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Barclays Wowed by Big Mac Beef Bonds on Debt Cut: Brazil Credit

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May 22 (Bloomberg) -- Marfrig Alimentos SA bonds are posting the biggest surge in two years after the Brazilian meatpacker won over Barclays Plc and JPMorgan Chase & Co. with a pledge to cut debt by $1 billion.

Yields on Sao Paulo-based Marfrig's $375 million of 2016 notes have plunged 7.06 percentage points from a two-year high on April 18 to 9.89 percent yesterday, after the company said it won't violate the terms of its local bonds and announced the debt reduction plan. The securities have since returned 22 percent, the most of any similar-dated bonds sharing its B2 rating from Moody's Investors Service, or five levels below investment grade, according to data compiled by Bloomberg.

The supplier of beef to McDonald's Corp. and leather for Gucci Group NV's Jackie handbags is allaying speculation that it will breach its bond agreements, which caused its borrowing costs to surge more than 7 percentage points in four days to distressed levels. Marfrig's plan, which includes selling and shutting South American plants to cut its debt-to-earnings ratio to a three-year low, prompted Barclays to recommend Marfrig bonds by switching out of rivals JBS SA and Minerva SA.

"They will outperform if they execute and so far I think they will," said Claudio Robertson, a head of fixed-income trading at Investment Placement Group in San Diego who helps manage $500 million of Latin American assets and scrapped a plan to sell the bonds after Marfrig announced the plan. "The way to make money is by putting your confidence in them now, not once the transactions have happened."

Bond Switch

Barclays's New York-based fixed-income analyst Ivan Fernandes recommended investors buy Marfrig bonds and sell those of rival Brazilian beef producers JBS and Minerva in a note to clients after the asset-sale plan was announced May 14.

JPMorgan's Sao Paulo-based analyst Isabela Bacchi raised her rating to the equivalent of hold from sell and Denis Parisien, head of emerging-market corporate-debt research at Deutsche Bank AG in New York, reiterated his buy recommendation.

Marfrig, Brazil's largest beef producer after JBS and the country's biggest food processor after BRF SA, said in an April
16 regulatory filing that it "vehemently" denied speculation it was breaking debt-ratio caps set by its local bond terms.

The meatpacker hasn't decided how it will use proceeds from asset sales to pay debt, Chief Financial Officer Ricardo Florence said in a telephone interview from Sao Paulo yesterday, declining to comment further on the plan.

"The market is reflecting what the company is doing,"
Florence said of the bond rally in past weeks.

City Outskirts

The asset sales, which follow an acquisition spree that increased net debt 11-fold in six years, will include three plants in Brazil. Marfrig is also seeking to close or sell four distribution centers in the country and a pair of slaughterhouses in Argentina. Its headquarters will move from the high-end Vila Olimpia district to the outskirts of Sao Paulo as it seeks to save 250 million reais ($123 million) of working capital this year.

Marfrig aims to cut gross debt of 13 billion reais at the end of March by as much as 2 billion reais before year-end, Sergio Rial, a former Cargill Inc. finance chief hired last year to head Marfrig's Seara food-processing unit, told reporters in Sao Paulo on May 14.

The company will look to reduce its net-debt ratio to 3.4 times earnings before interest, taxes, depreciation, and amortization this year, the least since the third quarter of 2010, from 4.4 at the end of March, said Rial, who's slated to replace Marfrig founder Marcos Molina as chief executive officer in January.

Feed Costs

The asset sales goal was announced after the company posted a net loss of 81.2 million reais in the first quarter, compared with a 34.5 million-real profit a year earlier, amid rising costs for soybeans and corn used to feed its chickens and hogs.

It was the first time management made an "explicit commitment"
to tackle the ballooning debt, Barclays's Fernandes said in his report.

"The remedy for their problems is very straight-forward, it's exactly that -- divestitures," Ian McCall, a money manager at Geneva-based Quesnell Capital SA who holds Marfrig bonds, said in a telephone interview. "There's some real interest from competitors in some of the Marfrig assets, so I think they have options."

Declining costs for corn in the second half of this year, as the U.S. is expected to reap a record crop, will probably also help Marfrig cut costs, Deutsche Bank's Parisien said in his note. The goal of cutting working capital is boosting investors' confidence because Marfrig's 3.17 billion reais of cash at the end of March don't entirely cover its short-term liabilities of 3.64 billion reais, JPMorgan's Bacchi said.

'Liquidity Risk'

"We're waiting to see if they can indeed deliver on their promise," Cedric Rimaud, a managing partner at Spread Research in Lyon, France, said in an e-mailed response to questions. "We remain concerned by the high leverage, the liquidity risk and the possibility that some concerns may arise again of a covenant breach on the debt."

The company's $500 million notes due in 2020 limit net debt to 4.75 times Ebitda, according to their offering memorandum.

The extra yield investors demand to own Brazilian government dollar bonds instead of U.S. Treasuries rose five basis points, or 0.05 percentage point, to 183 basis points yesterday, according to JPMorgan indexes.

Default Swaps

The cost of protecting Brazilian bonds against default for five years fell one basis point to 129 basis points, according to data compiled by Bloomberg. Credit-default swaps pay the buyer face value in exchange for the underlying securities or the cash equivalent if a borrower fails to adhere to its debt agreements.

The real weakened 0.1 percent to 2.0404 per U.S. dollar.
Yields on interest-rate futures contracts due in January 2014 were unchanged at 8.13 percent.

Marfrig tapped Deutsche Bank’s head of investment banking in Brazil, Jaime Singer, in March to lead the company’s planning and strategy after hiring Rial from Cargill in November. The management changes will help Marfrig meet its goals of reducing debt and increasing cash generation, Investment Placement’s Robertson said.

“They are institutionalizing management much more and that’s the key, because they are a good business,” Robertson said. “Now they have the right people to deliver.”

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