Research Update:

Frigorifico Concepcion Assigned Negative Outlook On Liquidity Pressure; 'B' Ratings Affirmed, Off CreditWatch Negative

September 11, 2024

Rating Action Overview

- Paraguayan protein-processing company Frigorífico Concepción S.A.'s liquidity continues to be pressured by high working capital needs, resulting in cash flow deficits and a relatively low cash position versus its short-term debt commitments.
- On Sept. 11, 2024, S&P Global Ratings assigned a negative outlook on its ratings on Concepción and removed the ratings from CreditWatch with negative implications. At the same time, we affirmed our 'B' issuer credit rating on the company and the 'B' issue-level rating on its senior secured notes.
- The negative outlook reflects the company's tight liquidity and potentially higher refinancing risk, with high working capital consumption and negative free operating cash flow (FOCF) in 2024 and 2025.

PRIMARY CREDIT ANALYST

Francisco Gomez Comelli
Buenos Aires
+ 54 11 4891 2112
Francisco.Comelli
@spglobal.com

SECONDARY CONTACT

Amalia E Bulacios
Buenos Aires
+ 54 11 4891 2141
amalia.bulacios
@spglobal.com

Rating Action Rationale

Liquidity will remain squeezed and extending the debt maturity profile could be challenging. We expect Concepción's liquidity to remain tight in the next six to 12 months because of limited financial flexibility to extend its debt maturity profile, amid high working capital needs to support volume expansion resulting in negative FOCF. The company has successfully rolled over short-term debt in the last three months, but continues to face about $185 million in debt maturities in the next 12 months versus $56 million in cash as of June 2024.

We think extending these maturities could remain challenging amid still high interest rates, with Concepción's own bonds trading at around 20% in the last three months. However, we view as positive that the company does not have any individual material amortization in the next 12 months--amortizations during that timeframe mostly relate to diversified banking financing.

Higher debt levels haven't relieved liquidity pressures. The company increased its consolidated debt to $735 million and gross leverage to 4.5x in the second quarter of 2024, from $625 million and 3.2x in December 2023. However, the higher debt has not extended the maturity profile or relieved liquidity needs. Concepción's short-term debt has increased every quarter in the last two years.

A sound operating performance wouldn't be enough to revert cash flow deficits in 2024 and 2025. We continue to forecast a solid operating performance with higher volumes, revenues, and EBITDA in 2024 and 2025. We anticipate EBITDA close to $190 million in 2024 and $215 million in 2025, and industry average EBITDA margins around 10%, which would allow the company to roll over short-term debt. However, operating cash flow will not be enough to cover high working capital needs, resulting in negative FOCF of $106 million in 2024 and $18 million in 2025.

The volume growth that we forecast will require funding. The company's efforts to reduce working capital consumption in the second quarter of 2024 (mainly through inventory reduction) and through the rest of the year may not be enough to avoid large outflows in 2024. We expect a 15% increase in heads of cattle processed in 2024 versus the previous year and a 34% increase in 2025, especially after Concepción obtained a license to export to the U.S. from its Paraguayan facility and to China from its Brazilian subsidiary. This will translate into large working capital outflows. As a result, we expect Concepción's adjusted debt to EBITDA to peak at 4.0x in 2024 and improve to 3.4x in 2025.

Outlook

The negative outlook reflects the company's tight liquidity and potentially higher refinancing risk, with high working capital consumption and negative FOCF in 2024 and 2025.

Downside scenario

We could lower the ratings on Concepción in the next six to 12 months if it doesn't improve its liquidity by extending its maturity profile and reducing cash burn. We could also lower the ratings if we perceive growing risk to refinance its short-term debt commitments.

Upside scenario

We could revise the outlook to stable if liquidity improves, with sources of cash covering uses of cash in the next 12 months. In this scenario, the company would reduce short-term debt, working capital consumption, and free cash flow deficits.

Company Description

Concepción is a protein-processing company based in Paraguay that is involved in 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. Concepción's installed cattle slaughtering capacity totals 8,345 heads of cattle per day.

The company also participates in the pork processing business with swine slaughtering capacity of 2,238 heads per day. Concepción operates three production units in Paraguay, two plants in

Bolivia, and nine plants in Brazil. The company exports to about 45 countries.

Our Base-Case Scenario

Assumptions

- Paraguay's GDP to grow 3.8% in 2024, 3.0% in 2025, and 2.8% in 2026.
- Brazil's GDP to grow 2.0% in 2024 and 2025 and 2.1% in 2026.
- Paraguay's average inflation of about 4.0% in 2024 and 2025 and 3.5% in 2026, mainly affecting labor-related costs.
- Brazil's average inflation of about 4.2% in 2024, 3.8% in 2025, and 3.5% in 2026, mainly affecting labor-related costs.
- Average exchange rate of Paraguayan guarani (PYG) 7,411 per $1 in 2024, PYG7,525 per $1 in 2025, and PYG7,536 per $1 in 2026.
- Average exchange rate of Brazilian real (R$) 5.15 per $1 in 2024, R$5.20 per $1 in 2025, and R$5.25 per $1 in 2026.
- Total slaughtering volumes of 1.9 million heads in 2024, 2.6 million in 2025, and 2.8 million in 2026.
- Total meat and pork production of about 400,000 tons in 2024, 500,000 tons in 2025, and 530,000 tons in 2026.
- Beef export prices of about $4.4 per kilogram for 2024 and $4.3 per kilogram for 2025 and 2026.
- Pork export price of about $2.5 per kilogram for 2024, $2.4 per kilogram in 2025, and $2.3 per kilogram in 2026.
- Annual capital expenditures (capex) of approximately $40 million in 2024-2026.
- Debt of about $740 million in 2024 and 2025 and $690 million in 2026.
- No dividend distribution.

Key metrics

Key metrics

	--Fiscal year end Dec. 31--					
(Mil. $)	**2021a**	**2022a**	**2023a**	**2024e**	**2025f**	**2026f**
Revenue	673.4	1,182.6	1,629.4	1,778.3	2,084.6	2,179.5
EBITDA (Adjusted)	65.5	105.4	174.2	187.1	217.9	226.6
Funds from operations (FFO)	42.4	75.5	124.2	102.0	122.0	131.3
Interest expense	21.6	36.1	47.6	63.1	69.4	66.7
Cash flow from operations (CFO)	(15.1)	(57.3)	(132.9)	(66.4)	22.2	90.6
Capital expenditure (capex)	41.7	49.3	53.1	40.0	40.0	40.0
Free operating cash flow (FOCF)	(56.8)	(106.6)	(186.0)	(106.4)	(17.8)	50.6

Key metrics (cont.)

	--Fiscal year end Dec. 31--					
(Mil. $)	**2021a**	**2022a**	**2023a**	**2024e**	**2025f**	**2026f**
Dividends	0.0	0.0	0.0	0.0	0.0	0.0
Discretionary cash flow (DCF)	(56.8)	(106.6)	(186.0)	(106.4)	(17.8)	50.6
Debt (Adjusted)	361.8	367.0	625.0	741.0	741.0	691.0
Cash and equivalents (reported)	91.4	4.0	56.9	66.5	48.7	49.3
Adjusted ratios						
Debt/EBITDA (x)	5.5	3.5	3.6	4.0	3.4	3.0
FFO/debt (%)	11.7	20.6	19.9	13.8	16.5	19.0
EBITDA interest coverage (x)	3.0	2.9	3.7	3.0	3.1	3.4
CFO/debt (%)	(4.2)	(15.6)	(21.3)	(9.0)	3.0	13.1
FOCF/debt (%)	(15.7)	(29.0)	(29.8)	(14.4)	(2.4)	7.3
DCF/debt (%)	(15.7)	(29.0)	(29.8)	(14.4)	(2.4)	7.3
EBITDA margin (%)	9.7	8.9	10.7	10.5	10.5	10.4

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

Liquidity

We assess Concepción's liquidity as less than adequate because we expect cash sources to be below cash uses for the next 12 months. Our view of its liquidity also reflects the short track record of the company's issuances in capital markets and relationships with banks, as well as its volatile credit metrics.

Also, Concepción is exceeding its leverage incurrence covenant, therefore reducing financial flexibility, which weighs on our liquidity assessment.

Principal liquidity sources:

- Cash and equivalents of $56 million as of June 30, 2024;
- Funds from operations of about $115 million in the next 12 months; and
- New Bolivian domestic bond for $25 million issued in July 2024.

Principal liquidity uses:

- Principal debt maturities of about $185 million as of June 30, 2024;
- Working capital outflows of about $90 million in the next 12 months; and
- Capex of about $40 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, Concepción is required to publish a sustainability report or have an environmental, social, and governance (ESG) evaluation annually. Failure to do so will raise the annual interest rate by 0.25%, but it won't constitute a default.

Compliance expectations

In 2024 and 2025, we expect the net leverage ratio to exceed the 3.0x covenant limit. Noncompliance with the covenant impairs Concepción's ability to issue new debt.

Issue Ratings--Subordination Risk Analysis

Capital structure

As of June 30, 2024, Concepcion's capital structure mainly consisted of $300 million in senior secured notes due 2028, $338 million in bank loans (of which $161 million corresponds to a facility with Bank of America), and $103 million in domestic unsecured bonds. Short-term debt represented 26% of total debt, and dollar-denominated debt represented 73%.

Analytical conclusions

We rate Concepcion's senior secured bonds at the same level as the issuer credit rating. The collateral on the notes includes certain real estate properties and equipment in Paraguay and a stock pledge on 51% of the company's subsidiary in Bolivia, Frigorífico BFC S.A. (not rated). The notes represent 41% of total debt, and the only other secured debt corresponds to the credit facility with Bank of America for $161 million (22% of total debt).

Ratings Score Snapshot

Issuer Credit Rating	B/Negative/--
Business risk:	Weak
Country risk	High
Industry risk	Intermediate
Competitive position	Weak
Financial risk:	Highly leveraged
Cash flow/leverage	Highly leveraged
Anchor	b

Issuer Credit Rating	**B/Negative/--**
Modifiers:	
Diversification/portfolio effect	Neutral
Capital structure	Neutral
Financial policy	Neutral
Liquidity	Less than adequate
Management and governance	Moderately negative
Comparable rating analysis	Neutral
Stand-alone credit profile:	b

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- 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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- 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/Negative/--	B/Watch Neg/--
Frigorifico Concepcion S.A.		
Senior Secured	B	B/Watch Neg

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors,