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Ratings

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Research Update:

Pesquera Exalmar Downgraded To 'B-' From 'B' On Weaker Credit Metrics; Outlook Negative

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Overview

- Volatile weather conditions and a delay in the opening of the first fishing season of 2016 have reduced fishmeal production volumes of Peru-based fishing company Pesquera Exalmar, resulting in low cash flow generation, weak liquidity, and high leverage metrics.
- We're lowering our corporate credit and issue-level ratings on Exalmar to 'B-' from 'B' and removed them from CreditWatch with negative implications.
- The negative outlook reflects the potential downgrade for the next 12 months if external factors continue to constrain Exalmar's production volumes and cash flow generation prospects, further eroding its liquidity.

Rating Action

On Aug. 26, 2016, S&P Global Ratings lowered its corporate credit and issue-level ratings on Pesquera Exalmar S.A.A. to 'B-' from 'B' and removed them from CreditWatch negative, where we placed on June 16, 2016. The outlook is negative.

Rationale

The downgrade on Exalmar reflects the decline in its cash flow generation given volatile weather conditions and a delay in the opening of the first fishing season of 2016 that have reduced fishmeal production volumes. The lower-than-expected cash flow is pressuring Exalmar's liquidity and constrains the company's capacity to reduce its high leverage. In addition, we consider that the lengthy unfavorable conditions in Peru's industry heighten Exalmar's vulnerability to external factors, which weakened its profitability metrics and other key financial indicators.

The issue-level rating incorporates the company's announcement that it will cap the tender offer on its senior unsecured notes due 2020 to $30 million, which it would fund with a new secured debt. In our view, Exalmar's priority liabilities will continue to represent less than 15% of total adjusted assets even if the notes are validly tendered, which mitigates a potential structural subordination per our criteria.

Exalmar's business risk profile reflects the vulnerability to external factors such as weather conditions, the start of fishing seasons, and the quota approval process by Peruvian authorities. In addition, given that Exalmar has a limited scale of operations and is heavily dependent on production volumes along the Peruvian coast, in our view, the company has limited flexibility to withstand adverse dynamics beyond its control that could impair its performance.

Exalmar's profitability metrics have weakened from declining production volumes and somewhat lower fishmeal prices. Although the company's EBITDA margins remain above the industry's average, Exalmar's five-year historical average return on capital of 4.5% is lower than that of its rated global peers.

Exalmar's financial risk profile remains highly leveraged, reflecting our expectation that leverage ratios will remain above 5.0x for the next couple of years despite an expected normalization of fishing conditions for upcoming seasons.

Our assessment continues to incorporate the potential for volatility in the company's cash-flow leverage ratios, as seen in the performance of recent quarters. For the 12 months ended June 30, 2016, Exalmar's adjusted debt-to-EBITDA ratio reached 8.1x, above our previous estimate of about 5.0x.

Our base-case scenario assumes the following factors:

- China's GDP growth of more than 6% in 2016 and 2017.
- Peru's GDP growth of 4% in 2016 and 2017.
- Consumer Price Index in Peru to remain close to 3.0% in the next couple of years.
- Exchange rate of PEN3.5 per $1 in 2016 and PEN3.6 per $1 in 2017. Exchange rate affects local currency costs (e.g. labor) due to the dollar-denominated revenue.
- Peru's real exports to increase by about 9.3% in 2016 and 4.4% in 2017, reflecting a recovery in commercial trade (from less than 1% in 2015).
- The company's production volumes to decline in 2016 following a delayed start of the first fishing season of the year, which led Exalmar to realize only 50% of the catch of its assigned quota (6.17% of 1.8 million tons) of 1.11 million. For 2017, we expect a recovery in fishmeal and fishoil production volumes.
- In light of improving weather and biomass reports, we expect global fishing quotas to gradually trend towards 2 million tons per fishing season.
- Exalmar's participation in the Global Quota for 2016 through owned quota and third-party purchases to remain in line with 2015 for a total market share of about 12%.
- Fishmeal prices to remain between $1,550 and $1600 per ton in 2016 and 2017.
- Fishoil prices in excess of $1,800 per ton throughout the forecast period.
- Revenue growth about 8.5% iin 2016 and 18.2% in 2017.
- EBITDA to decline in 2016 as a result of lower fishmeal prices for the forecasted period and reduced efficiency rates despite the sharp decline in fuel prices. (Labor and fuel represent approximately 50% of production costs (catch + processing)).
- Annual capital expenditures to remain close to $12 million in 2016 and 2017.
- No dividend payments in 2016, and resuming at $10 million starting in 2017.

Based on these assumptions, we arrive at the following metrics for 2016 and 2017, respectively:

- EBITDA margin of 16.5% and 23.5%;
- Debt to EBITDA of 9.4x and 5.9x;
- Funds from operations (FFO) to debt of 3% and 9.4%; and
- EBITDA interest coverage above 1.4x and 2.2x.

Liquidity

We're revising our assessment of Exalmar's liquidity to weak from less than adequate because we now forecast sources-over-uses ratio to be a considerable deficit for the next 12 months due to sluggish production volumes following a long delay in the start of the first fishing season of the year and relatively low fishmeal inventories as of June 2016.

Principal Liquidity Sources:

- Cash and liquid investments of $17.2 million as of June 2016;
- FFO of about $12 million for the next 12 months; and
- Committed credit facility of $20 million, of which $15 million was available as of June 2016.

Principal Liquidity Uses:

- Debt maturities of $33.3 million as of June 2016 mainly related to bank notes;
- Working capital outflows of $6.3 million for the next 12 months;
- Maintenance capital expenditures of about $7 million for the next 12 months; and
- Dividend distributions of about $5 million.

Exalmar has a debt incurrence covenant that consists of a leverage ratio below 3.5x. Currently, the company is in breach of this limitation, and we expect this breach for the next 12 months. However, the financing documents include a provision under which Exalmar could still incur debt consisting of receivables financing. This financing has to be in connection with the company's working capital needs in an aggregate principal amount of no more than $70 million or 14.5% of the company's consolidated assets. In our view, this provides Exalmar with a degree of flexibility to fund its operations.

All modifiers are neutral to Exalmar’s anchor.

Outlook

The negative outlook reflects a one-in-three chance of another downgrade within the next 12 months if external factors continue to constrain Exalmar's production volumes and cash flow generation prospects, further eroding its liquidity. This could be triggered by fishing quotas in the North Center region of less than 2 million tons per season or if delays in the opening of fishing activities continue. We could also lower the ratings if we deem the issuer's financial commitments appear to be unsustainable in the long term.

Downside Scenario

Upside Scenario

We could revise the outlook to stable in the next 12 months if a sustained recovery in production volumes strengthens Exalmar's liquidity position and key financial indicators, with a debt to EBITDA approaching 5.0x and an FFO to debt close to 20%. This could occur if improving weather conditions and biomass reports lead to an annual fishing quota greater than 4 million tons while demand from China continues to support fishmeal prices above $1,500 a ton.

Ratings Score Snapshot

	To	From
Corporate Credit Rating	B-	B
Business Risk	Vulnerable	Weak
Country Risk	Moderately High	Moderately High
Industry Risk	Intermediate Risk	Intermediate Risk
Competitive Position	Vulnerable	Weak
Financial Risk	Highly Leveraged	Highly Leveraged
Cash Flow/Leverage	Highly Leveraged	Highly Leveraged
Anchor	b-	b
Modifiers		
Diversification/Portfolio effect	Neutral/Undiversified	Neutral/Undiversified
Capital structure	Neutral	Neutral
Financial policy	Neutral	Neutral
Liquidity	Weak	Less than Adequate
Management and Governance	Fair	Fair
Comparable rating analysis	Neutral	Neutral

Related Criteria And Research

Related Criteria

- Criteria - Corporates - Industrials: Key Credit Factors For The Agribusiness And Commodity Foods Industry - January 29, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments - November 19, 2013
- General Criteria: Methodology: Industry Risk - November 19, 2013
- General Criteria: Group Rating Methodology - November 19, 2013
- Criteria - Corporates - General: Corporate Methodology - November 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers - May 07, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers - November 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- General Criteria: Rating Implications Of Exchange Offers And Similar Restructurings, Update - May 12, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue -

April 15, 2008

Ratings List

	Rating	
	To	From
Pesquera Exalmar S.A.A.		
Corporate Credit Rating		
Foreign and Local Currency	B-/Negative/--	B/Watch Neg/--
Senior Unsecured		
Foreign Currency	B-	B/Watch Neg

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings referenced herein can be found on S&P Global Ratings' public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.