasing the quality and consistency of the coffee its producers grow. To accomplish this, Cafenor provides technical assistance to small farmers, specialty seedlings bred for quality, and access to fertilizers and pesticides on credit. Post harvest, Cafenor mills the coffee to exacting standards at its solar-powered factory near Metapan, in the north of the country. Collectively, these steps enable Cafenor's coffee to command prices that average over $3.50 per pound, a 60% premium over conventional coffee prices.

Cafenor sells to five international buyers that have consistently purchased all of Cafenor's output for several years. Cafenor's coffee scores between 83 and 88 points on the 100-point SCAA scale. The coffee is considered specialty coffee if it gets a scoring of 80 or more points, with flavor, acidity, balance, and uniformity being among the rubrics of the scoring.

Even though the company is working with less than a hundred small farmers, it has identified nearly 200 coffee producers in the four regions it operates that could be coffee suppliers in the future.

Cafenor has requested a USD 74,000 loan to purchase new equipment to increase efficiency and quality in the cofee cleaning and selection process. This process is currently done manually.

Impact background and delivery

El Salvador is the smallest country in Central America and has experienced modest economic growth in recent decades, with an annual rate of 2.5% between 2013 and 2019. During the pandemic, the country's economy contracted and had negative growth levels (-7.9%), but it resumed its growth in 2021. 40% of its population is vulnerable and 29% live under the poverty line (earn less than USD 2.15 a day).

40% of El Salvador's population lives in rural areas (around 2.5 million people), and most of this population still lives in poverty (nearly 60%). Also, 27% of the rural population is represented by women as head of the household. These factors drive migration to urban areas and abroad for people looking for better economic prospects. This is reflected in the GDP: 20 years ago, agriculture represented 12% compared to less than 6% presently. The main subsectors in agriculture are coffee, sugar cane, tropical fruits, beans, maize, and rice.

Figure 1. Coffee dryer

In recent years, El Salvador has been plagued by gang violence. In response, President Nayib Bukele has instituted a state of emergency and imprisoned tens of thousands of El Salvadoreans. Today, El Salvador has the world's highest incarceration rate. The World Bank rates El Salvador 126 out of 190 countries for easily enforcing contracts.

The degeneration of natural resources and the environment in which rural families live, coupled with vulnerability and poverty, impacts the rural population. Deforestation, soil degradation, water pollution, and pesticides reduce agricultural productivity and limit the conditions for rural families' food security. Cafenor is tackling this problem by promoting organic and specialty coffee production. Through technical assistance the company provides, farmers can add more value to their existing crops, improving the household's income and reducing the use of chemicals in the soil.

Cafenor started producing bio-agricultural inputs a couple of years ago. Thanks to this initiative, 96% of coffee producers use fewer chemicals to manage the crop. However, this region can hardly be upgraded to organic fertilization due to the soil structure, which will always require some traditional fertilization.

Cafenor has 29 employees, of which 23 are temporary and only hired during the harvest seasons (from October to May).

The average volume Cafenor purchases ranges from 2,000 to 2,200 kilos of specialty coffee per small farmer. In 2023, Cafenor purchased over 162,000 kg from small coffee growers, averaging 2,190 kg per farmer. The average purchase price was USD 5 per kilo, generating an average annual income of nearly USD 11,000 per farmer. Cafenor bought, on average, 60% of the small farmers' entire harvest in 2023 for over USD 800,000.

Coffee farmers generally produce around 3,000 kg annually. The residual coffee (800 kg – 1,000 kg) not sold through Cafenor is sold to intermediaries, who, on average, pay USD 3 per kilo. A coffee farmer can earn up to USD 2,740 from these additional sales. Cafenor pays over 60% more per kilo compared to intermediaries.

Since 2020, Cafenor has steadily increased the volumes it buys from farmers. In 2020, Cafenor purchased around 72,000 kg of coffee, and by 2023, it reached over 162,000 kg. The company has grown its impact on small farmers by purchasing more significant volumes and allowing them to increase their yearly income.

Company Overview

Cafenor receives 30-day credit from the company that distributes the fertilizers to the organization and an additional 15 to 30-day credit from suppliers of services or goods.

Cafenor has five clients: Falcon Coffees Limited, Four Barrel Coffee, Typica INC, Covoya Limited, and La Primavera Coffee B.V. Figure 2 shows the revenue per client in 2023.

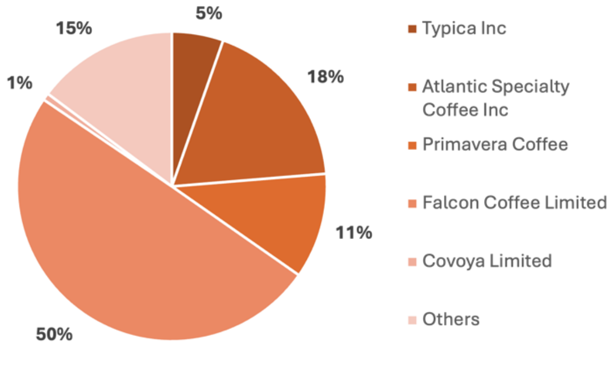

Figure 2. 2023 Revenue Distribution by Client

We spoke with Falcon Coffees and Four Barrel Coffee to better understand their relationship with Cafenor. Falcon Coffees has been working with Cafenor since 2019, and they value the company's work with small farmers to produce organically. This allows Falcon Coffees to position Cafenor's coffee more easily among its customers, and they expect to keep working together in the long term. The other customer we spoke with, Four Barrel Coffee, said, *"Cafenor has the best and most consistent quality of coffee I've encountered in the last 13 years that I've been buying coffee. I've worked with Alejandro Valiente for 12 years in various capacities; once he started Cafenor, I began to see his vision solidify and the quality of the coffee consistently improve, both in cup quality and in longevity. I value many things about Cafenor. From their focus on environmental sustainability, ingenuity, coffee quality, and social impact. I am confident that I will work with Cafenor as long as I am a coffee buyer and as long as they are an exporter — they are a key partner for us in Latin America."*

Cafenor has secured contracts to sell nearly 100 tons of specialty coffee (>60% of its 2023 sales) for the first semester 2024. The coffee collection period is from December to March. Contracts are negotiated from October to December and are usually signed in January based on expected yields. Cafenor has more demand for coffee than it can fulfill due to a bottleneck in its processing capacity. This will improve thanks to the Beneficial Returns loan.

Management

Alejandro Valiente General Manager	Alejandro's ancestors lived in Metapan; they owned large portions of land suitable for agriculture and industrializing their products. Alejandro is the 4th generation of his family and the youngest. In 2005, he was asked to collaborate in the family businesses. Alejandro agreed, but he wanted the freedom to get out of the traditional way of doing things with an emphasis on marketing, impact, and sustainability. Thus began a new stage for their farm in the specialty coffee trail. He sold coffee to the top coffee roasters in the USA, such as Verve Coffee Roasters, Counter Culture, Stumptown Coffee Roasters, MadCap Coffee, and Four Barrel Coffee Roasters. With these successes in sales, improvements in facilities, machinery, and equipment followed. Alejandro oversees the general operation and is focused on getting new clients.
Monica Cerezo Export Manager	Monica has over 20 years of experience in exporting, production processes, quality control, and management. She oversees the exporting processes by coordinating logistics and reviewing and negotiating contracts. Monica is the second in command and can assume general management whenever needed.
Valeria Valiente Sustainability Manager	Valeria has worked in the company since 2019 and is responsible for cultivating relationships with specialty coffee customers, small farmers, and import and roaster service providers. She also develops projects related to sustainability and communicates them through social networks.

Cafenor has a succession plan for the general management position. Currently, Alejandro is the organization's leader, but if Alejandro is unavailable, Monica will take over. Valeria would support Monica in all administrative and managerial tasks. All the areas in the company have an intern who constantly learns the different responsibilities of each role. Cafenor considers it crucial to have other people trained and ready to make a generational jump in leadership.

The company established a board with a defined organizational structure to manage administrative and productive processes. The critical areas in the company are quality and production, finances and administration, and sales.

Industry Overview

Figure 3. Coffee washing and fermentation

Five decades after being the world's fifth-largest coffee producer, El Salvador now ranks No. 16, according to the International Coffee Organization (ICO). However, El Salvador’s coffee is well known for its excellent quality, especially its aromatic and acidity notes. Brazil, Colombia, and Ethiopia occupy the first three positions in the coffee production ranking.

Coffee growing is highly vulnerable to climatic events and market shocks. In 2000, international prices fell due to an oversupply in the market. The Salvadoran Coffee Council (CSC) records that in the 1990s, harvests exceeded over 170,000 tons, but for the 2002-2023 cycle, they harvested only 53,000 tons.

The most significant blow to Salvadoran producers occurred in the 2012-2013 harvest, when a fierce attack of rust plummeted production by more than half, leaving it at almost 40,000 tons. Since 2021, the government has established a program to recover 25% of the affected coffee trees in the next five years. Coffee production is still hit; in the 2022-2023 cycle, it only reached 53,000 tons. Nevertheless, almost 40% of the market is known as “Strictly High Grown,” which is the best quality. In 2021, this coffee represented only 5% of total production.

Climate change still represents the most considerable risk for this sector as higher temperatures contribute to the proliferation of pests and diseases such as rust.

The Salvadoran Coffee Institute registers and monitors all coffee producers, and the Ministry of Finance regulates all service or goods suppliers. Although informality exists in rural areas, all commercial transactions are overseen. Also, as coffee growers are monitored, this gives enough information to government and sector-wise institutions to intervene when appropriate.

Financial Overview

Cafenor has shown solid financial performance, led by responsible growth through its commercial strategy. Rather than having many clients, Cafenor focused on deepening its relationships with its current clients and guaranteeing the quality of the coffee. COGS and SG&A have been stable in the last four years, showing a good understanding of how to run the business and secure a profitable one. Cafenor is expected to grow and maintain profitability through its export business because clients value the company’s commitment to social and environmental impact. The impact has driven sales in the last four years as clients purchase higher volumes yearly because they appreciate supporting small farmers.

Financial performance

In USDk	2020	2021	2022	2023	2024
Revenue	505,1	624,4	1.072,9	1.162,5	1.255,5
Cost of Sales	-440,4	-526,5	-903,1	-967,3	-1.063,7
Gross Profit	64,7	97,9	169,8	195,2	191,8
Overhead costs	-50,8	-97,8	-152,8	-182,1	-174,6
Net Profit	13,8	0,1	17,0	13,2	17,2
Financial performance metrics					
Annual revenue growth rate		24%	72%	8%	8%
Gross profit margin	13%	16%	16%	17%	15%
Net profit margin	3%	0%	2%	1%	1%

Figure 4. Cafenor Historial (2020 – 2023) Forecast (2024) Profit and Loss Statement

- The company's revenue growth volatility ranged from 72% from 2021 to 2022 to a minimum of 8% from 2022 to 2023. This is because of its strategy of acquiring new clients after deepening relationships with existing ones.
- Coffee purchases account for 83% of the total cost of sales, and the remaining 17% is represented by logistics costs, such as collecting the coffee at the farm gate.
- Gross profit margins have remained constant throughout the last four years, indicating a good understanding of the business model and commercialization strategies.
- Overhead expenses have also been constant in the last few years. This rubric comprises salaries and other administrative expenses to keep the commercialization model running. Nearly 40% of SG&A are wages and honorariums. This also implies that the business doesn't require considerable hires to keep growing.
- Like most coffee production and commercialization companies in the LAC region, Cafenor has a net profit margin of 1%. Beneficial Returns has studied several coffee enterprises in the last three years; only some have a net profit higher than 3%. Having a low net profit margin is standard for the industry and subsector.
- With the equipment financed by Beneficial Returns, Cafenor will reduce costs by up to 18%. The company manually selects the coffee, processing around 500 kg daily. The new equipment will allow them to process this volume in no more than two hours. This expands Cafenor's operational capacity and will enable it to bring more clients and sell bigger coffee batches.
- For the 2024 projections, we assumed a revenue growth of 8% as Cafenor has shown considerable growth volatility in the last three years. We also consider this growth rate achievable as the company already did it in 2023, and it is a conservative scenario. As per COGS and SG&A, we assumed 85% and 14%, respectively, due to historic performance.
- Cafenor expects to sell USD 1.4M in 2024, a 19% growth in revenue.

Financial position

In USDK	2020	2021	2022	2023
Current assets	138	364	325	314
Current liabilities	136	195	198	214
Total assets	366	613	592	808
Total liabilities	348	595	555	589
Total equity	18	18	37	219

Figure 5. Cafenor Historial (2020 – 2023) Balance Sheet

- 60% of the current assets are represented by accounts receivables, advance payments, and coffee inventories. Clients usually pay after a coffee container has been delivered. Preparing a shipment takes around 20 days.

- Cafenor owns a warehouse, vehicles to collect the coffee, and equipment to validate and standardize quality according to the client's needs. These fixed assets are valued at USD 434,000 after depreciation.
- Cafenor pays coffee farmers 50% in cash after the product is delivered; the remaining is paid 20 days later when the clients pay. The company expects to improve the cash payment conditions. This rubric represents 99% of the current liabilities; the remaining is taxes to be paid. Only 10% of the purchases are on credit because many farmers are willing to wait longer for their batches to be sold abroad. These farmers are paid better prices for the coffee, but payments are made when the international clients pay.
- Cafenor has three long-term loans with Banco Hipotecario, with an average annual interest rate of 8.6%. The outstanding balance of these loans is USD 136,562. USD 8,435 is due in October 2024, USD 33,446 is due in October 2027, and USD 94,681 is due in January 2028. The loans have annual payments of interest and capital. These three facilities are collateralized and were used to buy equipment and infrastructure.
- Cafenor manages two revolving credit lines for working capital totaling USD 280,000. It has used these credit lines since 2019, returning the capital yearly.
- The company's equity has grown in the past four years thanks to net yearly results. In 2023, the equity increased almost sixfold due to assets and equity being transferred from a family coffee farm on sale. Cafenor purchased part of the land and cashed part of the money for the sale. The land was revalued from an initial USD 2,000 per hectare to USD 3,800. These assets enabled Cafenor to provide collateral for the Banco Hipotecario loans. An additional USD 250,000 in land will be transferred as equity from Alejandro to Cafenor.
- Regarding DSCR, if the company performs as in 2023, the ratio would be 2.1. Cafenor is strong enough commercially and operationally to repay the loan and the HSBC facilities.

Transaction Overview


Figure 6. Coffee selection

Cafenor is requesting a USD 74,000 loan to acquire a sorting machine, a compressor, a vacuum packing machine, additional solar energy equipment, and infrastructure upgrades. Due to the seasonality of the business, this loan was structured as monthly interest payments and principal payments every quarter. Cafenor expects to purchase the equipment by August 2024, but they'll do it sooner if the resources are available. It takes around three months to acquire the equipment and make it operational.

The main piece of equipment is an optical sorter. Cafenor intends to purchase a Xeltron brand sorter made in Costa Rica. Currently, Cafenor sorts its beans entirely by hand, which is expensive, time-consuming, and inaccurate.

Twelve women currently sort green coffee from six to seven months per year. They are each paid USD 12 per day, or an annual cost of approximately USD 23,000. Sorting is the final stage before the milled coffee is bagged for export. Discolored beans, which can indicate pests or rot, are discarded during sorting.

With an optical sorter, Cafenor can remove its biggest bottleneck. The enterprise will be able to process up to 19 tons of additional coffee annually, generating an additional annual revenue of nearly USD 250,000. Additionally, the optical sorter will increase Cafenor's profitability. Currently, manual sorters discard many beans that are, in fact, acceptable. In tests that Cafenor ran with Xeltron, "false positives" were eliminated, increasing yield by 18%.

The company has three capex loans and two revolving credit lines with Banco Hipotecario. This financing option provides working capital to purchase coffee and fertilizers. Cafenor has received several financing options from other potential lenders. Still, they have rejected them due to the high cost of capital, and they prefer to develop a relationship with international lenders.

Major risks and mitigating factors

Risk	Probability	Risk mitigating factor
Intermittent coffee supply	Low	▪ Cafenor depends on external producers that sometimes sell their coffee to outsiders. The competition to obtain the best quality coffee is high. Cafenor mitigates this risk by providing better technical assistance to small farmers and improving the payment terms. Also, Cafenor owns their own coffee plantations, which they intend to expand to lower the dependency on external coffee producers. The company expects to purchase 30 to 35 hectares to sow coffee. This land is expected to be productive by the fourth year, capable of producing over 33,000 kg of coffee and an expected gross income of nearly USD 375,000. In the region, there are over 200 other coffee farmers that could sell their harvest to Cafenor, most of whom the company has never approached.
Climate change	Moderate	▪ In the past 20 years, climate change in the form of heavy rains and higher temperatures is something coffee farmers have to contend with. This has considerably decreased coffee production and increased diseases for the crops. The country has established a program to recover 25% of the total sowed land but it needs at least up to 2026 to see the results of this strategy. Cafenor adapts to climate change through crop management techniques like the use of adequate, high quality agricultural inputs.
Reduced labor	Low	▪ Migration makes it more difficult to find qualified labor. The company uses mechanization and wage increases for necessary workers to mitigate this risk.

Conclusion

We recommend making this loan as the company has had a good financial performance in the past four years, showing a good understanding of the coffee business. This loan will permit Cafenor to process five times more coffee than before, increasing its impact as it expands its capacity and increases productivity and efficiency. If the company keeps growing, it could be a candidate for a larger loan (possibly working capital), allowing Beneficial Returns to deepen the relationship with this borrower.

Appendix 1: Cafenor Impact Assessment

Impact score: 7.2 out of 10

Prospective borrowers are rated with 1 point for Low, 2 points for Moderately Low, 3 points for Moderately High, and 4 points for High. A minimum score of 7.65 for approval. Please refer to this document for a detailed understanding of credit score categories.

			Moderately				
		Low	Low	High	High	Score	
1. DEPTH AND BREADTH (30%)	Impact relative to the current size of the organization			X		3	2.7
	Meaningful changes to the beneficiaries			X		3	
	Beneficiaries' exclusion			X		3	
2. SYSTEMIC CHANGE (25%)	Industry game changer			X		3	2.25
	Social enterprise dependence			X		3	
	Wider impact commitment			X		3	
3. INTENTIONALITY (25%)	Focus on Impact			X		3	1.25
	Impact reporting		X			2	
4. COMMUNITY ENGAGEMENT (10%)	Stakeholder involvement			X		3	0,3
5. ADDITIONALITY (10%)	Credit history		X			2	0.7
	Catalytic funding		X			2	
	Use of funds			X		3	
TOTAL							7.2

Appendix 2: Cafenor Credit Assessment

Credit score: 12 out of 15

Prospective borrowers are rated with 1 point for Low, 2 points for Moderately Low, 3 points for Moderately High, and 4 points for High. A minimum score of 11 for approval. Please refer to this document for a detailed understanding of credit score categories.

			Moderately			
		Low	Low	High	High	Score
1. BELIEF IN MANAGEMENT (30%)	Entrepreneurs' character and motivation				X	4
	Completeness of skills between entrepreneur and next level management team				X	4
	Governance			X		3
	Reliability of financial information				X	4
2. CAPACITY (30%)	Ability to be profitable				X	4
	Revenue quality (B2B)			X		3
	Supply and operations reliability				X	4
	Working capital performance with respect to the business model				X	4
3. TRANSACTION CREDIT SCORE (20%)	Ability to service debt				X	4
	Collateral or guarantees	X				1
4. CUSHIONS AND EXTERNAL FACTORS (20%)	Vulnerability to industry-specific regulations			X		3
	Competition		X			2
	Liquidity			X		3
	Leverage	X				1
	Runway (Cash divided by last 12 months' operating cash flows)	X				1
TOTAL						12