Research Update:

Becle S.A.B. de C.V. Downgraded To 'BBB-' From 'BBB' On Increased Leverage And Tighter Liquidity; Outlook Negative

September 6, 2023

Rating Action Overview

- We expect Mexico-based and global leading tequila producer Becle S.A.B. de C.V.'s adjusted leverage will remain above 1.5x, our downgrade threshold for the 'BBB' rating, over the next few years as it adjusts its capital structure.
- Moreover, Becle's reduced cash position and significant use of short-term debt financing has tightened its liquidity, and failure to refinance its upcoming bank debt maturities could further pressure its ratings.
- On Sept. 6, 2023, S&P Global Ratings lowered the global scale long-term issuer credit and issue-level ratings on Becle to 'BBB-' from 'BBB'. The outlook is negative.
- The negative outlook indicates that we could lower the ratings if Becle fails to refinance its upcoming bank debt maturities to a longer tenor, in a timely manner, or if the company sustain a tight liquidity position over a 12-months' time horizon.

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Rating Action Rationale

The downgrade reflects our expectation that Becle's leverage will remain above 1.5x going forward. After years of maintaining leverage well below 1.5x, Becle's adjusted debt to EBITDA reached 1.6x at year-end 2022 and 2.2x in the 12 months ended June 2023. The rise in leverage stemmed from the company's depleted cash balance in recent quarters.

Margins contracted due to the appreciation of the Mexican peso (MXN) against the U.S. dollar; still elevated input costs (including agave price, the main raw material for tequila production); higher advertising, marketing, and promotion expenses; and higher working capital requirements to support its products premiumization strategy. The company also increased its gross debt by about MXN6.1 billion during the first half of 2023 to support its working capital needs. This tightened its liquidity position and pushed up leverage.

We expect EBITDA margins to gradually recover toward 22.5% in 2024, as we anticipate several operating tailwinds, including substantially lower agave prices (around MXN10-MXN20/kilogram), easing inflationary pressures on other input costs (such as glass prices and distribution costs), and the company's lower inventory stock needs due to a normalized supply chain. We also expect these measures to lower working capital needs in the short to medium term.

Nonetheless, given the company' strategy to optimize its capital structure, we believe Becle's adjusted leverage will remain 1.5x-2.0x in the next few years.

Moreover, Becle's tighter liquidity could continue to pressure the ratings if the company does not extend its short-term debt maturities to a longer tenor. At the end of June 2023, Becle reported a cash balance of MXN4.3 billion and MXN6.1 billion in short-term bank loans. The bulk of these mature during the first half of 2024. We forecast free operating cash flow of near MXN1.4 billion for the next 12 months, exposing the company to refinancing risk.

Although we believe Becle maintains well-established and solid bank relationships and is currently in discussions with several creditors to refinance its short-term maturities, the process is still at an early stage. Failure to refinance within the next few months and to maintain consistently an adequate liquidity position over a 12-months' time horizon, could further pressure the company's investment grade rating level. We will continue to monitor Becle's refinancing efforts over the next few months.

We expect Becle's revenue and EBITDA to keep growing steadily over the next two years. Although we expect Becle will post adjusted leverage near 2.0x in 2023 and 1.8x in 2024, we believe the business will remain resilient amid high inflation. We estimate the company's revenue will continue to grow in the low- to mid-single-digits for the next 12-18 months, considering stable consumption trends across its wide product portfolio, especially through the tequila category.

The tequila category remains the main revenue driver for Becle, accounting for around 70% of the company's total sales in second-quarter 2023. The largest player in the global tequila market, Becle continues to expand its tequila category through different brands, specifically in the premium and super premium category--which maintains high demand and keeps gaining traction and popularity among consumers.

Outlook

The negative outlook indicates that we could lower the ratings, if Becle fails to refinance its upcoming bank debt maturities to a longer tenor, in a timely manner, or if the company sustain a tight liquidity position over a 12-months' time horizon. Although less probable in the next 12-24 months, a downgrade could also occur if Becle pushes its adjusted debt to EBITDA above 3x.

Downside scenario

We could lower our ratings in the next few months if:

- Becle fails to refinance its upcoming bank debt maturities with a longer tenor, such that its sources of liquidity are less than 1.2x over its uses of liquidity in a 12-months' time frame horizon;
- Becle's operating performance weakens considering difficult global economic conditions or input cost inflation and higher agave prices further denting its profitability; or
- Becle's financial policy materially changes, and it increases its debt position to fund unexpected working capital needs, capital expenditure (capex), mergers and acquisitions,

dividend payments, or share repurchases.

Upside scenario

We could revise our outlook on Becle to stable in the next few months if Becle successfully refinances its short-term debt maturities with a longer tenor, so that its sources over uses of liquidity stay consistently above 1.2x over a 12-months' time frame horizon.

Company Description

Founded in 1758 and headquartered in Mexico City, Becle has been led by 11 generations of the Beckmann family. Becle is the world's largest producer of tequila, with well-known brands such as Jose Cuervo, 1800, Centenario, and Maestro Dobel. It is also the first and second-largest distributor of premium spirits and liquors in Mexico in terms of volume and value, respectively.

The company has more than 30 brands and produces, bottles, and sells spirits worldwide, with a presence in more than 85 countries. In the past few years, the company has mainly grown through successful brand acquisitions, such as Three Olives, Hangar 1, Stranahan's, Bushmills, Boodles, Pendleton, and its recent investment in Proper No. Twelve whiskey.

Our Base-Case Scenario

Assumptions

- Mexico's GDP to grow 1.8% and U.S. GDP 1.7% in 2023. For 2024, we expect GDP to grow 1.5% and 1.3%, respectively.
- Consumer price index (CPI) to reach 5.7% in Mexico and 4.3% in the U.S. for 2023. In 2024, we expect 4.2% and 2.7%, respectively.
- Average exchange rate of MXN18.3 per $1 in 2023, and MXN18.8 per $1 in 2024.
- Revenue growth in MXN near 1.5% in 2023 and 6.5% in 2024, driven by steady volume growth of around 1.5%, an ongoing shift toward premium spirits, and higher prices as U.S. and Mexican inflation remains sticky.
- EBITDA margin of about 20.5% in 2023 that gradually recovers to around 22.5% (or more) for 2024 on. We expect lower input costs (specifically agave prices) to lower the company's costs and gradually improve its margins. Moreover, we expect Becle's product premiumization strategy, pricing initiatives, and strict cost control to somewhat offset inflationary pressures on some input costs.
- Capex of about MXN3.7 billion in 2023 and about MXN3.0 billion in 2024--mostly for innovation, product development, and to reinforce Becle's premiumization strategy. The company's capex plan also relates to the construction of its "1800 tequila distillery" project, which we expect it to finish during 2024. The company's minimum maintenance capex is about MXN1.0 billion.
- Dividend payments of MXN1.8 billion paid in August 2023, and about 30% of Becle's previous year net income for 2024 on. Nonetheless, we believe the company has the flexibility to reduce dividend payments to protect its liquidity, if necessary.
- Share buyback activity will depend on cash flow and market conditions.

- No large acquisitions over the projected horizon.
- About MXN6.0 billion ($350 million) of incremental debt in 2023, disbursed in the first half of 2023, and no further increase in debt during the projected period.

Key metrics

Becle S.A.B. de C.V.--Key metrics

	--Fiscal year ended Dec. 31--			
(%)	2021a	2022a	2023e	2024f
Revenue growth	12.5	16.0	1.2	6.5
EBITDA mragin	20.0	21.4	20.5	22.5
Debt to EBITDA (x)	1.1	1.6	2.1	1.8
Discretionary cash flow to debt	-25.9	-46.4	-7.3	5.2

All figurse adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

Liquidity

We have revised downward our liquidity assessment on Becle to adequate because the company faces significant short-term banking debt maturities, the bulk of which mature during the first half of 2024. However, we believe that the company maintains well-established and solid relationships with banks, a generally high standing in credit markets, generally prudent risk management, and has a credible plan to refinance those maturities within the next few months. Therefore, we expect sources of liquidity to exceed uses by more than 1.2x in the next six months, and this ratio to remain above 1.0x even if EBITDA declines by 15%.

Principal liquidity sources

- Cash and cash equivalents of MXN4.3 billion as of June 30, 2023
- Funds from operations of about MXN7.2 billion for the next 12 months

Principal liquidity uses

- MXN108.2 million of debt maturing in the next six months as of June 30, 2023
- Working capital outflows of about MXN2.5 billion for the next 12 months
- Maintenance and expansionary capex of around MXN3.3 billion for the next 12 month
- Dividend payments of about MXN1.7 billion for 2023

Covenants

As of June 30, 2023, Becle didn't have any financial maintenance covenants.

Environmental, Social, And Governance

Environmental, social, and governance factors have had no material influence on our credit rating analysis of Becle.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of June 30, 2023, Becle's capital structure consisted of $153.3 million of outstanding senior unsecured notes due May 2025, $800 million of senior unsecured notes due October 2031, and two short-term loans disbursed during the first half of 2023: one with Banco Inbursa of $150 million and the other with BBVA Mexico of $200 million.

Becle issued and borrowed all of its debt instruments on a senior unsecured basis, and the 2025 senior notes benefit from guarantees from some of Becle's subsidiaries that generated a limited portion of its consolidated revenue in 2022. Therefore, the 2025 senior notes have first priority over the other debt instruments outstanding only with respect to the cash flow from the subsidiaries that provided the guarantees.

Analytical conclusions

Based on Becles existing debt structure, low leverage, and the fact that there are no priority debt obligations that rank ahead of the company's senior unsecured debt obligations, we rate the senior unsecured notes 'BBB-', at the same level as the issuer credit rating.

Ratings Score Snapshot

Issuer Credit Rating	BBB-/Negative/--
Business risk:	Fair
Country risk	Intermediate Risk
Industry risk	Low Risk
Competitive position	Fair
Financial risk:	Modest
Cash flow/leverage	Modest
Anchor	bbb-
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)

Issuer Credit Rating	BBB-/Negative/--
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile:	bbb-

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- 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: 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

- Full Analysis: Becle S.A.B. de C.V., Sept. 9, 2022

Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
Becle S.A.B. de C.V.		
Issuer Credit Rating	BBB-/Negative/--	BBB/Stable/--

Downgraded

	To	From
Becle S.A.B. de C.V.		
Senior Unsecured	BBB-	BBB