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## Research Update:

# Pesquera Exalmar S.A.A. Downgraded To 'B' From 'B+' On Weak Credit Metrics; Outlook Stable

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## Table Of Contents

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Overview

Rating Action

Rationale

Outlook

Ratings Score Snapshot

Related Criteria And Research

Ratings List

## Research Update:

# Pesquera Exalmar S.A.A. Downgraded To 'B' From 'B+' On Weak Credit Metrics; Outlook Stable

## Overview

- Pesquera Exalmar has underperformed our original expectations because of an unfavorable operating environment in the Peruvian fishing industry, which weakened its key credit metrics and cash flow generation.
- We are lowering our corporate credit rating on Pesquera Exalmar to 'B' from 'B+'. At the same time, we are lowering our issue-level rating on the company's senior unsecured notes to 'B' from 'B+'.
- The stable outlook reflects our expectation that a recovery in volume sales during 2016 would gradually reverse the negative trend in its credit metrics and prevent further weakness in the company's cash flow generation.

## Rating Action

On Jan. 28, 2016, Standard & Poor's Ratings Services lowered its corporate credit rating on Peru-based fishing company Pesquera Exalmar S.A.A. to 'B' from 'B+'. The outlook is stable. We also lowered our issue-level rating on the company's \$200 million senior unsecured notes due 2020 to 'B' from 'B+'.

## Rationale

The downgrade on Exalmar reflects the underperformance of the company's key credit metrics and cash flow generation amid weaker-than-expected operating conditions in the Peruvian fishing industry over the past 12 months. In particular, the closure of the second fishing season in 2014 led to an important decline in fishmeal production volumes and sales during 2015, resulting in our reassessment of the company's financial risk profile.

Previously, our 'B+' ratings incorporated our expectations that Exalmar's total debt to EBITDA would remain in the 3.0x area, EBITDA interest coverage would exceed 4.2x, and funds from operations (FFO) to debt would be close to 20%. We also indicated that our previous 'B+' ratings factored in the potential for high cash flow volatility due to the seasonality of Exalmar's business. We previously forecast that financial metrics would, in general, be stronger than those of companies with more stable cash flows. However, for year-end 2015, we expect Exalmar's debt to EBITDA to be more than 5.5x, EBITDA interest coverage to be 2.4x, and funds from operations (FFO) to debt to be less than 10%. Even though we do anticipate a recovery in volume sales during 2016, we consider that the company's credit metrics would still underperform

our original expectations (for a higher rating).

Our assessment of Exalmar's business risk profile has not changed and still incorporates the inherent volatility of the fishing sector, which is affected by weather conditions, global demand, and government regulation. It also incorporates the company's business concentration in anchovy fishing along the Peruvian coast and its relatively small scale as the third-largest fishmeal producer in Peru, with a market share of about 12%. Offsetting factors are the company's favorable geographic location--Peru is the largest producer and main exporter of fishmeal worldwide. Additionally, medium-term demand growth prospects for fishmeal and fish oil consumption, coupled with Exalmar's gradual diversification into the direct human consumption (DHC) segment, support the long-term sustainability of the company's business model. Moreover, Exalmar maintains a competitive cost structure thanks to the vertical integration of its operations. The company benefits from a positive and long-term track record in the fishing industry and maintains sound and reliable relationships with third-party suppliers.

We revised our assessment of Exalmar's financial risk profile to "highly leveraged" from "aggressive," reflecting our expectation that the company's leverage ratios will remain above 4.0x for the next couple of years. Our assessment also incorporates the potential for intense volatility in the company's upcoming quarterly results, in light of still-challenging conditions during the 2016-2017 business cycle.

Our base-case scenario assumes:

- GDP growth in Peru will reach 3.4% in 2016, and 3.8% in 2017.
- Consumer price index in Peru of less than 3.0% in the next couple of years. Labor costs in local currency adjusted accordingly.
- Exchange rate of Peruvian nuevo sol (PEN) 3.5 per \$1 and PEN3.8 to \$1 in 2016 and 2017, respectively. The exchange rate only impacts local currency costs (for example, payroll) because all revenues are denominated in U.S. dollars.
- GDP growth in China will reach 6.3% in 2016, and 6.1% in 2017.
- Peru's real exports increase by about 15.0% in 2016 and 2017, reflecting a recovery in commercial trade (from less than 1% in 2015).
- Fishmeal volume sales in 2016, supported by an approved global quota of 1.11 million tons during the second season of 2015; we expect 2.0 million tons approved during the first season of 2016.
- Exalmar's participation in the global quota through owned quota and third-party purchases in line with 2015, for a total market share of about 12%.
- Volume sales for 2016 will benefit from 10 thousand tons of fishmeal stock carried over from the 2015 production.
- Fishmeal prices of about \$1,700/ton during 2016, and US\$1,650/ton for the remainder of the forecast period.
- Fish oil prices of about \$1,800/ton.
- Approved global quota of DHC will support about \$40 million revenues in this segment in 2016.

- A 300 bps increase in EBITDA margins starting in 2016, driven by cost savings stemming from a stronger dollar, which reduces the cost of payroll, and the decline in fuel prices.
- Capital expenditures (capex) below \$10 million in 2016, gradually increasing until reaching \$15 million from 2018 and increasing thereafter.
- No dividend payments in 2016; dividend distributions to shareholders of \$10 million per year, starting in 2017.

Based on these assumptions, we arrive at the following credit metrics for 2015 and 2016, respectively:

- EBITDA margin of 26.2% and 29.0%;
- Consolidated debt to EBITDA of 5.6x and 4.1x;
- FFO to consolidated debt of 9.6% and 14.7%; and
- EBITDA interest coverage ratio of 2.4x and 3.2x.

### **Liquidity**

Based on its likely sources and uses of cash during the next 12 months and our performance expectations, we assess Exalmar's liquidity as "less than adequate". We expect liquidity sources will cover uses by less than 1.2x in the next 12 months. We also include qualitative factors in our liquidity analysis, such as our view that current market conditions and lower credit availability could pose higher risks to access capital, particularly to fund working capital requirements.

#### Principal Liquidity Sources:

- Cash and liquid investments of \$8.8 million as of Sept. 30, 2015
- FFO of about \$25.9 million for the next 12 months
- Committed credit facilities of approximately \$20 million

#### Principal Liquidity Uses:

- Debt maturities of \$66.1 million as of Sept. 30, 2015
- Capex of about \$10 million for the next 12 months
- No dividend payments in 2016

Exalmar has a debt incurrence covenant that requires that the leverage ratio not exceed 3.5x. The company is currently in breach of this covenant, and we expect this breach to linger in the next 12 months. However, the financing documents include a provision that the company could still incur debt consisting of receivables financing. This financing has to be in connection with its working capital needs in an aggregate principal amount, which is not to exceed the greater of \$70.0 million or 14.5%, of the company's consolidated assets. In our view, this continues to support its financial flexibility and ability to access working capital debt to fund its operations.

## Outlook

The stable outlook reflects our expectation that a gradual recovery in volume sales during 2016 would, over time, reverse the negative trend in credit metrics and prevent further deterioration in the company's cash flow generation. We expect that the global fishing quota for 2016 will remain between 3.0 million tons and 3.5 million tons, resulting in a debt to EBITDA ratio of more than 4.0x and FFO to debt slightly above 10%.

### Upside Scenario

An upgrade would be triggered by significant improvement in the operating environment for the Peruvian fishing industry, including less volatile weather conditions that raise the annual fishing quotas above 4.0 million tons on a consistent basis. Under such conditions, we would expect Exalmar's EBITDA generation to exceed \$60 million, and therefore improve the company's debt to EBITDA ratio to less than 4.0x and FFO to debt to more than 20%.

### Downside Scenario

Downside risks in Exalmar's key credit metrics, stemming from highly volatile weather conditions along the Peruvian coast that deteriorate the company's fishmeal production volumes, would trigger a negative rating action. A global annual fishing quota below 2.0 million tons would result in debt to EBITDA above 7.0x and FFO to debt below 5.0%, which, in our view, would increasingly pressure the company's liquidity, and therefore result in a downgrade.

## Ratings Score Snapshot

Corporate credit rating: B/Stable/--

Business risk: Weak

- Country risk: Moderately high
- Industry risk: Intermediate
- Competitive position: Weak

Financial risk: Highly Leveraged

- Cash flow/leverage: Highly Leveraged

Anchor: b

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Less than Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)

Comparable rating analysis: Neutral (no impact)

## Related Criteria And Research

### Related Criteria

- Key Credit Factors For The Agribusiness And Commodity Foods Industry, Jan. 29, 2015
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Industry Risk, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Ratios And Adjustments, Nov. 19, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

## Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
Pesquera Exalmar S.A.A.		
Corporate Credit Rating	B/Stable/--	B+/Negative/--
Senior Unsecured	B	B+

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