NEW RISK ALERT: (CAG)

New Disclosure Contradicts Conagra's Supply Chain Financing Claim

Consumer packaged goods company uses third-party to finance suppliers, then squeezes them for extended payment terms but denies any economic interest.

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This alert compares the language used in the company's latest filing with the period before. Research suggests changes in language, particularly in the risk factor section, is a powerful indicator of future performance. Companies that change filing language, according to research, underperform those that don't by 30-50 basis points per month for the following year.

New Language Reveals Conagra is Benefiting From Reverse Factoring But Claiming No Economic Interest

Conagra is engaged in what appears to be a too-good-to-be-true variant of supply chain financing. Conagra offers vendors a third-party service that provides certain suppliers with advances on scheduled payments from Conagra. Conagra states the financing is at the sole-discretion of the supplier and third-party.

> *"We have no economic interest in these financing arrangements and no direct relationship with the suppliers, the third party, or any financial institutions concerning this service."*

Though it denies any economic interest in said financing, Conagra has added new language to its latest 10-Q that reveals a clear economic benefit to the company:

> ***"The program commenced at about the same time that we began an initiative to negotiate extended payment terms with our suppliers.*** *Although difficult to predict, we generally expect the incremental cash flow benefits associated with these extended payment terms to increase at a slower rate in the future. A number of factors may impact our future payment terms, including our relative creditworthiness, overall market liquidity and changes in interest rates and other general economic conditions."*

The program launched in FY2017 yet it's not until 2021 that Conagra added new language to its quarterly filing that reveals it is simultaneously negotiating extended payment terms with suppliers.

Financing Accounts for Approximately 17% of Conagra's Accounts Payable

The company did not break out what it pays the third-party vendor that provides financing to suppliers in the most recent 10-Q. What is disclosed is the amount of payables that the third-party vendor has financed.

> *"The associated payments are included in net cash flows from operating activities within our Condensed Consolidated Statements of Cash Flows. As of November 29, 2020 and May 31, 2020, **$280.6 million and $258.7 million**, respectively, of our total accounts payable is payable to suppliers who utilize this third-party service."*

This amounts to 17.5% and 16.9% of Conagra's total Accounts Payable for the last two quarters. Interestingly, Conagra also includes a new risk factor in its latest 10-Q warning investors about its increasing reliance on third parties to perform key operations. In addition to boilerplate language detailing outsourcing risk, Conagra specifically calls out risk to its supply chain:

> *"If any of our third-party service providers experience a breach or system failure, their businesses could be negatively impacted, and it may result in disruption to our end-to-end supply chain or affect our ability to fulfill customer orders, both of which could have a material adverse effect on our business."*

Though new when compared to CAG's last 10-Q, this risk factor is included in the company's last 10-K. What is brand new in CAG's latest 10-Q, is a more detailed assessment of the risks associated with relying on a "wide array of third parties" like the one it partners with for supplier financing.

> *"The success of our end-to-end supply chain relies on the continued performance of a wide array of third parties. Suppliers, co-manufacturers, third-party outsourcers, warehousing partners, and transportation providers are among our critical partners. Although we take steps to qualify and audit third parties with whom we do business, we cannot guarantee that all third parties will perform dependably or at all. It is possible that events beyond our control, such as operational failures, labor issues, cybersecurity events, pandemics or other health issues, such as COVID-19, or other issues could impact our unaffiliated third parties. If our third parties fail to deliver on their commitments, introduce unplanned risk to our operations (e.g., through cyber activity), or are unable to fulfill their obligations, we could experience manufacturing challenges, shipment delays, increased costs, or lost revenue."*

For some reason Conagra felt compelled to double down on its warning related to third-party risk. It may have no direct economic interest in the supplier advances, but Conagra undoubtedly benefits from the extended payment terms that result. Disclosing the fee it pays for such a service— and the identity of the service provider— would position investors to better assess the health of the provider and possibly learn why Conagra is issuing new warnings regarding the potential failure of its outsourcing partners to deliver on their commitments.