PROMIGAS NON BANKING FINANCING CASE STUDY: AN INCLUSIVE BUSINESS

FINANCING GAS CONNECTIONS: THE LINK BETWEEN MICROCREDITS AND THE BOTTOM OF THE PYRAMID (BOP)

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Company Background

Promigas is a publicly listed energy holding company, founded in 1974 and with its headquarters in Barranquilla, Colombia. In addition to its own operations, it has investments in 18 other companies in natural gas transmission and distribution, power distribution, and telecommunications in Colombia, Peru, Panamá and Costa Rica. Promigas is the largest private natural gas transmission company in Colombia and owns a 2,363 km pipeline extending along the Atlantic coast from Ballena to Jobo.

For twenty years, Gas Natural Colombiano S.A. developed natural gas fields in the Bolívar region, on Colombia's north coast. As these fields were depleted, the search for new gas sources led to the discovery of natural gas in La Guajira. A new company, known as Promotora de la Interconexión de los Gasoductos de la Costa Atlántica (Promigas Ltda.), was established in an effort to explore these deposits. In 1990, Promigas changed its name to Promigas S.A.

No longer involved in the exploration and production segments of the energy business, Promigas has helped to develop the market for natural gas in Colombia by promoting extensive use of this fuel on the north coast and throughout the country. Promigas' customers include power plants, cement, petrochemical, and mining companies as well as residential users. In its home country, Colombia, Promigas, through its five distribution companies, serves close to 2.4 million households or 12 million people, approximately 25% of the country´s overall population.

As of December 2011, Promigas is a major player across all segments of Colombia's natural gas supply chain, with assets accounting for over 38% of Colombia's gas transportation infrastructure. Through our directly and indirectly held companies, we are responsible for 47% of the natural gas transit within Colombia, as well as providing for 2.4 million customers nationwide, representing 39% of the domestic market. Our power distribution company supplies 286,673 households and our telecommunications branch operates 2,368 km of the metropolitan fiber optics network.

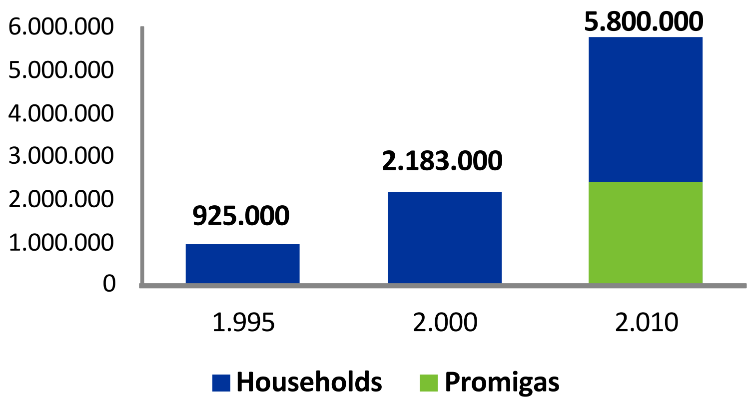
Promigas is primarily owned by private investors such as Corficolombiana, Corredores Capital Private Equity, EEB, Amalfi, and Consultoría de Inversiones. Around 8.5% of shares are controlled by Colombian pension funds and the remainder is owned by more than 800 minority shareholders.

Promigas has a structure that cannot be duplicated by its competitors. As the Colombian natural gas regulations were being developed, transporters were prohibited from having more than a 25% share in distribution companies. Promigas, which already owned a large stake in local distribution companies along its main pipeline, was exempted from these restrictions.

Promigas' senior unsecured debt is rated AAA in Colombia and BBB- internationally by Fitch rating Colombia. The company has historically been able to access both local Colombian financial markets as well as international debt markets.

Business Background

After a great success in the spread of natural gas by our five distribution companies in Colombia, which was made possible due to the financing of the natural gas connection, Promigas decided to enter into non-banking financing business, taking advantage of the experience gained throughout many years of work penetrating the Colombian market.

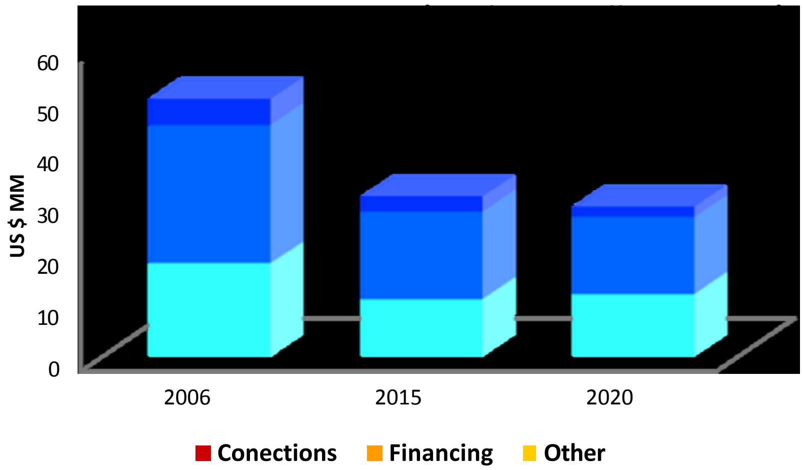


The key factors that have helped us to start this new business line are: The 6 year scheme for financing the cost of connection, that 98% of our costumers used and that the payment commitments were fully honored by our users. Also, we had close and permanent contact with 2.4 million families, due to our natural gas business.

Approximately 87% of Promigas' residential customers in Colombia belong to the lowest income brackets (BoP). Promigas has connected more than 90% of these to the natural gas network for the first time. Given that the cost of a new home connection can be about US$500 per home, as much as three times a monthly income for these families, Promigas and its local distribution companies (Gases de Occidente, Surtigas, Gases del Caribe, Gases de La Guajira, and EfiGas) offer financing in order to get over this, which is considered to be the main barrier for gas service penetration. New customers pay $25 up front, and spread the balance over up to 72 months, paying an additional $10-15 (principal plus interest) a month on the top of their regular gas bills (commodity portion). Because of the lower cost of natural gas, customers generally recoup their investments over four to six years through their savings in energy costs.

98% of users belonging to the country's lowest-income brackets have utilised the financing option, with an overall repayment rate of 98%.

As market penetration increased and more and more existing customers paid off their connections, Promigas' non-regulated revenues from that part of the business began to decline, leading the company to undertake a strategic planning process, seeking ways to a considered unavoidable decrease on EBITDA, create additional value for consumers, differentiate itself from competitors, and connect with the next generation of customers. Promigas realised then that with more than 30 years of financing new home connections, it had developed a remarkable "hidden asset": detailed knowledge of the payment habits of more than two million clients, 70% of whom had no access to the financial system whatsoever, and did not have credit histories available from other financing sources. Therefore, by rendering natural gas services and financing the connection, our companies were provided with a ***"natural credit scoring"*** that could be used to launch a non-banking financing strategy based on microcredits. The concept also took into account the so called "share of wallet" from these clients: the $10-15 set aside in each or their monthly budgets for the last 5-6 years to pay off their gas connections to keep their gas service available, that would be released once the debt balance is totally paid off.



Promigas decided to take advantage of this asset and retain this "share of wallet" by offering their clients micro-credit for other uses once they had paid off their gas connections. A large-scale survey was conducted, finding that people needed credit primarily for home improvements, starting their own businesses, school fees, household appliances, and emergencies. Home improvements, especially floors, were clients' top priority since 50% of respondents either had plain cement floors in their homes or no floors at all.

After a successful year-long pilot phase, Promigas launched a new microcredit line focused on home improvements and appliances in December 2007 under the name BRILLA. The single brand name enabled Promigas and its LDCs to launch a unified marketing campaign and maximize brand recognition for the new program. By endorsing it using their individual brand names, the companies could take advantage of the consumer trust they had already gained as public utilities in their geographical sphere of influence.

Aim

Replenishment of the companies' financing revenues coming from the natural gas connection, by taking into consideration the advantages of the company's existing hidden assets; while benefiting BoP (Social Impact) with a microcredit line, with almost no formalities and requirements, other than having been a good natural gas customer in the past.

We could definitely take advantage of our business platform, operational credibility, physical space, equipment, knowledge and continuous contact and access with our clients launching a new business line that replaced the parting revenues, once our clients paid for the connection charges.

Our target was to find something to be financed using the gas bill, highly valued by customers, that increases quality of life and generates financial income, therefore replacing companies Ebitda at stake.

Methods

Our main premise is that Brilla offers loans only up to the same amounts clients had borrowed for gas connections, at market interest rates and with repayment periods of up to 60 months. No down payment, co-signer, or collateral is required. The average amount borrowed is $400, with monthly payments of $15-30 incorporated into the borrower's gas bill. To be eligible, a prospective borrower must be an active natural gas customer, have two years without missing a single gas payment, be the gas account holder, and have finished repaying the gas hookup. The monthly repayment includes credit life insurance (typically up to $0.50 per person/month premium) to cover the outstanding amount in the event of the borrower's death.

Therefore, it is a minimum formalities automatic credit line they get for having been a good natural gas customer in the past.

Promigas and its five LDCs approach Brilla sales in different ways. They all rely heavily on two sales channels: door-to-door (either through contractors or through agents belonging to retailers) and direct point-of-sale transactions. Other channels include fairs, agencies, and call centers. For Brilla as a whole, point-of-sale accounts for 50% of transactions while door-to-door accounts for more than 45%, other channels account for only a minor share.

Once a borrower is pre-approved, he or she can purchase on credit from any one of the 271 retailers registered with Promigas. These include hardware stores, department stores, and appliance vendors eager to expand their sales into a huge demographic that would not have been able to afford their products without the microcredit provided by Promigas and LDCs. Promigas obtains capital to lend from its own retained earnings and local commercial bank lending. To manage risk, it relies on accurate assessment up-front, rigorous document control, and a highly reliable repayment channel: The borrower's existing monthly gas bill. As a safety measure, the company also sets aside 3% of loans outstanding as a provision for delinquency levels in receivables; so far this provision has not been used, given the good performance of debtors.

Brilla's management team consists of a board of directors, integrated by a credit risk expert, and experienced executives with finance, commercial, operational and administrative skills, who have monthly meetings to analyze business results and future movements. There is also a Business Development Manager in charge of Brilla integrated operations, results, unified business scheme and standards. Each distribution company has a Brilla working team that reports directly to the commercial manager of the distribution company. There is also a monthly commercial and account receivable committee are held in order to manage the different aspects of these two relevant fields.

Brilla has been a great example of team work. Discipline and focus on the originally planned business model has been one of the fundamentals for the program's success. We have taken the advantages and synergies of natural gas companies, as well as the good image, revealed in the annual survey conducted by Súper Intendencia de Servicios Públicos Domiciliarios, an entity that regulates public service companies in Colombia. Our gas service has been qualified as the best public service in our country in the last years.

By taking advantage of lessons learned while dealing with BoP and considering the positive image originally built up by the gas distribution companies and strengthened by Brilla´s financing operation we decided to move forward in 2010 into a new benefit creating business for BoP: Financing of micro-insurance in Colombia.

Micro-insurance in Colombia reaches only 8.4% of the target population. The main obstacle is the high cost of marketing and collection of insurance premiums. Natural gas distribution companies have the resources to raise the monthly premium and the contacts within the insurance market. In 2010 we launched an alliance with an insurance broker and 3 insurance companies for a massive business.

Currently, we are selling serious and permanent work disability, life and funeral insurances, at a monthly cost of approximately two dollars a month that pays up to US 2,000 in the case of serious illness. Sales are made door to door through a sales force trained and able to sell this type of intangible product to most needy, and also, those who would never expect having access at all to an insurance product. Thus, we kept on bringing service and confidence to our customers within the BoP.

This is because, usually people tends to think that insurance policies are products designed for the wealthier middle class, but Promigas decided to venture into this market in order to help low income families, who are the most exposed and the least protected when it comes to all kinds of hazards. When a family member dies or gets a permanent illness, these families are forced to reduce food consumption, pull their kids out of schools or sell their belongings, making them even poorer and further reducing their prospects. That is why every day new people and companies are becoming interested in promoting micro-insurance in low income strata, finding, unfortunately, barriers and high agency costs that prevent them from entering into the business.

Results as of 2011

- More than 600,000 borrowers have benefited from Brilla credit, 93% of them in very low-income segments (BoP) most of them located in rural areas; 31% of loan proceeds invested in home improvements and 24% in appliances, the balance have been used to computers, T.V. sets and other.
- US$300 million in loans allocated, with only 1.28% more than 60 days past due; outstanding balance as of December 31 2011 is US 146 million showing good recoup ratios.
- Net revenues of US$39.4 million in 2011, up from $1.5 million in Brilla's first year, and EBITDA of US$ 21million.

To date, Brilla has provided borrowers with access to home improvement materials, appliances, computers, and capital to start micro-enterprises and pay school fees, thus helping to improve their standards of living. Since borrowers come from very low-income segments of the population, most of them have no access to banking system whatsoever. The only way to get funds would be in the informal market with interest rates out of regular boundaries.

Promigas now considers Brilla one of its main businesses, not only because of its relevant social impact by improving low-income families' living standards, but also because by being profitable it is something the company can sustain over time. Brilla has created a wider economic ripple effect as well, creating 1,000 jobs within distribution companies as well as among the suppliers and retailers who are part of the program.

The Brilla program has been internationally known as a business case to illustrate when it comes to working closely with BoP without thinking in the traditional charity based approach. We have been invited to seminars, congresses and conferences in different parts of the world throughout which we share program business model. Recently Brilla was awarded by IFC (the World Bank) with the "Inclusive Business Leader Award 2011".

Brilla along with, other 30 participants were invited to the 2nd Annual IFC's Inclusive Business Leaders Forum. The forum took place on 22-23 September before the annual meetings of IMF and World Bank, IFC brought together customers, partners, donors and international experts to exchange experiences and knowledge of inclusive business. "Accelerating Inclusive Business Opportunities: Business Models That Make a Difference" The program of which was released at the Forum in Washington D.C.

Conclusions

Due to our natural gas market penetration and the experience gained managing more than 2.5 million gas connections, micro-credits and distribution companies throughout a strategic plan analysis of its hidden assets, originated a respond to avoid the decline of the companies Ebitda. As a result, a new solid business line was created, based on a ***natural credit profitability scoring*** provided by the natural gas business, with positive and greater results than expected and with an explosive social impact through benefiting the bottom of the social pyramid.

THROUGH MICROCREDITS, THE MOST DISADVANTAGED ARE GETTING A FOOT ON THE SOCIAL LADDER. ALL BECAUSE OF NATURAL GAS!