Research Update:

Frigorifico Concepcion S.A. Outlook Revised To Positive On Sound Operating Performance; 'B' Ratings Affirmed

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Rating Action Overview

- Paraguayan protein-processing company Frigorifico Concepcion S.A. continues to raise its slaughtering volumes following consolidation from plants acquired in the past couple of years.
- We believe these higher volumes, coupled with lower cattle costs, will result in record EBITDA generation and improving EBITDA margins.
- On Oct. 2, 2023, S&P Global Ratings revised its rating outlook on the company to positive from stable and affirmed its 'B' issuer credit and issue-level ratings.
- The positive outlook reflects our expectation that Concepcion will post EBITDA above $150 million and an EBITDA margin above 10% in 2023 and 2024. We also expect the company to keep debt to EBITDA below 3.5x and sources of cash above uses of cash in the next 12 months, while ramping up the recently acquired facilities and expanding its operations.

Rating Action Rationale

Concepcion has sound operating performance, with high slaughtering volumes, and record EBITDA generation. During 2021 and 2022, the company increased its slaughtering capacity from around 850,000 heads to about 2.3 million. It also has increased geographic diversification, and we now estimate around 40% of total production will come from Brazilian assets.

Given this growth, last-12-months EBITDA as of June 2023 reached $138 million, and we expect EBITDA around $170 million in 2023, from $115 million in 2022 and $65 million in 2021. At the same time, the EBITDA margin reached 14.5% and 11.6% in the second and first quarters of 2023, respectively. Therefore, we now expect EBITDA margins above 10% in 2023 and 2024. The increase in the company's size and diversification, raising production volumes and EBITDA generation, could lead us to improve our business risk assessment.

Business growth has put some pressure on liquidity, but we expect the working capital cycle to normalize during 2024. Although EBITDA is increasing along with higher production amid favorable pricing, larger sales volumes are raising working capital needs, with an outflow of $113 million in the second quarter of 2023. As a result, the company posted negative free operating cash flows in the first half of 2023, weighing on its liquidity position. Cash declined to $49 million in the second quarter of 2023 from $75 million in December 2022.

We believe the company has made significant progress in ramping up acquired plants and is close to reaching optimal capacity usage. Thus, we believe working capital needs should start easing during 2024. To consider an upgrade, we would look for Concepcion to keep sources of funds above uses of funds in the next 12 months, to ensure some liquidity cushion to withstand industry downturns.

In line with building additional liquidity cushion, management has made public plans to raise additional financing in domestic markets in Bolivia and Brazil, and potentially through a private placement. We believe this will continue holding back a reduction in leverage as gross debt will likely increase during 2023 and 2024. Nevertheless, we expect Concepcion to maintain financial discipline, keeping leverage between 3.0x-3.5x.

Further opportunities in the international market could boost sales volumes. The Paraguayan and U.S. governments are negotiating to resume protein exports to the U.S. If this happens, Concepcion could enter a large market, increasing production and sales volume. The company could also expand its slaughtering volumes if the Bolivian government increases export quotas that would elevate the company's plant utilization above the current 62%. Furthermore, recent consolidation in the regional market could bring additional opportunities for Concepcion.

Minerva's acquisition of Marfrig plants positions Concepcion as the third-largest beef producer in the region with 8,465 heads slaughtered per day.

Outlook

The positive outlook reflects our expectation that Concepcion will post EBITDA above $150 million and an EBITDA margin above 10% in 2023 and 2024. We also expect debt to EBITDA below 3.5x and sources of cash to exceed uses of cash in the next 12 months, while the company ramps up the recently acquired facilities and expands its operations.

Upside scenario

An upgrade in the next 12-18 months could stem from last-12-months EBITDA above $150 million and margins above 10%, which could improve our assessment of business risk. At the same time, we would expect gross debt to EBITDA below 3.5x and positive free operating cash flow, even amid industry downturns. To consider an upgrade, we would also look for evidence of conservative financial policy maintaining a comfortable liquidity cushion, with sources of cash persistently exceeding uses of cash over the next 12 months.

Downside scenario

We could revise the outlook to stable if operating performance worsens owing to lower-than-expected slaughtering activity, weaker prices, or poor working capital management, leading to gross debt to EBITDA consistently close to or above 4.0x and funds from operations

(FFO) to debt below 20%. We could also revise the outlook to stable if liquidity does not improve, because of either high capital expenditures (capex) or working capital outflows or a more aggressive shareholder return strategy, which could result in persistent cash-flow shortfalls.

Company Description

Concepcion is a protein-processing company based in Paraguay that's involved throughout the beef supply chain, from production to processing, distribution, and exporting. It's among the top five beef exporters in Latin America, and it's the second-largest in Paraguay.

Concepcion's slaughtering capacity totals 69,000 heads of cattle per month. Its processing facilities consist of 22 refrigeration chambers, and it has meat freezing capacity of 8,050 metric tons (MT), chilled meat deposit capacity of 3,980 MT, and offal meat freezing capacity of 1,625 MT.

The company recently entered the pork processing business through the acquisition of Cabaña El Nido in Paraguay and BMG Agricola in Brazil.

Concepcion operates three production units in Paraguay, two plants in Bolivia, and four plants in Brazil. It also has a service contract with Frigonorte, increasing production capacity. The company exports to about 38 countries. Concepcion produces mainly "in natura" beef, but also chilled beef cuts, frozen products, leather, and pork products.

Our Base Case Scenario

Assumptions

- Paraguay's GDP to grow 5.0% in 2023, 3.3% in 2024, and 3.5% in 2025.
- Brazil's GDP to grow 2.9% in 2023, 1.2% in 2024, and 1.8% in 2025.
- Paraguay average inflation of about 5.0% in 2023, 4.5% in 2024, and 4.0% in 2024, mainly affecting labor-related costs.
- Brazil average inflation of about 4.9% in 2023, 3.9% in 2024, and 3.7% in 2025, mainly affecting labor-related costs.
- Paraguay average exchange rate of Paraguayan guarani (PYG) 7,310 per $1 in 2023, PYG7,345 per $1 in 2024, and PYG7,469 per $1 in 2025.
- Brazil average exchange rate of Brazilian real (R$) 5.02 per $1 in 2023, R$5.10 per $1 in 2024, and R$5.20 per $1 in 2025.
- Total slaughtering volumes of 1.73 million heads in 2023, 1.85 million in 2024, and 2.15 million in 2025.
- Total meat and pork production of about 345,000 tons in 2023, 370,000 tons in 2024, and 395,000 tons in 2025.
- Meat export prices of about $4.89 per kilogram for 2023, and $4.65 per kilogram for 2024 and 2025.
- Pork export price of about $2 per kilogram for 2023-2025.
- Capex of approximately $40 million in 2023-2025.
- Debt of about $580 million in 2023-2025.

- No dividend distribution.

Key metrics

Frigorifico Concepcion S.A.--Key metrics

	--Fiscal year ended Dec. 31--					
(Mil. $)	**2020a**	**2021a**	**2022a**	**2023e**	**2024f**	**2025f**
Revenue	514.6	673.4	1,144.2	1,528.9	1,560.1	1,605.7
EBITDA (adjusted)	64.5	65.5	115.5	169.1	169.9	174.8
Funds from operations (FFO)	47.5	42.4	85.6	119.7	113.8	118.3
Interest expense	14.8	21.6	27.5	38.3	45.7	45.7
Cash flow from operations (CFO)	(38.4)	(15.1)	(42.8)	(9.7)	56.4	101.4
Capital expenditure (capex)	6.2	41.7	49.3	40.0	40.0	40.0
Free operating cash flow (FOCF)	(44.6)	(56.8)	(92.1)	(49.7)	16.4	61.4
Dividends	0.0	0.0	0.0	0.0	0.0	0.0
Discretionary cash flow (DCF)	(44.6)	(56.8)	(92.1)	(49.7)	16.4	61.4
Debt (adjusted)	191.3	361.8	397.3	582.3	582.3	582.3
Cash and equivalents (reported)	37.2	91.4	33.7	151.0	164.5	222.9
Adjusted ratios						
Debt/EBITDA (x)	3.0	5.5	3.4	3.4	3.4	3.3
FFO/debt (%)	24.8	11.7	21.5	20.6	19.5	20.3
EBITDA interest coverage (x)	4.3	3.0	4.2	4.4	3.7	3.8
CFO/debt (%)	(20.1)	(4.2)	(10.8)	(1.7)	9.7	17.4
FOCF/debt (%)	(23.3)	(15.7)	(23.2)	(8.5)	2.8	10.5
DCF/debt (%)	(23.3)	(15.7)	(23.2)	(8.5)	2.8	10.5
EBITDA margin (%)	12.5	9.7	10.1	11.1	10.9	10.9

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. e--Estimate. f--Forecast.

Liquidity

We expect Concepcion's cash sources to be slightly below cash uses for the next 12 months, which strains liquidity. Moreover, we believe Concepcion has a limited ability to absorb high-impact liquidity events without refinancing. The liquidity assessment also reflects the short track record of the company's issuances in capital markets and relationships with banks, as well as credit metrics volatility.

Principal liquidity sources are:

- Cash and equivalents of about $49 million as of June 30, 2023;
- FFO of about $120 million in the next 12 months; and
- Promissory notes for $30 million issued in Bolivia during third-quarter 2023.

Principal liquidity uses are:

- Principal debt maturities of about $108 million as of June 30, 2023;
- Working capital outflows of about $90 million in the next 12 months; and
- Maintenance capex of about $20 million in the next 12 months.

Covenant Analysis

Requirements

Under the 2028 notes, the company must comply with debt- incurrence covenants that include gross leverage below 3.0x and net interest coverage above 2.5x. In addition, it's required to publish a sustainability report or have an ESG rating annually. Failure to do so will raise the annual interest rate by 0.25% but it won't constitute a default.

Compliance expectations

We expect the leverage ratio to be above the covenant limit in 2023 and 2024. Non-compliance with the covenant impairs Concepcion's ability to secure new loans, but we expect the company to continue accessing working capital financing according to agreed baskets. The breach of the incurrence covenants should not be an impediment for any of the financing options the company is working on (Brazilian Certificado de Recebíveis do Agronegócio, local bonds in Bolivia, and bank lines).

Issue Ratings--Subordination Risk Analysis

Capital structure

As of June 30, 2023, Concepcion's capital structure mainly consisted of $300 million in senior secured notes due 2028, $53 million in bank loans, and $20 million in domestic unsecured bonds. Short-term debt represented 23% of total debt, and dollar-denominated debt represented 76%.

Analytical conclusions

We rate Concepcion's senior secured bond at the same level as the issuer credit rating, given that the bond is the only secured debt and represents about 60% of total debt.

Ratings Score Snapshot

Issuer credit rating: B/Positive/--

Business risk: Vulnerable

- Country risk: High
- Industry risk: Intermediate

- Competitive position: Vulnerable

Financial risk: Aggressive

- Cash flow/leverage: Aggressive

Anchor: b

Modifiers

- Diversification/portfolio effect: Neutral
- Capital structure: Neutral
- Financial policy: Neutral
- Liquidity: Less than adequate
- Management and governance: Fair
- Comparable rating analysis: Neutral

Stand-alone credit profile: b

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Frigorifico Concepcion S.A.		
Issuer Credit Rating	B/Positive/--	B/Stable/--

Ratings Affirmed	
Frigorifico Concepcion S.A.	
Senior Secured	B