Bond Analysis: Frigorifico Concepcion S.A. (FRICON) 7.70% 2028

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Bond Recommendation:

Appetite for Low Risk: UNDERWEIGHT
Appetite for Moderate Risk: MARKETWEIGHT
Appetite for High Risk: OVERWEIGHT

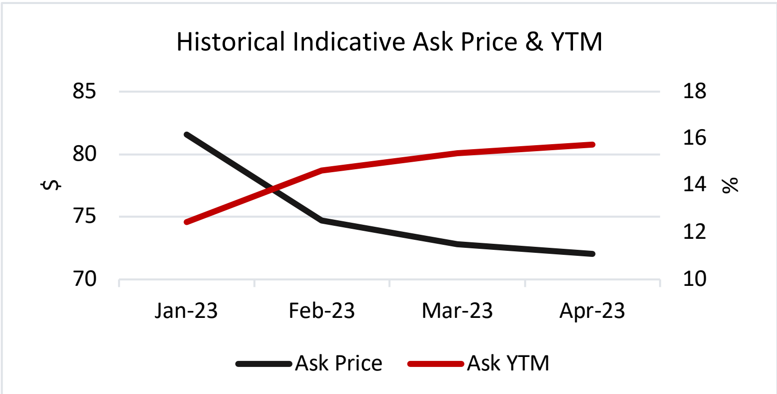
ABOUT THE COMPANY

Frigorifico Conception S.A. (FRICON) is a leading beef exporter from Paraguay accounting for 22.2% of Paraguay's beef processing in 2020. The company also has a 51.0% ownership interest in a Bolivian beef processing facility (Frigorifico BFC S.A.) and most of the company's sales are made to the international market, with exports to 37 countries. Demand continues strong from countries such as China and Taiwan.

In the years 2021 and 2022, Frigorifico purchased a pork processing facility in Paraguay, four beef processing facilities in and two pork processing facilities in Brazil, and a second beef processing facility in Bolivia. In addition, the company is building an advanced casing processing plant in Paraguay. These acquisitions have increased FRICON's business diversification and slaughtering capacity from roughly 850,000 heads to about 2.3 million.

Increased capacity has resulted in record revenues, EBITDA and net income for full year 2022, resulting in a transformational year with positive performance despite headwinds and capacity expansion costs. Revenues reached $1.1 billion and EBITDA $116 million in 2022, up 70% and 76% respectively over 2021. Net income was $63.5 million for the year, up 84% year-over-year.

Frigorifico Concepcion S.A: Bond Term Summary	
Parent Company	N/A
Issuer	Frigorifico Concepcion S.A.
Currency	USD
Issued Amount	300,000.00 (MM)
Issue Date	21/07/2021
Tenor	7 years
Indicative Ask Price[1]	72.04
Indicative Ask Yield to Maturity[2]	15.74%
Coupon (Semi-Annual)	7.70%
Credit Rating (S&P)	B
Outlook (S&P)	Stable
Maturity Type	Callable on: July 21, 2024 @ 103.850 July 21, 2025 @ 101.925 July 21, 2026 @ 100.000
Maturity	21/07/2028
Day Count Basis	30/360
Use of proceeds	General Corporate Purposes; Refinance



Recommendation: The FRICON 7.70% 2028 notes (B/B+, S&P/Fitch) are secured by real estate and equipment located in Paraguay. Given improved company fundamentals for FY 2022, we believe these bonds have been oversold on the market with an indicative yield of around 15.74% and currently offer investors an attractive entry point. The year end results provided confirmation that the company is executing on its plan to grow its scale and cash flow and provided positive guidance for this year.

[1] As at April 28th, 2023
[2] As at April 28th, 2023

ECONOMIC OVERVIEW (PARAGUAY, CHINA, BRAZIL, RUSSIA & CHILE)

Country	12/31/2022	12/31/2021
China	121,006,234	40,517,121
Brazil	116,567,948	129,453,691
Russia	110,767,972	168,694,462
Chile	88,002,301	105,348,512
Taiwan	62,650,761	42,791,474
Hong Kong	60,957,847	-
Kuwait	24,713,049	-
Israel	21,610,843	11,511,705
Other countries	78,085,419	60,264,946
Total exports	**684,362,374**	**558,581,911**

For the year ended December 31, 2022, FRICON reported that nearly 60.0% of their revenue was derived from exports to markets such as China, Brazil, Russia, and Chile. The remaining 40.0% of sales were earned in its home country of Paraguay.

Paraguay (S&P Rating: BB/Stable)

On May 18, 2022, S&P affirmed Paraguay's rating at 'BB' with a stable outlook on policies that should support Paraguay's strong GDP growth prospects and maintain macroeconomic stability. The intense drought should take a toll on the economy; However, S&P believes that the damage to Paraguay's economic fundamentals should be limited. GDP is expected to expand 5.0% in 2023 thanks to rebounding agricultural output.

China (S&P Rating: A+/Stable)

On June 29, 2022, S&P affirmed China rating at 'A+' with a stable outlook. The rating reflects the government's reform agenda, and the country's robust growth prospects and strong external metrics. These strengths were weighed against certain factors that are weaker than what is typical for peers at a similar rating level. For example, China has lower average income, less policy transparency, and a more restricted flow of information, in our view. S&P also expects that heightened geopolitical risks should not fundamentally affect China's long-term growth potential, which is anchored by the country's large domestic market and substantial productivity gains that can be made in the manufacturing and services sectors.

Brazil (S&P Rating: BB-/Stable)

On June 15, 2022, S&P affirmed Brazil's rating at 'BB-' with a stable outlook on strong private consumption due to favourable terms of trade, which should lead to stronger-than-expected economic growth in 2022, despite long-term prospects remaining low. Although inflation remains high, it is reported to be declining.

Russia (S&P Rating: CC/Watch Negative)

On March 17, 2022, S&P downgraded Russia's rating to 'CC' from 'CCC-' while maintaining a credit watch with negative implications. The downgrade follows the Russian government's reported difficulties meeting debt-service payments on the due date on its US$-denominated 2023 and 2043 Eurobonds. According to CNN in a February 2023 article, when Russia launched its full-scale invasion of Ukraine one year ago, Western countries hit back with unprecedented sanctions to punish Moscow and pile pressure on President Vladimir Putin. The aim was to deal an economic blow that was severe enough to have President Putin reconsider his invasion. Russia's economy did weaken as a result however it also showed surprising resilience. As demand for Russian oil fell in Europe, Moscow redirected its barrels to Asia. The International Monetary Fund (IMF) still expects Russia's economy to expand by 0.7% in 2023 and 1.3% in 2024. However, any outlook is contingent on what happens in Ukraine. Whether the economy shrinks or expands in 2023 may be determined by developments in the war.

Chile (S&P Rating: A/Stable)

On October 21, 2022, S&P affirmed Chile's rating at 'A' with a stable outlook. Chile's economy is expected to slow down in 2023 with GDP forecasted at 0.3%, but S&P believes it should regain momentum by 2024 to grow at 2.5%. The report also states that the country's strong institutions and policy pragmatism are likely to support sustainable growth. Chile's ratings reflect its significant monetary flexibility, stable democracy, and rule of law, and low corruption levels.

Credit Ratings - FRICON

Standard & Poor's: B/Stable
On January 25, 2023, S&P revised FRICON's outlook to Stable from Positive while maintaining its 'B' rating. The rating action reflects the Company's continued ability to raise its slaughtering volumes amid high global meat prices, but the company had missed S&P's EBITDA and deleveraging targets at the time. The stable outlook reflects S&P's belief that FRICON should post EBITDA margins of about 9.0% and debt-to-EBITDA close to 3.5x in 2023 while incorporating and ramping up the recently acquired facilities and expanding its operations.

Fitch Ratings: B+/Stable
On June 29, 2022, Fitch Ratings affirmed FRICON's rating at 'B+' while maintaining a stable outlook. The rating reflects the Company's improved business profile and expected deleveraging with the ramp-up of profitability from the recent acquisitions in Brazil and Paraguay. Additionally, Fitch affirmed that the Company benefits from low production costs, cattle availability in the domestic market, and high international prices. Efforts towards expansion activities, increased geographical protein diversification and an export business model that benefits from high international protein demand were other factors influencing the rating.

FINANCIAL ANALYSIS – FY 2021/22

USD (In Millions)	FY 2018/19	FY 2019/20	FY 2020/21	FY 2021/22
Revenue	298.3	514.6	673.4	1,144.2
EBITDA	28.5	64.5	65.5	115.4
Interest Expense	9.3	15.6	20.5	27.4
Total Equity	99.2	161.0	204.7	275.5
Long Term Debt	33.8	178.6	337.7	354.5
Short Term Debt	72.2	12.7	24.1	42.7
Total Debt	106	191.3	361.8	397.2
Operating Cash Flow	24.4	(22.5)	8.0	(12.9)
Total Debt to Equity (%)	106.9%	118.8%	176.7%	144.2%
Total Debt to EBITDA (x)	3.7	3.0	5.5	3.4
EBITDA Margin (%)	9.6%	12.5%	9.7%	10.1%
Interest Coverage Ratio (x)	3.1	4.1	3.2	4.2

For the year ended December 31, 2022, FRICON reported record revenues, EBITDA and net income resulting from a transformational year with positive performance despite headwinds and capacity expansion costs. Revenues increased to $1.1 billion from the $673.4 million recorded in the previous year, representing growth of 70.0% year-over-year (YoY). The improvement in revenue was mainly driven by a 2.8x growth in sales volume during the final quarter of 2022 (4Q22) due to expanding capacity in Brazil and higher domestic sales in Brazil and Bolivia. The positive results for the quarter also reflect management's execution of its expansion plan in Brazil.

Capacity utilization in Brazil remained at 59.0% for 4Q22 but production growth continues, and utilization is planned to reach about 80.0% over the short term.

EBITDA for the period increased to $115.4 million from the $65.5 recorded in 2021, representing an increase of about 76.0% YoY. Improved EBITDA was the result of the foregoing improvement in revenue in addition to lower cattle prices in all three countries of operation - Paraguay, Brazil and Bolivia. These factors offset lower export prices for major export destinations and lower capacity utilization. The EBITDA margin was also positively impacted, growing to 10.1% from 9.7% recorded in 2021, indicating effective cost management despite growing operations and integration of acquisitions. The foregoing culminated in reported net income of $63.5 million for 2022, which was up by 84.0% when compared to the $34.5 recorded in 2021.

For the year ended December 31, 2022, FRICON continued to demonstrate its ability to manage its debt burden well, despite higher total debt. Total Debt-to-Equity fell to 144.2% from 176.7% in the previous year. A decreasing D/E ratio means that a company is using less debt to finance its operations and investments, and instead relying more on equity. This can be viewed as a positive sign by investors, as a lower D/E ratio indicates that a company is less leveraged and has a stronger financial position. A lower D/E ratio can also make it easier for a company to obtain financing in the future, as lenders may view the company as less risky. Debt-to-EBITDA also followed a positive trend, falling to 3.4x from 5.5x and in line with the Company's target of 3.0x. The interest coverage ratio improved to 4.2x from 3.2x indicating improved ability to pay interest on debt using operating profit.

S.W.O.T Analysis

Strengths:	Weaknesses:
• Favourable Industry characterized by high demand and moderate prices. • The company adopts a pure-play strategy focused on exports which contributes to earning income in stable foreign currency. Its large size contributes to economies of scale. • Management has demonstrated adequate ability to execute on acquisitions which have materialized in a positive way. • Unaffected by concentration risks as the company benefits from geographic diversification by operating in 3 countries. •	• Diversification of product is weak with focus on beef and pork. • Fitch classifies FRICON's corporate governance as somewhat weak based on concentrated ownership and the existence of related party transactions.
Opportunities:	**Threats:**
• Recent acquisitions present an opportunity to increase capacity and volume. • The originating and main operating country, Paraguay is rated as a stable country with improving economic prospects. • Possible expansion via exports to the US to begin in short order.	• Drought conditions may affect the ability to nurture cattle stock. The most recent drought occurred in 2021. • Export restriction risk. • Disease in Feedlot Cattle.

COMPANY OUTLOOK

Cashflows expected to stabilize as expansion phase ceases.

Larger capacity and diversification of revenues should be achieved through the new capacity in Brazil and new business lines in the medium term. This year (2023) is expected to be a transition year with Brazil production expanding and exports getting under way by the middle of the year. In fact, according to Oppenheimer & Co, FRICON increased its slaughtering capacity by close to 60% as of the beginning of 2023 with the addition of new beef and pork capacity, mainly in Brazil but also in Bolivia. The end of acquisitions can be beneficial for FRICON in a few ways. First, it allows the company to focus on integrating and consolidating its existing operations, which can lead to increased efficiency and profitability. Second, it reduces the risks associated with acquiring new businesses, such as overpaying for an acquisition or encountering unexpected challenges in integrating a new company. Finally, it can make the company's credit story more attractive to fixed-income investors, as the company's cash flows become more stable and predictable without the potential volatility of acquiring new businesses.

Update on Brazilian Beef Exports to China

The recent case of "mad cow[3]" disease in Brazil did not cause any major disruptions to FRICON's operations. In 2022, a case of "atypical" BSE was found in Brazil, causing a temporary suspension of the country's beef exports to China. FRICON held an investor call to provide an update on the situation. While FRICON was not currently exporting to China from Brazil, it is part of the list of 29 beef processing plants that the Brazilian government sent to China for approval. FRICON's plants are expected to be approved for export soon, and Chinese buyers are continuing to place orders from Brazil, expecting the suspension to be lifted in May 2023.

Despite concerns that the suspension would pressure domestic prices in Brazil, FRICON's management stated that the short duration of the suspension should prevent such an outcome. Additionally, the company's Bolivian operations have benefited from the export suspension in Brazil, with prices for Bolivian exports to China increasing by 6% since the announcement of the suspension as Chinese buyers sought alternatives. Overall, while the temporary suspension of Brazil's beef exports to China caused some disruption, FRICON's management expects exports to resume soon, and the company's Bolivian operations have benefited from the situation.

CONCLUSION

The FRICON 7.70% 2028 notes (B/B+, S&P/Fitch) are secured by real estate and equipment located in Paraguay. Given improved company fundamentals for FY 2021/22, we believe these bonds have been oversold on the market with a yield around 15% and currently offers investors an attractive entry point. The year end results provided confirmation that the company is executing on its plan to grow its scale and cash flow and provided positive guidance for this year.

With the foregoing we recommend that investors invest in these this instrument based on their risk appetite as follows:

Appetite for Low Risk: UNDERWEIGHT
Appetite for Moderate Risk: MARKETWEIGHT
Appetite for High Risk: OVERWEIGHT

[3] Mad cow disease, also known as bovine spongiform encephalopathy (BSE), is a degenerative and fatal disease that affects the nervous system of cattle.

SOURCES

Bloomberg, FRICON's Company's Website, S&P, Fitch Ratings, Oppenheimer, US Department of Agriculture, CNN, IMF, Oppenheimer & Co., FRICON's Financial Statements

DISCLAIMER

DEFINITIONS

- **OVERWEIGHT** - Security is deemed to be undervalued and is expected to outperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **MARKETWEIGHT** – Security is expected to provide similar returns compared to the market in general or at the same pace as comparable companies; neither strongly positive nor negative.
- **UNDERWEIGHT** – Security is deemed to be overvalued and is expected to underperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **ZEROWEIGHT** – This security is substantially distressed or at risk of a shock which may significantly impair its value.