

Boparan: in the nature of Xover investors

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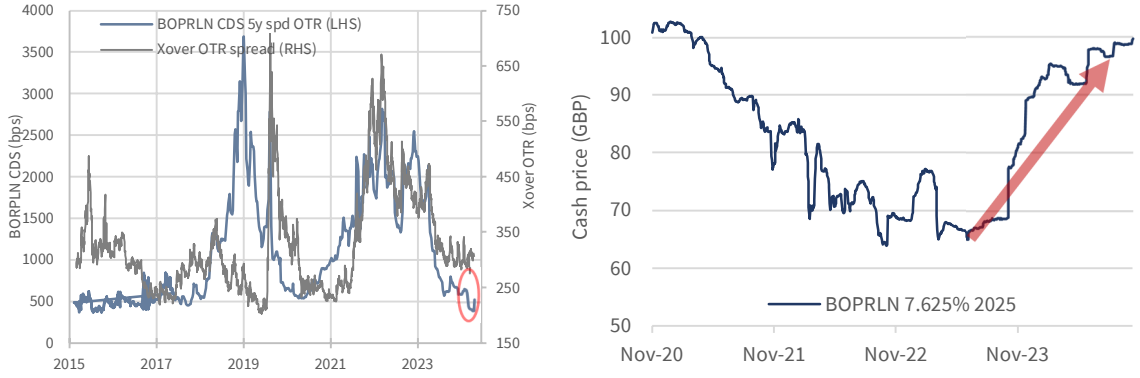
UK poultry giant Boparan (Ticker: BOPRLN, rated B) is a credit that has been a constituent of the iTraxx Xover since 2014. Timing perfectly with the biodiversity COP, BOPRLN is now in the market with a refinancing of its current BOPRLN £7.625 11/25 bond (XS2262082758). This comes shortly after an announcement that the company is divesting its European poultry business to a private investment vehicle in the same ownership sphere.

Given the bonds' membership of the Xover index as well as being a GBP high-yield benchmark issue, deforestation and nature loss analysis of the name should be expected.[1] Third party scorings of Boparan are varied: it receives 148/350 in the Food and Agriculture Benchmark,[2] it is 25th out of 30 in the UK-focused Better Food Index with 43.5%[3], scores a 1 out of 5 from Forest500,[4] and ranks 5.2 out of 100 for the World Benchmarking Alliance's Nature Benchmark[5].Significant commitments in the company's bond prospectus such as a reduction of 90% Scope-3 FLAG emissions by 2035, and to have all soy certified deforestation-free by 2025, can be viewed as quite strong.

The refinancing appears to have driven a generated widening in CDS (+140bps), which is counterintuitive, though there are likely underlying technical reasons for this. The BOPRLN bonds have rallied significantly, over 20pts in the past year.

Given the infrequent appearance of Boparan in credit markets, its membership in one of the key indices, and the diversity of views on the company, this bond deal is a significant opportunity to engage and establish benchmark disclosures for a company that will not be subject to the transparency requirements of the EU Deforestation Regulation (EUDR).

Figure 1. (Left) BOPRLN 5y CDS vs on-the-run iTraxx Xover. (Right) Price of BOPRLN £7.625% 2025s. Source: AFII, Bloomberg.



[1] Due to the relatively low notional amount of bonds outstanding, BOPRLN, has not previously been included in the RDCP, see "Deforestation exposure: Q2 & Q3 2024 issuance review", AFII, 10 Aug 2024.
[2] "Food and agriculture benchmark", World Benchmarking Alliance, accessed 28 Oct 2024.
[3] "Better Food Index 2023", "Better Food Index Methodology 2023", Tortoise Media, accessed 28 Oct 2024.
[4] "A decade of deforestation data", p. 79, Forest500/Global Canopy, 2024.
[5] "Boparan", World Benchmarking Alliance Nature Benchmark, accessed 29 Oct 2024.

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The bond transaction

Boparan Holdings Limited, trading as 2 Sisters Food Group, is the largest UK poultry meat producer and second-largest poultry processor in the European market.[6] The company has seen volatile credit performance in recent years, Figure 1, impacted by changing consumer demand driven by cost of living challenges in recent years and disruption to agricultural operations due to extreme heat in July 2022.[17] Boparan Holdings Limited has announced that wholly-owned subsidiary Boparan Finance plc will be:[7]

- offering £390m aggregate principal of senior secured notes due 2029, which makes the issuance a relatively large deal in the GBP high-yield space, to close shortly;
- entering into an amendment and restatement to its existing revolving credit facility, increasing the provided commitments from up to £80m to up to £90m; and
- launching a tender offer for any and all of its £525m 7.625% Senior Secured Notes due 2025.

The core driver of this package of the sale and the bond refinancings appears to be to manage the looming 2025 maturity of the current bond, which otherwise could have led to negative rating actions.[6] The tender offer and issuance will decrease debt, including the revolving credit facility by just over 21%, from £605m to £480m.

From a technical CDS perspective, we notice the widening of the CDS as the announcement of the new deal came along. Two alternative hypotheses for this:

1. The potential that the 2025 bonds would be taken out with no replacement issuance from this financing vehicle, leaving the CDS orphaned. With the new bonds in place, there are new deliverables into the CDS, and thus (more) value to CDS protection.
2. As BOPRLN is an illiquid CDS, the transaction announcement led to a few new prints in CDS such that levels were refreshed to reflect the actual market. Mark-to-market vs mark-to-matrix.

This package should be seen in conjunction with that earlier this year, the company divested of its 2 Sisters Storteboom B.V. operations[8] to Boparan Private Office (BPO, owned by Boparan Holdings Limited's shareholders) in a €200m transaction. This sale of EU poultry operations will focus the group on UK operations and leave the UK operations out-of-scope for the EU Deforestation Regulation (EUDR).[9]

Following the announcement of the potential new bond issuance on 25 Oct, there was a rating action from Fitch, Moody's and S&P.[10] The rating upgrade is supported by positive changes to the underlying financials, including addressing refinancing risk with this issuance, with the lower total debt amount expected to reduce leverage from circa 4.4x in FY24 to 3.7x by FY25; profitability recovery translating to free cash flow margins of over 1% supporting a structurally improved EBITDA margin of 5-6%; and expectations that divestment of the EU poultry business to BPO is expected to lift margins to slightly above 6% in FY26.

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[6] "Fitch Places Boparan on RW Positive on Debt Reduction Announcement", FitchRatings, 16 Sep 2024.
[7] "Boparan Holdings Limited Announcement", Boparan Holdings Limited, 25 Oct 2024.
[8] "Why has the 'Chicken King' sold poultry arm to himself?", The Grocer, 6 Sep 2024.
[9] "Commission strengthens support for EU Deforestation Regulation implementation and proposes extra 12 months of phasing-in time, responding to calls by global partners", European Commission, 2 Oct 2024.
[10] "Fitch Upgrades Boparan to 'B' on Announced Refinancing", Fitch Ratings, 25 Oct 2024; "Moody's Ratings upgrades Boparan's CFR to B3 from Caa1", Moodys, 28 Oct 2024; "S&P: BOPARAN HOLDINGS 'B-' RATINGS REMAIN ON CREDITWATCH POS", Bloomberg, 25 Oct 2024. Note the company's financial year runs to July.

Nature risk exposure for investors

Nature risk for investors is in this instance primarily driven by exposure to systemic deforestation-driven losses such as decreases in soy crop yields as a result of changes in rainfall patterns.[11] 53% of the world's soy is used as livestock feed for poultry and eggs,[12] making Boparan part of an industry that is inherently linked with deforestation risk. Further, in this instance driven by exposure to systemic deforestation-driven losses as the UK operations will now not be covered by the EUDR,[9] which would otherwise drive deforestation-free sourcing.

Given the increasing scrutiny of potential deforestation risks on behalf of investors,[13] as well as the public-to-private nature of the transaction,[14] and historical governance concerns which have been widely reported,[15] the company's deforestation-free sourcing and greenhouse gas commitments are important reads.[16]

Sustainable sourcing

The company sources live birds and ingredients from farming partners and suppliers. This includes some assured certifications (free range, freedom food, corn fed and organic). Profits are derived from two divisions: 'poultry' and 'meals & bakery'.[17] Both divisions use soy and so have a risk of links to deforestation, as the poultry division uses soy meal as a significant part of animal feed and the meals & bakery division uses soy embedded in animal-derived raw materials.[18]

Deforestation-free soy sourcing

As at the most recently available sustainability report, the company uses soy meal that is "to recognise deforestation free standards of which 47% is basis mass balance". The company's goal is to increase this to 100% by 2030.[19] Given that the company has more recent sustainable sourcing policies, and included a target of having 100% deforestation-free soy by 2025, which is in line with recommendations from the Accountability Framework initiative[20], in the bond documentation this suggests recent forward progression by the company.

Though sourcing commitments themselves appear robust, we note that there is an opportunity for investors to request more current data on both the volume of soy recognised as deforestation free and milestones on the journey to reaching 100% deforestation-free soy.

The company has made commitments to a gross deforestation-free and ecosystem conversion-free supply chain and publicly recognises that deforestation can be focused on the Cerrado[21], which has

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[11] "Deforestation-induced changes in rainfall decrease soybean-maize yields in Brazil", Ecological Modelling, 17 Oct 2023.
[12] "Deforestation & Biodiversity", FAIRR, accessed 29 Oct 2024.
[13] "Managing Deforestation risk within our investment portfolios", Schroders, Jan 2024.
[14] "Public to private divestment in Asia: trends and best practice", AFII, 21 May 2024.
[15] "2 Sisters boss apologises for standards at West Bromwich", Poultry World, 26 Oct 2017.
[16] For a further climate analysis, based on slightly older data, see "Boparan – ESG QuickTake", 9fin, 27 Oct 2023.
[17] 'Boparan Holdings Limited Annual Report and Financial Statements for the 52 weeks ended July 2023', p. 8, Boparan Holdings Limited, published 7 May 2024.
[18] "Soy sourcing policy", 2 Sisters Food Group, Jun 2024.
[19] 'Boparan Holdings Limited Annual Report and Financial Statements for the 52 weeks ended July 2023', p. 34, Boparan Holdings Limited, published 7 May 2024. Note that this includes the most recent Sustainability Report.
[20] See "The AFi recommends a target date no later than 2025 to eliminate deforestation and conversion in supply chains", Afi, 3 June 2022.

less widely recognised deforestation risks leading to less robust monitoring of this region, receiving little protection from the Brazilian Forest Code.[22]

Soy embedded in animal-derived raw materials is covered by the company's UK Soy Manifesto goal. Company policy requires that suppliers of meat, fish, seafood, poultry and eggs must be able to demonstrate that embedded soy is purchased in line with the FEFAC benchmarked deforestation free Segregated, Mass Balance or Area Mass Balance supply chain standards, or that at a minimum RTRS Credits can be purchased to cover soy volumes.[18]

We note that the company references Cargill's Triple S soy certification scheme, which we comment on in other research.[23] Due to the 'mass balance' nature of the certification scheme it is unlikely to comply with EUDR criteria and there may be costs occurred in moving to a more robust physical verification scheme.

We value the comprehensive nature of this requirement and its potential to drive responsible sourcing in the supply chain. **However, we note that this is a broad requirement and there is an opportunity for investors to ask for details on the proportion of soy subject to each of the potential certification standards listed in the policy above.**

Scope 3 Greenhouse Gas (GHG) Emissions

In terms of GHG emissions, Boparan Holdings' has in the past committed to introducing Science Based Targets, with an intention to submit for verification "by 2024", with a long-term target of achieving Net Zero by 2040.[24] Positively, the documentation for this bond indicates the goal of achieving Net Zero by 2035, so five years ahead of the previous target. Further, the company has set targets for Forest, Land and Agriculture (FLAG) emissions, see Table 1. FLAG emissions cover emissions related to the land use sector, including but not limited to emissions and removals from agriculture and forestry production "up to the farm gate" (excluding energy-related emissions from biomass).[25]

Table 1: Scope 3 FLAG Emissions and targets. Source: Bond prospectus.

Emissions	Units	2022	2030	2035	Reduction (%)
FLAG emissions	Metric tons CO2e	2,349	1,700	683	(71%)
Non-FLAG emissions	Metric tons CO2e	497	288	50	(90%)

We do not see companies setting FLAG emissions targets often, but the practice is becoming more common, with issuers such as REWE Group[26] setting targets linked to FLAG emissions and Auchan, part of ELO Group, which has stated an intention to set FLAG emissions targets.[27]

Our overall view is that this disclosure, some of which is leading (such as the use of FLAG emissions), and some of which lags (such as not having targets assured by the SBTi yet), is clouded by multiple targets for the same metric and there is a need for greater transparency. The company is the only one of 30 in the Better Food Index to be excluded from the 'Affordability' pillar scoring for lack of data.[28]

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[22] "Cerrado Manifesto", FAIRR, accessed 29 Oct 2024.
[23] "Cargill's EUDR compliance: risks of a soy-prise", AFII, 14 Jun 2024.
[24] "Environmental Policy", 2 Sisters Food Group, Mar 2024.
[25] "Forest, Land and Agriculture Science-Based Target-setting guidance", SBTi, Dec 2023.
[26] "Sustainability linked bonds bumper week", AFII, 11 Sep 2023.
[27] "Le SLB d'Auchan, il change la vie?", AFII, 22 Sep 2023.
[28] "The Better Food Index 2023", Tortoise Media, 23 May 2023.

The company is clearly taking material steps forward but these are recent and the company has historically had low scores for a number of sustainability benchmarks.

This indicates a need for investors to form a view on whether these targets will translate into real gains to be made by the company, and this is an opportunity for investors to request transparency on the milestones required on these journeys, which actions the company has already undertaken, and what is planned for the near-term.

Conclusion

Boparan is an infrequent issuer of bonds yet is a relatively important credit with respect to passive investors and the iTraxx Xover index. It is thus instructive to look under the bonnet of how the company performs in terms of deforestation-free sourcing and climate commitments. As we note in this piece, the company has historically received some less than positive rankings in this context and there appears to be space for greater transparency. Having said that, recent commitments on its sustainability objectives appear relatively robust and could provide leadership in the sector.

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