Research Update:

Minerva S.A. Upgraded To 'BB' From 'BB-' On Substantial Deleveraging And Strong Liquidity, Outlook Stable

October 15, 2020

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Rating Action Overview

- Brazil-based protein producer Minerva S.A. has posted strong performance in the first half of 2020, enjoying robust export prices and volumes that should boost EBITDA above our expectations for 2020.
- We expect Minerva to use cash inflows to prepay debt, improving its capital structure and lowering interest burden.
- On Oct. 15, 2020, S&P Global Ratings raised the ratings on Minerva to 'BB' from 'BB-' on the global scale and to 'brAAA' from 'brAA+' on the national scale.
- We're also raising our issue-level rating on the company's unsecured debt to 'BB' from 'BB-' and keeping our recovery rating of '4' (40%) unchanged.
- The stable outlook reflects our expectation that the company will continue to deleverage by maintaining debt to EBITDA comfortably below 3x even amid the industry downturns.

Rating Action Rationale

Equity inflows accelerating the deleveraging. Two large capital inflows boosted the deleveraging in 2020. Minerva plans to use the majority of the proceeds from the equity follow-on and the warrant exercise of capital increase of a 8.4% additional stake in Salic (which now holds 33.83% of Minerva), totaling around R$1.6 billion, to prepay debt. We expect debt to EBITDA below 2x and funds from operations (FFO) to debt approaching 30% in 2021. Our estimates assume around R$1 billion in debt repayment per year in 2021 and 2022. But we also forecast a strong cash balance and ongoing debt refinancing.

Appetite for expansion, but likely reliant on third-party capital. We believe Minerva will continue to pursue growth mainly through its foreign subsidiaries controlled by Athena Foods through third-party capital. Initially, Minerva planned an IPO of Athena and then a private placement to sell a minority stake in it, but both were cancelled. We believe that any transaction would contribute to a further deleveraging of Minerva, but it should not reduce leverage much beyond 1.5x, as an equity injection would be intended for either strengthening the capital structure or for acquisitions.

Strong industry momentum should boost cash flows. We believe the sharp rise in demand from China because of the African Swine Flu will continue to boost meat demand and support the industry volumes and prices. Although the cattle owners in Brazil have also enjoyed a significant margin gain with cattle prices more than 30% higher than on average for 2019, Minerva's export profits should continue offsetting the weaker foodservice consumption and somewhat weaker meat demand in Brazil because of constant price adjustments.

Outlook

The stable outlook reflects our expectation that the company will continue to use excess cash to reduce interest burden and debt, which will enhance its financial flexibility during industry downturns. In this scenario, Minerva's growth without third-party capital would be limited in the next two years, while it uses free operating cash flow (FOCF) mainly for prepaing debt, and makes a 25% payout dividend and minor shares repurchase. In this scenario, debt to EBITDA will remain below 3x and FFO to debt will gradually approach 30% in 2021.

Downside scenario

We could take a negative rating action in the next 12 months if weaker business conditions and high input costs would hinder free cash flow generation, consuming liquidity gradually and bringing debt to EBITDA to around 3.5x and FFO to debt closer to 20%. The maintenance of a robust cash position in hard currency, in our view, acts as a buffer for scenarios of domestic stress, so a weaker cash position could prompt us to limit Minerva's ratings to those of Brazil.

Upside scenario

An upgrade is unlikely in the next two years. In our view, it would depend on Minerva's broader business scale and diversification, while the company builds a track record on maintaining liquidity, profits, and lower leverage through the cycle. However, we could take a positive rating action in the next 24 months if the company maintains debt to EBITDA below 2x, FFO to debt above 45%, and sizable FOCF generation through cycles.

Our Base-Case Scenario

- Mid double-digit revenue growth over the next couple of years, with domestic prices following inflation and export prices benefitting from a weak Brazilian real. Export prices to follow rate of the foreign currency exchange rate in the R$5.00-R$5.10 per $1 over the next few years.
- Brazil's real GDP to contract close to 5.8% in 2020 and grow 3.5% in 2021.
- Argentina's GDP to contract 12.5% in 2020 and grow 4.82% in 2021.
- Paraguay's GDP to contract about 2.5% in 2020 and grow 4.5% in 2021.
- Recession to dent Minerva's domestic volumes, while global demand bolsters its export

business. The disruption in China's hog herd--because of the ASF--should keep demand fundamentals for beef favorable at least for the next two to three years.

- Volumes in domestic market and exports to slip in 2020 because of plants' temporary closures because of the pandemic, but revenue and EBITDA to increase considerably due to higher prices.
- Inflation in Brazil of about 2.7% in 2020 and 3.5% in 2021.
- Average reference cattle prices in Brazil close to R$230 per arroba in 2020 and R$238 in 2021.
- Capital expenditures (capex) of R$276 million in 2020 and R$300 million in the next few years.
- No dividends distribution in 2020, but distribution of 25% of previous' year net income starting in 2021.
- Cash proceeds from the equity follow-on of R$1.1 billion and around R$800 million from the addition sale of stake to Salic, part in cash and part that can be received in the next 12 months.
- Shares repurchase of around R$220 million in the next 18 months.

Based on these assumptions, we arrive at the following credit metrics:

- EBITDA margins close to 11.5% in 2020 and 10.5% in 2021;
- Debt to EBITDA of 2.0x-2.5x in 2020 and in the 1.5x-2.0x range in 2021;
- FFO to debt close to 28% in 2020 and 2021; and
- FOCF of about R$1.4 billion in 2020 and R$1.1 billion in the next two years, leading to FOCF to debt ratio of above 25% at the end of 2020 and in 2021.

Liquidity

We're revising our assessment of Minerva's liquidity to strong from adequate. The company has been holding large cash positions for several years and will keep a comfortable sources-to-uses of cash ratio of above 1.5x for the next 12 months. Cash position strengthened thanks to the equity follow-on and the warrant exercise of an additional stake to Salic. This, along with expected favorable momentum for protein producers, will allow Minerva to generate strong operational cash flows in the next 12-24 months. Also, the company has maintained a smooth debt amortization profile and has cushion of above 20% in its incurrence covenant measurements, which excludes foreign exchange variation in the calculation.

Principal Liquidity Sources:

- Cash position of R$6.8 billion as of June 2020;
- Cash FFO of R$1.5 billion for the next 12 months;
- Proceeds from stock warrant execution of R$776 million in the next 12 months from June 30, 2020, R$395 million of which entered in the third quarter.

Principal Liquidity Uses:

- Short-term debt of R$3.1 billion as of June 2020;
- Working capital outflows of R$240 million in the next 12 months as of June 30, 2020;
- Seasonal working capital requirements of R$600 million;

- Capex of R$288 million for the next 12 months from June 2020;
- Dividends of R$120 million and 25% from net income; and
- Cash outflows of R$91 million for share repurchases in the next 12 months.

Environmental, Social, And Governance

Minerva's exposure to environmental risks is comparable to that of the overall industry. Its assets are spread across five countries in South America, which reduces the risk of the disease outbreak and partly offsets its heavy concentration in Brazil, where just under 40% of its production capacity is located. In addition, Minerva audits all its livestock suppliers to cope with any potential deviations in environmental practices and export restrictions.

The company has increased oversight to try to control the risk of outsourcing cattle in the biodiversity deforestation areas in Brazil but it remains a key risk to oversight. We believe Minerva is somewhat less exposed than JBS and Marfrig because of its smaller scale and because only four of its plants are located in the Amazon and Cerrado regions, representing around 18% of its slaughtering capacity in Brazil.

Social and governance risk both factor heavily in the Brazilian protein sector, because of high number of COVID-19 infections and the investigation since 2017 into bribery allegations and charges of food safety evasion practices. Minerva has remained fairly isolated from any fallout, because its senior management was not directly involved in those investigations and the company was able to reroute a portion of its production to units outside Brazil, reducing the impact from the temporary embargoes. The company reduced its slaughtering capacity by about 10% in the second quarter 2020 to implement social-distancing measures.

Ratings Above the Sovereign

We have tested Minerva's ability to withstand a sovereign default scenario to support its rating one notch above the 'BB-' sovereign foreign currency rating on Brazil, in which about 45-50% of the company's production is located, while the remainder is roughly distributed between Argentina (15%), Paraguay (20%), and Uruguay and Colombia (15%).

Minerva comfortably passes the stress test because of the export nature of its business, the 55% cash flows in foreign currency, and large cash position in hard currency (about 60% of its cash position). We assume an economic stress with currency devaluation, as observed in previous crisis in Brazil, which ends up boosting cash flows. We incorporate the following assumptions for our stress test:

- We forecast an overall decline of 30% in the company's FFO for the stressed year, which we are considering 2021, mainly reflecting higher inflation rates affecting COGS in Brazil, a GDP decline leading to a drop in slaughtering volumes and higher input costs.
- We apply a haircut of 10% over cash bank deposits in reals and of 70% over short-term investment in domestic currency, due to the inability to fully access it in the banks. We apply also haircut the cash to be received by Salic.
- We also double the company's short-term dollar denominated debt, due to the depreciated currency, but capex is reduced to maintenance levels.

Issue Ratings - Recovery Analysis

Key analytical factors

- We're raising our issue-level ratings on Minerva's senior unsecured notes to 'BB' from 'BB-' and to 'brAAA' from 'brAA+', while keeping a recovery rating of '4' (rounded estimate 40%), reflecting our expectation of an average recovery (30%-50%) for its unsecured debt in the event of default, unchanged.
- Our simulated default scenario contemplates a payment default in 2025. The default scenario encompasses a combination of increasing cattle prices, a weak demand for beef in Brazil and Argentina, and higher competition in global markets that pressures export prices.
- The subsidiary, Athena, has limited debt levels, but a scenario of higher debt there could reduce recovery prospects at Minerva, because the subsidiary doesn't guarantee the bonds at the parent and it would benefit from priority cash flows to pay down debt at Athena.
- We have valued the company using a 5.0x multiple (standard multiple for the agribusiness sector) applied to our projected emergence-level EBITDA of R$1.1 million, arriving at a stressed enterprise value of around R$5.5 billion.

Simulated default assumptions

- Simulated year of default: 2025
- EBITDA at emergence: R$1.1 billion
- Implied enterprise value multiple: 5.0x
- Estimated gross enterprise value at emergence: R$5.5 billion

Simplified waterfall

- Net enterprise value after 5% administrative costs: R$5.3 billion
- Priority secured debt: R$1.1 billion (ACC lines and other secured loans)
- Senior unsecured debt: R$10.7 billion
- Recovery expectations: 30%-50% for its unsecured debt (rounded 40%)

Ratings Score Snapshot

Issuer credit rating:

- Global scale: BB/Stable/--
- National scale: brAAA/Stable/--

Business risk: Fair

- Country risk: Moderately high risk

- Industry risk: Intermediate risk
- Competitive position: Fair

Financial risk: Significant

- Cash flow/leverage: Significant

Anchor: bb

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | Industrials: Key Credit Factors For The Agribusiness And Commodity Foods Industry, Jan. 29, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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

Related Research

- Implications Of Brazilian Meat Processors' Juicy Second-Quarter Results, Aug. 20, 2020

Ratings List

Upgraded

	To	From
Minerva S.A.		
Issuer Credit Rating	BB/Stable/--	BB-/Stable/--
Brazil National Scale	brAAA/Stable/--	brAA+/Stable/--
Senior Unsecured	brAAA	brAA+
Minerva Luxembourg S.A.		
Senior Unsecured	BB	BB-
Ratings Affirmed		
Minerva S.A.		
Senior Unsecured	brAAA	
Recovery Rating	4(40%)	
Minerva Luxembourg S.A.		
Senior Unsecured	BB	
Recovery Rating	4(40%)	

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.