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Inflation to Pressure Mexican Global Food Company Margins

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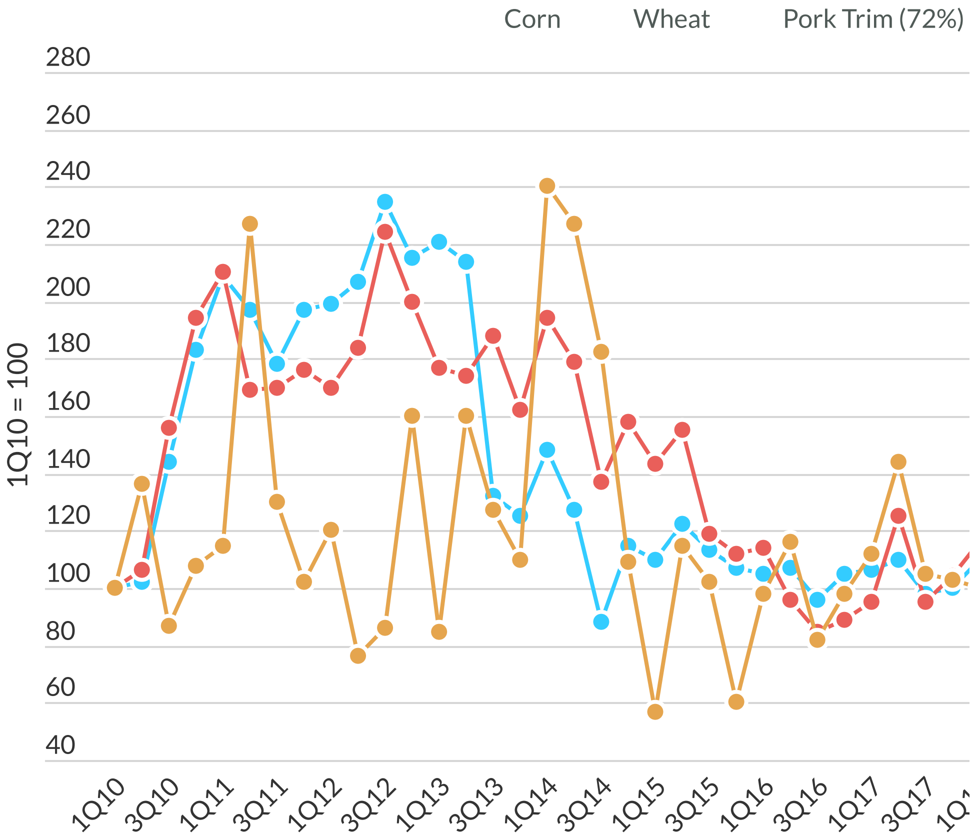
Fitch Ratings-New York/Monterrey-01 July 2022: Sustained commodities price inflation and slowing growth will increase profitability pressures of Mexican global food companies in 2H22-1H23, says Fitch Ratings. Our base case is for the sector's average EBITDA margin to fall to 11.9% at YE22, versus 12.3% at YE21. However, risks lean to the downside should stagflation materialize globally.

Mexican global companies in the packaged food sector have proven stable performers over the past decade, as demand for basic food products during periods of economic pressure have historically been resilient and relatively inelastic. These companies have generally been able to pass through higher costs to consumers to sustain margins. We expect higher raw materials and labor cost pressures to be mitigated somewhat with price increases, operating efficiencies and hedging strategies.

However, the current global economic outlook is unique relative to recent history with a combination of very high inflation and sharply reduced growth unseen in developed markets since the 1970's. The Russia-Ukraine war has exacerbated tight global commodity markets that had already been facing supply-demand imbalances linked to supply chain constraints during the coronavirus pandemic. We recently updated our global commodities price forecasts including additional rises to our global fertilizer price assumptions. This reflected increases to our gas price assumptions.

Core Commodity Price Trends



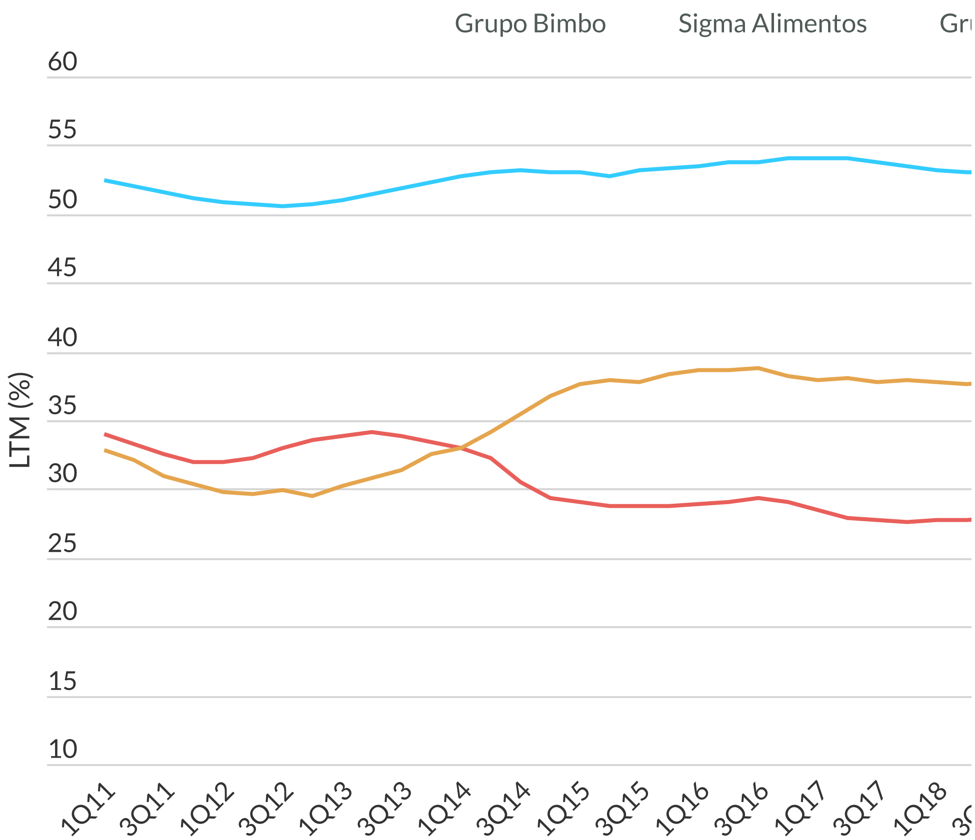
Source: Fitch Ratings, USDA.

Corn and wheat prices, which are among the main raw materials for Mexican global food companies, are likely to stay historically high in 2022. Wheat prices increased from USD6.28/bushel at YE20 to USD11.63/bushel as of mid-June 2022 and the USDA projects the season-average farm price for 2022/2023 to be USD10.75/bushel. Corn prices have additionally risen to USD7.74/bushel as of mid-June 2022 from USD4.74/bushel at YE20. USDA estimates that corn prices could reach a season-average farm price of USD6.75/bushel for 2022-2023. Pork prices too have been volatile and remain higher relative to last year.

Higher labor and energy costs will also feed through to end-prices of food products. Should these economic and commodity price trends extend beyond 2022, the risks of further margin pressure would rise. The impact on the labor market under a scenario of more permanent inflationary pressures and continued economic deceleration would mean a more pronounced impact on consumer incomes that what we have seen. Food companies would also face increased profitability pressures from weakened consumer demand. While hedging policies have mitigated cost pressures, the renewal of these hedging contracts will be more challenging and costly in 2023.

Gross Margin Trends

Mexico Global Packaged Food Companies



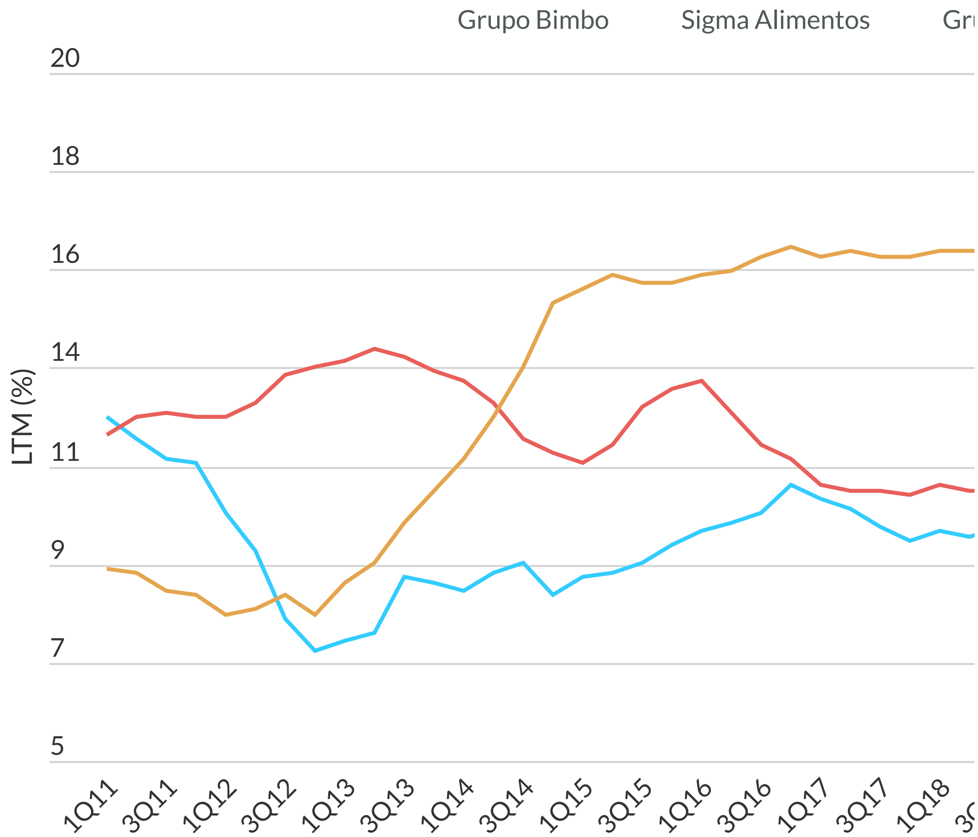
Source: Fitch Ratings, Fitch Solutions.

Gruma's (BBB+/Stable) profitability is below its peak levels in 2019-2020 as initiatives to offset inflation on raw materials, mainly corn, and labor costs in the U.S. have not been fully passed to customers. We estimate an EBITDA margin of around 14% in 2022 compared to 15% in 2019-2020. Gruma's U.S. operations contribute 66% of its consolidated EBITDA.

Grupo Bimbo's (BBB/Stable) and Sigma Alimentos's (BBB/Stable) profitability have proven to be more resilient. These companies have demonstrated greater flexibility to absorb inflationary headwinds thanks to hedging policies, price increases and operational efficiencies. This resilience is in part supported by their operations in Mexico, which contribute close to 55% and 46% of their consolidated EBITDA for Bimbo and Sigma Alimentos, respectively, and have higher margins than their operations in U.S. and Europe.

EBITDA Margins

Mexico Global Packaged Food Companies



Source: Fitch Ratings, Fitch Solutions.

We forecast for 2022 a slight EBITDA margin contraction for Grupo Bimbo to 11.9% from 12.1% in 2021. For Sigma Alimentos, which has more cost exposure, we project an EBITDA margin of 9.8% in 2022 from 10.2% in 2021.

Contacts:

Rogelio Gonzalez Gonzales
Director, Corporates
+52 81 4161 7034
Fitch Mexico S.A. DE C.V.
Edificio Connexity
Prol. Alfonso Reyes No. 2612, Piso 8
Col. Del Paseo Residencial
Monterrey, N.L.
64920

Justin Patrie
Senior Director, Fitch Wire
+1 646 582 4964
Fitch Ratings, Inc.
Hearst Tower
300 W. 57th Street
New York, NY 10019

Media Relations: Elizabeth Fogerty, New York, Tel: +1 212 908 0526, Email: elizabeth.fogerty@thefitchgroup.com

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