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Research Update:

JBS S.A. And JBS USA LLC Removed From CreditWatch Negative; 'BB' Corporate Credit Ratings Affirmed; Outlook Stable

Primary Credit Analyst:
Flavia M Bedran, Sao Paulo (55) 11-3039-9758; flavia.bedran@standardandpoors.com

Secondary Contacts:
Marcelo Tayar, Sao Paulo (55) 11-3039-9762; marcelo.tayar@standardandpoors.com
Laura Martinez, Mexico City (52) 55-5081-4425; laura.martinez@standardandpoors.com

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Overview

- We expect that Brazil-based protein producer JBS S.A. will successfully complete its acquisition of Seara, which includes the extension of the duration of the debt assumed from Marfrig Alimentos S.A.
- We are removing the corporate credit ratings on JBS S.A. and its U.S. subsidiary JBS USA LLC from CreditWatch negative.
- We are also affirming the 'BB' corporate credit and debt ratings on both companies and the 'brAA-' national scale corporate credit rating on JBS S.A.
- The stable outlook reflects our view that JBS will be able to improve operations and cash flows from Seara and resume its deleverage trend from 2014 onward.

Rating Action

On Aug. 29, 2013, Standard & Poor's Ratings Services removed the corporate credit ratings on JBS S.A. (JBS) and its U.S. subsidiary JBS USA LLC from CreditWatch, where they were placed with negative implications on June 11, 2013. At the same time, we affirmed the 'BB' corporate credit ratings on both companies, the 'BB' issue-level ratings on the companies' debt totaling U$5.7 billion, and the 'brAA-' national scale corporate credit rating on JBS S.A. The outlook is stable.

Rationale

The rating affirmations reflect our view that JBS will be able to deliver a total debt to EBITDA of less than 4x and funds from operations (FFO) to debt ratio of about 20% by year-end 2014, even assuming additional Brazilian real (R$) 5.85 billion in debt for JBS' acquisition of Brazil-based poultry producer Seara. We previously estimated that JBS S.A. would reach these ratios by year-end 2013. Even though we expect that JBS will show higher leverage during the next few quarters, we believe that the acquisition is accretive to the company's business profile, which we now view as "satisfactory." We expect JBS to successfully integrate Seara, based on its track record with other acquisitions, and that it will be able to extend the duration of the debt transferred with Seara.

We have revised our assessment of JBS' business profile to "satisfactory" from "fair." Our view reflects the company's consolidation of its businesses and its strengthening portfolio with the acquisition of Seara. JBS' geographic and portfolio diversification has proven to be successful in 2012 as stronger cash flows from the Brazilian beef division have offset the challenging business conditions its U.S. beef division faced. Moreover, JBS has proven its positive track record of improving operating efficiency of acquired assets. We believe that the company has a significant opportunity to achieve economies of scale from the integration of its sizable beef and Seara's poultry and pork operations in Brazil by unifying the administrative, commercial, and logistic operations.

The most relevant assumptions in our projections include:

- Top line revenues increasing by approximately 30% in 2013 and 17% in 2014, assuming four months of Seara's operations in 2013, the addition of all new leased beef and poultry plants, and the acquisition of XL Foods Inc. in Canada.
- Organic growth in all existing businesses due to the plants' increased utilization capacity and pricing adjustments. We did not incorporate all of the potential upside of the weaker Brazilian currency in JBS' exports, which account for more than 40% of the Mercosul division.
- EBITDA will increase in all business segments in line with improved performance. We expect the following margins: JBS Mercosul from 10% to 12.5%; JBS Seara improving to approximately 8% in 2014; JBS USA beef segment from 3% to 4%; JBS USA pork from 6% to 7%; and JBS USA poultry from 7% to 9%.
- Working capital requirements should be higher than R$2 billion in 2013 and decline to about R$1.2 billion in 2014 as all plants will operate at higher capacity, and Seara will be integrated.
- Annual payments for small acquisitions of about R$150 million, and Seara and Zenda's debt assumed as of June 30, 2013, of R$1.8 billion will gradually amortize from 2015 onward.
- An additional R$4 billion of debt from the Seara acquisition, with 30% paid in 2014.
- Capital expenditure of about R$1.4 billion to R$1.6 billion per year.
- Dividend payout of 25% of net income.

We expect JBS' financial profile to remain "aggressive," with total debt to EBITDA of about 4.6x and FFO to debt of 14% by year-end 2013. However, we also expect those ratios to improve rapidly in 2014, with an estimated FFO generation of more than R$5 billion combined with a lower working capital requirement. This would result in positive free operating cash flow of about R$2 billion, which should help to gradually reduce debt.

Liquidity

We assess JBS' liquidity as adequate. We believe that its sound access to banks and capital markets enable it to refinance maturing debt at adequate funding terms and to continue rolling over working capital facilities. Our main assumptions for liquidity sources are as follows:

- Cash on hand of R$7.2 billion as of June 30, 2013, and an availability under the existing JBS USA and Pilgrim's Pride revolving credit facility of about $1.1 billion;
- Estimated FFO generation of about R$4 billion in 2013 and of more than R$5 billion in 2014; and
- Refinancing of the JBS USA US$700 million bond due in 2014.

These compare favorably with estimated uses of:

- Short-term debt maturities of R$8.5 billion (considering the existing terms on debt transferred with Seara),
- Working capital outflows of R$2.2 billion,
- Capital expenditures of R$1.4 billion,
- Acquisitions of R$163 million, and
- Dividend payout of R$190 million in 2013.

In our estimates, sources exceed uses by 1.2x and sources are higher than uses even if FFO decline by 30%. JBS also has a cushion of more than 25% in its covenant agreements, which requires it to sustain a net debt to EBITDA less than 4.75x.

Outlook

The stable outlook reflects our view that JBS will gradually reduce leverage by improving cash flows in all business lines and lower debt as it generates positive free operating cash flows from 2014 onward. We also expect that the company will be successful in improving Seara's operating performance and sustaining adequate liquidity upon the refinancing and extension of the debt assumed with the acquisition.

An upgrade is unlikely in the short to medium term, since we had already foreseen a significant deleverage to maintain the current ratings. We could lower the ratings if the capital structure following Seara's acquisition is materially different from what we expect or if it weakens the credit ratios and cash flow generation, or if significant working capital requirements to integrate Seara and to ramp up new leased plants pressures liquidity and prevents JBS from starting its deleveraging in 2014.

Related Criteria And Research

- Methodology: Management and Governance Credit Factors for Corporate Entities and Insurers, Nov. 13, 2012
- Methodology: Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Corporate Ratings Criteria: Analytical Methodology, April 15, 2008
- 2008 Corporate Criteria: Ratios And Adjustments, April 15, 2008

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
JBS S.A.		
Corporate Credit Rating		
Global Scale Rating	BB/Stable/--	BB/Watch Neg/--
Brazil National Scale	brAA-/Stable/--	brAA-/Watch Neg/--
Senior Unsecured	BB	BB/Watch Neg
JBS USA LLC		
Corporate Credit Rating	BB/Stable/--	BB/Watch Neg/--
Senior Secured	BB	BB/Watch Neg
Senior Unsecured	BB	BB/Watch Neg
ESAL GmbH		
JBS Finance II Ltd.		
JBS USA Finance Inc.		
Senior Unsecured	BB	BB/Watch Neg

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