



BRF SA and JBS SA face challenging outlook amid the intensified meat crisis

By [Yu Ning](#)

Dominating 88% of market value among listed meat processing companies in Brazil, BRF SA and JBS SA are the two biggest players in the industry with major markets in Asia, Chile, the Middle East and Russia. The two companies, which suffered from a series of [food-safety probes](#) and experienced a sharp fall in exports last year, are seeing more headwinds in the beginning of 2018.

		Q3 2017	Q4 2017
BRF SA	Net Debt / Equity (%)	110.99	116.42
	Net Income (USD mn)	46.0	-161.9
JBS SA	Net Debt / Equity (%)	167.03	173.23
	Net Income (USD mn)	107.0	-158.4

Table 1: Financial Data for BRF SA and JBS SA Source: Bloomberg

The turmoil that Brazil meat companies exports 'tainted meat' started in Mar 2017, when the Federal Police carried out raids and arrested dozens of federal inspectors who had accepted bribes to ignore the expiration of processed foods and falsified sanitary permits. Hurt by the scandal, the world's [biggest meatpacker JBS SA](#) and the world's [largest poultry exporter BRF SA](#) were forced to shut down some assets, incurred one-off expenses related to investigations and found marketing expenses higher. In the last two quarters of 2017, the price of corn, which was used to feed animals, [increased sharply by 24.58%](#) and this put further pressure on the sector's profitability. Both of the two players released disappointing financial results in Q4 2017 with net incomes in red.

While the companies were seeking opportunities to seek a turnaround, the turmoil intensified as the Brazilian federal police announced on Mar 5, 2018 that they had started [a new phase of the investigation](#), targeting meat processors of acting fraudulently to evade food security checks. Subsequently, some countries started to temporarily ban imports of Brazil's beef and chicken. As of Mar 19, 2018, China, the EU, South Korea, and Chile announced [full or partial suspensions of shipments of meat and chicken](#) from Brazil. According to China's Commerce Ministry, between 2013 and 2016, Brazil accounted for more than 50% of broiler product supplies to China. Japan, which is Brazil's third biggest market for chicken with USD 720mn in sales, said it would not allow imports of products from the 21 business under investigation in Brazil.

Worse still, on Mar 27, 2018, Saudi Arabia, the biggest buyer of Brazilian chicken with about 14% of total exports, has planned to implement stricter halal rules for the slaughter of chickens in exporting nations, throwing a further blow to the companies. Brazil's Agriculture Ministry stated that stunning the chickens into unconsciousness before cutting necks violates Muslim principles and demanded that the electric treatment be eliminated from April 2018. As the waste of meat will increase due to broken wings when the animal struggles, the new procedures are estimated to cause yield losses as much as 30%, according to Bloomberg analysts.

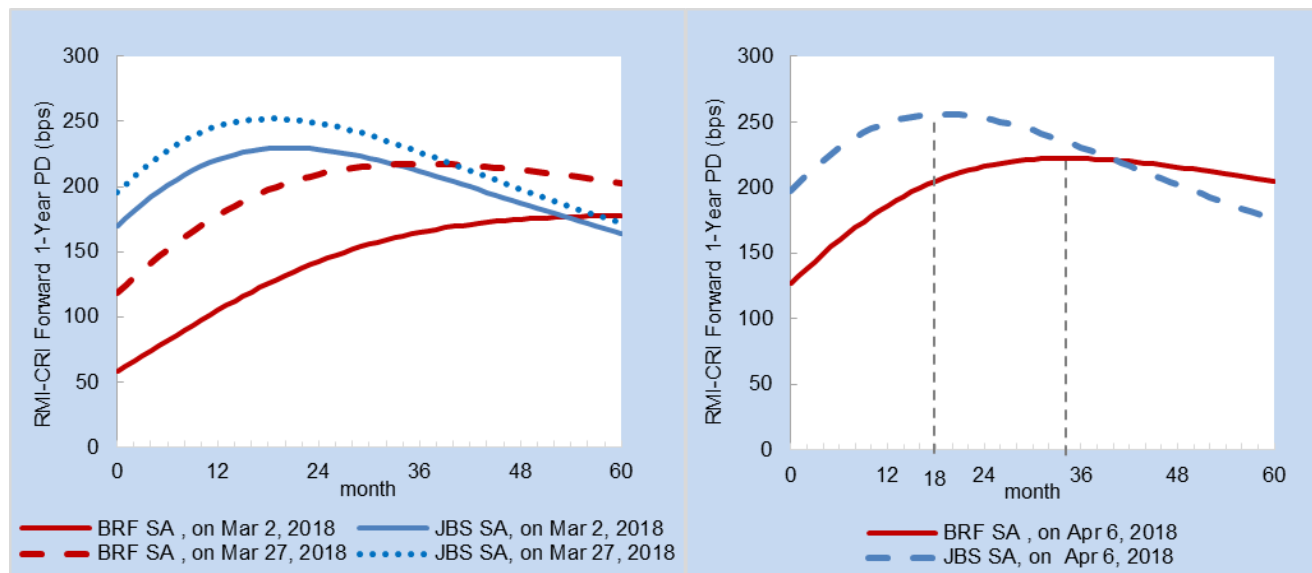


Figure 1 (LHS): RMI-CRI Forward 1-year PD term structures for BRF and JBS on Mar 2, 2018, Mar 27, 2018 Figure 2 (RHS): RMI-CRI Forward 1-year PD term structures for BRF and JBS on Apr 6, 2018. Source: RMI-CRI

As seen in Figure 1, the intensified meat investigation announced on Mar 5, subsequent export bans and stricter halal rules announced on Mar 27 caused a rise in the term structures of the RMI-CRI Forward 1-year Probability of Default (Forward PD) for the two biggest players in the industry, with greater impact on BRF as the company exports more poultry than JBS (See Figure 1). Intuitively, the forward PD computes the credit risk of the firm on a future period, which works like a forward interest rate. For instance, the 3-month forward 1-Year PD is the probability that the firm defaults during the period from 3 months onwards to 1 year plus 3 months, conditional on the firm surviving the next 3 months. Moreover, based on the market information available as of Apr 6, 2018, the term structures of the Forward PD for BRF and JBS increased and peaked around 34 months and 18 months respectively, suggesting that the two companies' financial situation is likely to continue worsening. (See Figure 2).

Currently, BRF is cooperating with the investigations and announced on Mar 27 that it would [send around 3,000 workers on a 30-day paid leave](#) as the poultry slaughter will be halted for 30 days, which will further dent the company's operations as it could slaughter up to 7mn poultry per day. JBS has already sold about USD 2bn assets and announced to offload more assets in Argentina, US and Brazil to reduce its debt burden. The effect of the divestment program remains uncertain as JBS faces massive debt maturities in the next few years. In conclusion, under the already deteriorating financial structures, the two players may not see their credit profile improve until profitability is strengthened as they recover from the meat scandal.

Credit News

Deripaska's Rusal roiled by sanctions as aluminum prices jump

April 9. Deripaska's United Co Rusal (Rusal), which is the world's second-largest aluminum company, saw its stock price plunged 50% in Hong Kong on April 9 due to the US sanctions, which might prevent Rusal from supplying to the global commodity market. The aluminum price jumped 4% on the London Metal Exchange because of a panic buying by traders worrying about the insecurity of supply. Russia was hit with the sanctions on Friday. The sanctions will make it almost impossible for Rusal to do business in US dollar and pose a grave threat to Putin's closest oligarch allies. The Foreign Ministry of Russia is currently studying a list of possible reactive measures. ([Bloomberg](#))

Bond investors get access to USD 16bn of extra debt in India

Apr 9. In order to spur demand in India's debt markets, the central bank eased several limits for overseas bond investors. This effort could lure USD 16bn of new funds to revive the sovereign debt market. However, there are concerns that the incremental inflows will be much lower this year amid global rising interest rates. Foreign investors became net sellers in the last two months amid worries of an oversupply of debt and higher yields. Furthermore, the Indian government has trimmed its fiscal first-half borrowing plans to reduce debt supply. ([Bloomberg](#))

Nine West files for bankruptcy in New York

April 7. Nine West Holdings Inc. filed for Chapter 11 Bankruptcy with a plan to sell some assets and restructure. The shoe and clothing company, controlled by Sycamore Partners, has a debt of more than GBP 1bn, one of the most severe debt loads in the retail industry. The company has been negotiating with its lenders since last year to raise cash. It will use the bankruptcy to sell its Nine West and Bandolino brand while reorganizing other businesses including Anne Klein. Creditors have agreed to support the reorganization and GBP 300mn will be injected to fund the transition operations. ([Bloomberg](#))

Coal generator's bankruptcy threatens solar farm in Maryland

Apr 6. 8Point3 Energy Partners LP's Maryland solar farm is threatened following an unexpected bankruptcy of FirstEnergy Solution Corp's coal generator division. The purchase agreement between First Energy with 8Point3 to purchase output from the 8Point3 20-megawatt plant in Washington County may be terminated. As a result, the solar company expects to take USD 40mn to USD 48mn non-cash impairment this quarter according to the filing. ([Bloomberg](#))

China said to study yuan devaluation amid US trade spat ([Straits Times](#))

Manhattan home sales tumble most since 2009 as buyers walk ([Bloomberg](#))

Regulatory Updates**RBI gives provisioning relief to stressed banks**

Apr 5. The Reserve Bank of India has temporarily relaxed the provisioning regulations for lenders to defaulters in bankruptcy to help banks bolster their financial health. Provisions for secured loans accounts have been reduced to 40% of dues at the end of March. However, the number is predicted to increase back to 50% at the end of second quarter. The revised regulation is only applicable to the companies on the list of 40 stressed accounts. As for other cases referred to the tribunal, banks have to set aside funds in accordance with the maturity time, starting at 15% in the first year of default. ([Economic Times](#))

MAS likely to bear burden of rescuing local failed bank: Moody's

Apr 4. A Moody's report stated that equity holders may be the ones that pay the price in a case when the Monetary Authority of Singapore (MAS) needs to resolve a failing bank problem. In recent years, the "bail-in" solution has gained prominence, where creditors bear the bulk of the rescue. However, MAS' ability to carry out an effective bail-in may be limited due to certain liabilities being not "bail-in-able". MAS is looking to review this limitation but as of now, it favors a private-sector solution which has the potential to minimize moral hazard and instill market discipline. ([Straits Times](#))

MAS urges banks in Singapore to be vigilant against cyber threats ([Straits Times](#))

UK banks and brokers face Mifid II reckoning ([FT](#))