Food Hub Financing 101

National Good Food Network – Food Hub Conference
March 2014
Wholesome Wave works to equip urban and rural communities to make healthier food choices by increasing access to and affordability of fresh regionally-grown fruits and vegetables.

Our innovative programs address issues of food insecurity, farm viability, economic vitality and diet-related diseases.

Our reach spans the nation with partners in 30 states operating over 300 program sites engaging nearly 2,500 farmers.
Our mission is to help create economically and environmentally healthy communities in which all people, especially those with low incomes, can reach their full potential.

Sustainable Agriculture and Food System Program

- Supports viability and expansion of rural food economies in Maine and the Northeast
- Foundation in farm financing; now along the value chain to healthy food retail
- Sample FY 13 food hub investments: Pearl Food Processing Center, Northern Girl
Farm Fresh Rhode Island’s programs grow a local food system that values the environment, health, and quality of life of farmers and eaters

- Nutrition incentive programs for low-income families
- Culinary education
- Value-added production
- Farmers markets
- Nutrition education
- Multi-farm CSA program
- Farm-to-school
- Aggregation and distribution of local farm products
How does WW work with food hubs?

Financing is a process that starts well before executing a deal

<table>
<thead>
<tr>
<th>Purpose</th>
<th>Screen</th>
<th>Assess</th>
<th>Engage</th>
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</thead>
<tbody>
<tr>
<td>Get to know the organization</td>
<td>Determine if and how we will work with the organization: TA or help another way?</td>
<td>Lay groundwork to secure investment</td>
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| Food hubs contact us or submit plans |

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<tr>
<th>Key Questions</th>
<th>Is this a social enterprise that fits our basic criteria for investment and mission impact?</th>
<th>What is the enterprises’ potential for growth, impact on the food system, and financial viability?</th>
<th>Which investors would be interested in this opportunity?</th>
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A food hub screening might look like this

Criteria Checklist: Does the enterprise fit with our team’s work?
Farm Fresh Rhode Island

<table>
<thead>
<tr>
<th>SUMMARY [SELECT ONE]:</th>
<th># No/Not yet Hold &amp; Watch</th>
<th>FYI</th>
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<tbody>
<tr>
<td></td>
<td>Strong</td>
<td>Medium</td>
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**Unique from traditional models: Is it a food hub?**
- Pricing: favorability towards farmers, transparent pricing model
- Traceability: is it clear where the product is sourced from?
- Market Access: small farms accessing larger institutional markets
- Development services for farmers: assistance with crop planning, food safety training, etc.

**Strategy & Business Model: Does the entity show promise and viability?**
- Potential for revenue and margin growth
- Business activities can be separated from operations (clear line of business)
- Sales track record (notable sales, even if from a pilot)
- Potential to improve, expand or replicate operations

**Impact potential: Is there a mission fit with WW?**
- Farmer equity: farm incomes (soc-eco)
- Low-income healthy food access (social)
- Low-income healthy food affordability (social)
- Employment (economic)
- Sustainable production (environmental)
- Land preservation (environmental)

**Team: Is there clear leadership? A real entity?**
- Formalized entity exists to run operation
- Entrepreneurial leadership, driver runs operation [not just collection of stakeholders]
- Quality of operating team and leadership

**Other questions**
- Are there strategic reasons to engage with this company?

<table>
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<tr>
<th>Notes/Explanations</th>
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<tbody>
<tr>
<td>Farmers set price, FFRI takes percentage</td>
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<tr>
<td>Buyers know which farms they are purchasing from</td>
</tr>
<tr>
<td>Corporate Dining, Restaurants, Schools, Hospitals</td>
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<tr>
<td>Crop planning</td>
</tr>
<tr>
<td>Diverse range of wholesale &amp; Retail opportunities</td>
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<tr>
<td>Hard to separate expenses and activities from rest of org</td>
</tr>
<tr>
<td>Operating since 2004</td>
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<tr>
<td>Potential to expand sales, have warehouse to expand in</td>
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<tr>
<td>Farmers receive more of the end price</td>
</tr>
<tr>
<td>Org focus on access, unclear how much MM and VB</td>
</tr>
<tr>
<td>SNAP, WIC, DVCF - unclear how much MM or VB</td>
</tr>
<tr>
<td>MM exp -&gt; more workers; Farm expansion -&gt; more workers</td>
</tr>
<tr>
<td>Need more info</td>
</tr>
<tr>
<td>Need more info</td>
</tr>
<tr>
<td>MM and VB are programs of FFRI</td>
</tr>
<tr>
<td>Strong leader, strong team</td>
</tr>
<tr>
<td>Team is very driven, but lacks some expertise</td>
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<tr>
<td>New England</td>
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• And ask these questions:
  • Unique from traditional models?
  • Current or potential viability?
  • Strong impact potential?
  • Clear leadership and capable support staff?
**WW assesses 9 major dimensions of a food hub enterprise**

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>BUSINESS MODEL &amp; STRATEGY</td>
<td>Business justification, revenue generation mechanism, value proposition, competitive advantage</td>
</tr>
<tr>
<td>IMPACT POTENTIAL</td>
<td>Social, environmental, and economic impact potential</td>
</tr>
<tr>
<td>MARKET OVERVIEW</td>
<td>Market size and growth, key customer segments, competitive environment, regulatory climate, trends and other market influences</td>
</tr>
<tr>
<td>MARKETING &amp; SALES</td>
<td>Target customers, customer and supplier value proposition, customer acquisition plan, product and service description, pricing strategy, go-to-market strategy</td>
</tr>
<tr>
<td>OPERATIONS</td>
<td>Core activities, use of physical resources, supplier and product mix, supplier management, processes and procedures, legal and regulatory compliance</td>
</tr>
<tr>
<td>ORGANIZATION &amp; MANAGEMENT</td>
<td>Organizational structure, CEO/Executive Director, senior management, staff, board, board governance, professional services, special relationships and resources, support network</td>
</tr>
<tr>
<td>RISK MITIGATION</td>
<td>Food safety, labor, supplier, policy environment, liability and legal coverage</td>
</tr>
<tr>
<td>TECHNOLOGY &amp; SYSTEMS</td>
<td>Technology and systems used for all aspects of operations including interactions with suppliers, customers, and employees and management of orders, delivery, accounting, inventory</td>
</tr>
<tr>
<td>FINANCES</td>
<td>Analysis of and metrics from the income statement, balance sheet, and cash flow statement</td>
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For each element of the 9 dimensions, we collect **data**, **analyze** it, and compare it to **benchmarks/examples**

### BUSINESS MODEL & STRATEGY

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<td>· What issue/need is the business addressing?</td>
<td>· A food hub should be able to explain what value it provides and why its business is necessary. Because most food hubs are launched in order to address unmet needs for farmers and/or consumers, the operators should be able to articulate how the business helps these market constituents. This justification is made stronger when the food hub can speak to specific needs in its locale or region, and has supporting research.</td>
<td>· The business can clearly articulate why its services and products will be accepted in the market area it plans to serve. The hub has supporting data and analyses.</td>
<td>· The business only vaguely explains the need for its services and does not have sufficient data to support its claims of learning.</td>
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### BUSINESS JUSTIFICATION

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<td>· Many of the microbreweries that have popped up across the country value local and do their best to incorporate local products in their beers. However, with barley spread across the country and the world and only a handful of facilities in the country processing barley into malt, most breweries are not able get one of their key ingredients from local sources. Valley Malt built its facility in Hadley, MA to address this need.</td>
<td>· With the decline of tobacco production in North Carolina, many farmers were looking for new crops and new markets. Some had begun to grow vegetables, even organic vegetables, but did not have sufficient outlets for their production. Eastern Carolina Organics stepped up to work with farmers transitioning their fields from tobacco production to organic produce production connecting farmers with wholesale markets.</td>
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A full assessment might look like this

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5 C’s of Credit

- **Capacity** – ability to pay
  - Historical numbers
  - Cash flow analysis
- **Character** – propensity to pay
  - Credit reports
  - Relationships
- **Collateral** – secondary source of repayment
- **Capital** – “skin in the game”
- **Conditions**
  - Industry and adaptability

→ Constructive Credit
  → A condition under which both parties clearly understand and agree on terms
  → Can’t make borrower worse off by giving them a loan!
Spectrum of Capital

**Business Model**
- Non-profit
- Transition business models
- For profit businesses

**Use of Capital**
- Seed capital
- Capex / growth capital
- Expansion / risk capital

**Financing Duration**
- Short-term one-off
- 1-5 years, potential refinancing
- Open-ended duration

**Repayments**
- No payments
- Fixed / variable payments (+ principal)
- Dividend payments

**Operating Control**
- Restricted use of funding
- Operational and ownership control
- Ownership dilution

**Investor Type**
- Foundations, Government
- Banks, CDFIs, Impact Investors
- Angel investors, venture capital
Capital Continuum

**Banks**
Risk averse, collateral based

**VSJF Flexible Capital Fund**
Sub debt, royalty financing, risk tolerant, no ownership dilution

**Community-based Lenders / Revolving Loan Funds**
Collateral and / or cash flow based, mission driven
EXAMPLES: VT Community Loan Fund, VEDA/VACC
Community Capital of Vermont, The Carrot Project

**State and Federal Government**
Collateral driven, looks at past performance
EXAMPLES: USDA, SBA

**Investment Clubs**
Group of individuals who meet regularly to pool money and invest, equity or debt
EXAMPLES: No Small Potatoes (Maine)

**Friends, Family, Fools**
Higher risk, may never see a return

**Grants**
Potentially risky to funder, but no repayment required by grantee
EXAMPLES: VSJF, Foundations, USDA Rural Development

**Angel Investors and Venture Capital**
High risk tolerance, ownership position, requires exit strategy
EXAMPLES: North Country Angels, Fresh Tracks Capital

**Bootstrapping**
Vendor / customer financing and growth from cash flow

**Program-Related Investments**
Very mission driven, equity or debt, usually lower returns required
EXAMPLE: Foundations (e.g., Castanea Foundation)
Types of Loans (Debt Capital)

- Internal cash flow
  - Revolving Line of Credit
  - Seasonal Line
  - Permanent Working Capital
- Acquisition of Business Assets
  - Term Loan
  - Mortgage and Construction
Loan Structuring

- Relationships and communication! – now and throughout loan term
- Match loan structure and capital type to the needs of the business
- Capital stacking – multiple types of capital and/or multiple lenders
- Senior and subordinate debt
- Terms and price, i.e. 5 year equipment loan at 6%
- Risk management and mitigation
- Loan documentation and covenants
  - Information disclosure
  - Key management, e.g. life insurance
  - Maintain Loan-to-Value or LTV [debt/collateral (discounted)]
Typical Application Requirements

• Business plan
  – Business description, history, etc.
  – Marketing plan and analysis of competition
  – Management: resumes, etc.
• Historical financials
  – 3-5 years tax returns, balance sheets, P&L statements
  – A/R and A/P aging
• Projections
  – 1-3 years, at least the first year by month
• Personal financial statements
• Sources and uses
• Summary of collateral
• Corporate docs, i.e. bylaws
• Specialty data, i.e. CDFIs collect demographics and job numbers
Common challenges from a financing perspective

• Evolving business models in a “new” industry (what are the comps?)
• Collateral coverage
  – Credit enhancements
  – Guarantees (USDA, individual, foundation)
• Often capital intensive
• Start-up or transitioning businesses
• Relationship between debt and equity
• Trading cycle and permanent working capital
• Supply chain and market analysis weak
• Entrepreneurial capacity
• Non-profits and cooperatives
• Walk before you run
FINANCING SUSTAINABLE FOOD SYSTEM BUSINESSES

WHAT IS NEEDED

Transition Capital
- Catalyst Fund
- Advisory Capital
- "Debt with Training Wheels"

WHO IT IS FOR

Evolving revenue-based businesses in the sustainable agriculture and food system sector

CHALLENGES WE FACE

- Operators require high degree of technical assistance (TA)
- Matching the right form of capital with stage of business growth.
- Coordination among the financial entities to assemble the capital stack.

COMMUNITY DEVELOPMENT FRAME: Mission-driven results, creating opportunity for economic prosperity in underserved communities
Now, let’s practice assessing a business like an investor!

We’ll be focusing on 4 of the 9 major areas for assessment:
• Business model and strategy
• Market Overview
• Organization and Management
• Finances
**Business Model and Strategy:** business justification, revenue generation mechanism, value proposition, competitive advantage

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**Business Justification**

**Context/Examples**

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**Market Overview:** market size, key customer segments, competitive environment, regulatory climate, market trends

### Market Overview

**DATA**
- What is the size of the addressable market for local food (i.e., the offerings of the business)?
- Population drives food purchases and consumption (local or not). A market sizing will rely on population, per capita consumption, and, as growth indicators, consumer trend data.

**INTERPRETATION**
- "Addressable" refers to the part of the market that is relevant to the products and services offered by the business being evaluated. The USDA’s estimate of a $5 billion market for local food nationally is not relevant to a business starting operations in, for example, Detroit, MI. Rather, a small subset of this figure—based on Detroit’s population, purchasing players, and regional consumer growth trends—would be the size of the addressable market.
- The business must determine the size of the area in which it will serve customers and then estimate the size of demand for local food within that region. This figure provides a sense of the market opportunity available to the food hub and allows you to ask: if the food hub captured 1% of the area market for local food, what volume of sales would it achieve? What about 5%? 10%?

**STRONG**
- The business demonstrates a clear understanding of its addressable market.
- The business has sized the addressable market with supporting data and indicators of growth.
- The food hub’s addressable market is large enough to support the hub’s projected sales.

**MEDIUM**
- The business demonstrates a good understanding of its addressable market.
- The business provides data on a market size, but one that is larger than the addressable market.
- The food hub’s addressable market is just barely large enough to support the hub’s projected sales.

**WEAK**
- The business cannot describe or identify the addressable market.
- The business offers no supporting data about any market size.
- If the business can identify the market, its addressable market is not large enough to support projected sales.

### Context/Examples
- Free tools, such as New Venture Advisors’ Local MarketSizer available at [http://newventureadvisors.net/marketssizer.php](http://newventureadvisors.net/marketssizer.php) can help you get a sense for the size of the area’s local food market.
**Organization and Management**: org structure, leadership, staff, training and development, board, support network

### Organizational Structure

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| • Incorporation status and legal structure of food hub.  
• Department or division roles and responsibilities (organizational chart).  
• Inter-department coordination. | • The legal structure of a food hub does not determine its capacity to be a well-functioning food hub, but in combination with the food hub’s staffing structure indicates whether or not the food hub has clear entrepreneurial leadership and direction and a formalized entity to run the operations.  
• For example, a food hub may be a project of a larger non-profit. Does the food hub have leadership and staff solely focused on the operation of the food hub or are they involved in other projects? A food hub with a strong organizational structure will have management and staff focused on food hub’s day-to-day operation and will be either a project of or a standalone formalized entity. | • The food hub is a formalized standalone entity or separate project of a larger organization.  
• The food hub has a logical departmental structure with formally and clearly delineated responsibilities for each that complement each other.  
• Food hub departments and programs coordinate activities seamlessly. | • The food hub is project of a larger organization and the activities of the food hub are not clearly separated.  
• The food hub’s departmental structure is sound, but some responsibilities overlap or lack a home.  
• Food hub departments and programs coordinate but often inefficiently. | • The food hub has no independence or separation from its larger organization.  
• The food hub’s departmental structure is illogical and it is unclear for what each department is responsible.  
• Food hub departments and programs work in silos with little coordination among them. |

### Context/Examples

- Of the respondents to the 2013 Food Hub Survey, 47% were for-profit business, 34% were non-profit, and 13% were cooperatives.
**Finances:** financial literacy, key areas of focus and metrics for income statement, balance sheet, and cash flow statement

### Financial Literacy

#### Key Areas of Focus and Metrics

- **Income Statement:**
  - Revenue growth is sporadic, but generally trending upward.
  - Expenses show support for sales activity and reflect costs of an operation that is at least improving if not close to steady and efficient.
  - Operating profit is low or frequently slightly negative, but becoming break-even is feasible with targeted changes.

- **Balance Sheet:**
  - Revenue growth is sporadic, but generally trending upward.
  - Expenses show support for sales activity and reflect costs of an operation that is at least improving if not close to steady and efficient.
  - Operating profit is low or frequently slightly negative, but becoming break-even is feasible with targeted changes.

- **Cash Flow Statement:**
  - Revenue growth is sporadic, but generally trending upward.
  - Expenses show support for sales activity and reflect costs of an operation that is at least improving if not close to steady and efficient.
  - Operating profit is low or frequently slightly negative, but becoming break-even is feasible with targeted changes.

### Income Statement Overview

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<tbody>
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<td>Historical and projected annual and monthly revenues, costs, gross income, expenses, EBITDA, and net profits.</td>
<td>If you are a non-financial person reviewing financial statements of a food hub, here are a few starting points on how to approach the income statement:</td>
<td>The food hub has generally had consistent growth in revenue.</td>
<td>Revenue growth is sporadic, but generally trending upward.</td>
<td>The food hub’s expenses consistently exceed revenue and historical trends do not suggest clear sales or operating success.</td>
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<tr>
<td></td>
<td>- Identify the core components of sales and costs.</td>
<td>Expenses have tracked revenue, represent thoughtful investments, and reflect the costs of an efficient steady operation.</td>
<td>Expenses show support for sales activity and reflect costs of an operation that is at least improving if not close to steady and efficient.</td>
<td>The income statement includes many large unexplained expenses or income and expense items that are not related to the core operations of the food hub.</td>
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<td>- Observe trends in historical data.</td>
<td>Periods of positive profit in the high season make up for periods of any low or negative profit in the low season.</td>
<td>Operating profit is low or frequently slightly negative, but becoming break-even is feasible with targeted changes.</td>
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<td>- Understand methods and assumptions on how food hub estimated sales and expenses.</td>
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<td>- Some questions you may ask include:</td>
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<td>- What are the trends? How quickly has the food hub grown historically? How quickly does the food hub project it will grow in the future? Do these trends seem reasonable?</td>
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<tr>
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<td>- How did the food hub estimate cost and expenses? Do their assumptions for projections seem sound?</td>
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### Context/Examples

- CEI prefers to provide debt financing to food hubs that are at least 3-5 years old. At this point, many food hubs need debt financing to digest continued growth and are more credit-worthy. However, CEI does occasionally work with start-ups. When looking at pro forma projections for a start-up, CEI wants to see that the assumptions and projections are as conservative as they can be and that their projections pass stress testing. CEI will ask questions, such as, “What happens to the food hub’s financial outlook if the largest customer fails through? Or if the largest supplier fails to provide the promised product?”
Group practice exercise: Assessing the business fundamentals of Farm Fresh Rhode Island

• Groups of 4-5 people, your group will look at 1 of the 4 areas:
  – Business model and strategy
  – Market overview
  – Organization and Management
  – Finances

• Each group will take a packet of materials that include one of the sections of WW Toolkit, relevant parts of Farm Fresh Rhode Island’s business plan, and a table to fill out

• Work with your group to review the materials and evaluate Farm Fresh Rhode Island for its strengths and weaknesses in one of the above areas
  – Take notes in the table provided
  – Work together to come to consensus about Strong/Medium/Weak
  – You’ll have about 30 minutes to make the evaluation in your group
  – Be prepared to share out
Share out: Would you finance Farm Fresh Rhode Island?

- How did your group rate FFRI in your area? Why?
- Would you finance FFRI? Why?
- What kind of capital do you think is appropriate for FFRI? Why?
What actually happened with FFRI?

• Deal Structure – Catalyst Fund
• Guaranty
• Monitoring Agreement
Thank you!

RESOURCES

Download the FOOD HUB BUSINESS ASSESSMENT TOOLKIT: wholesomewave.org/hfci
www.ceimaine.org
www.farmfreshri.org

Daniel Wallace
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