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## Research Update:

# Pesquera Exalmar Outlook Revised To Negative On Weaker Operating Environment; 'B+' Rating Affirmed

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## Research Update:

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## Overview

- Adverse weather conditions in Peru that weakened the anchovy population led the government to recently close the second fishing season of 2014 in the north-center region of the country, which will result in lower production and sales for 2015.
- We also anticipate a sharp decline in Peru-based fishmeal producer Exalmar's cash flow generation in 2015, which will pressure its liquidity and weaken credit measures beyond our previous forecast.
- We are affirming our 'B+' long-term corporate credit rating on the company and the 'B+' issue-level rating on its \$200 million senior unsecured notes due 2020.
- We are revising our outlook on Exalmar to negative from stable, reflecting one-in-three chances of a downgrade in the next 12 months if the company doesn't maintain sufficient financial flexibility to withstand adverse operating prospects without jeopardizing liquidity or if credit metrics don't remain consistent with the rating.

## Rating Action

On Jan. 5, 2015, Standard & Poor's Ratings Services revised its outlook on Pesquera Exalmar S.A.A. (Exalmar) to negative from stable. At the same time, we affirmed our 'B+' long-term corporate credit and issue-level ratings on Exalmar.

## Rationale

Difficult weather conditions affected fishing activities in the Peruvian coast and posed a challenging scenario for anchovy catch during the second half of 2014, which weakened Exalmar's operating performance. Also, following the decrease in the anchovy population within the allowed fishing zone to less than 2 million tons from more than 10 million tons in early 2014, the Peruvian government recently announced the closure of the second fishing season of 2014, which could lead to a moderate-to-significant decline in production volumes and sales in 2015. However, in our opinion, Exalmar is planning to take steps that could help it to withstand current weak operating environment until the assignment of the anchovy quota for the first fishing season of this year (between April and May). This plan includes:

- The reduction of capital outlays up to maintenance and regulatory levels,

- deferring the rest of its planned investments to the second half of 2015;
- Maintaining enough cash and availability of bank credit facilities, including a committed working capital credit line of \$20 million that is currently under negotiation, to secure funds for fixed cost. We estimate that the company closed 2014 with cash holdings of \$20 million - \$25 million, which is enough to cope with two coupon payments of its outstanding \$200 million bonds; and
  - Cost saving initiatives.

Considering these measures, under our base-case scenario (that incorporates a recovery of anchovy biomass absent El Niño weather phenomenon and, therefore, the normalization of fishing quotas from the second half of 2015) Exalmar's financial risk profile should remain consistent with the current rating.

The ratings on Exalmar continue to reflect our assessment of the company's "weak" business risk profile, "aggressive" financial risk profile and "less-than-adequate" liquidity.

Our assessment of Exalmar's business risk profile incorporates the inherent volatility of the fishing sector, which is affected by climate, global demand, and government regulation. It also reflects the company's business concentration in anchovy fishing along the Peruvian coast and its relatively small scale as the fourth-largest fishmeal producer in Peru with a share close to 12%. Offsetting factors are the company's favorable geographic location as Peru is the second producer and main exporter of fishmeal worldwide. Additionally, favorable 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.

In the last twelve months ended Sept. 30, 2014, Exalmar's EBITDA margin reached 27.4%, which is better than the 21.1% during the same period a year before and supports our assessment of a high volatility of profitability for the company. Margins improvement mainly reflects the higher quota assigned during this period amid rising international prices, which was partly offset by lower catch levels and increased fishing efforts due to harsh sea conditions. Moreover, operating efficiency improved following more efficient utilization of installed capacity in the DHC business, with higher production volumes resulting from the consolidation of investments in this segment. For 2015, we expect the EBITDA margin to deteriorate to about 20% by the end of the year. The greater contribution of the DHC segment won't be sufficient to mitigate the expected lower economies of scale as a consequence of the suspension of fishing activities imposed by the government for the first four to five months of 2015.

Exalmar's financial risk profile incorporates the company's high intra-year earnings and cash flow volatility, which are inherent to fishing activities,

and reflects our expectation that key credit ratios will recover by the second half of 2015, after a sharp deterioration during the fishing ban of the first half. We also expect the company to further develop its high value-added DHC business segment, which could somewhat soften our estimates of weaker operating results.

Under our baseline scenario, main assumptions for 2015 and 2016 include:

- Global fishing quota for anchovy close to 2 million tons in 2015 and 4 million tons in 2016, amid a somewhat stable climate;
- Average processing share stable at about 12% of total assigned anchovy quota (including 6.45% of own quota for the north-center fishing zone);
- Fishmeal prices would remain high at about \$1,650/ton on average during 2015 due to a global supply deficit, gradually decreasing to \$1,550/ton in 2016 following the recovery of fishmeal global availability; and
- Annual capital expenditures of \$15 million - \$25 million, mainly to fund maintenance and regulatory needs.

Based on these assumptions we arrive at the following credit measures:

- We expect significant swings in key credit indicators due to the volatility of the volume of production inputs (raw fish), with debt to EBITDA of about 7.0x and funds from operations (FFO) to debt slightly below 10% in 2015, then recovering during 2016 and reaching debt to EBITDA and FFO to debt close to 4.0x and 15%, respectively; and
- Interest coverage should follow the same pattern of volatility, reaching 2.5x in 2015 and improving up to 3.5x-4.0x in 2016.

## **Liquidity**

Based on its likely sources and uses of cash during the next 12-18 months, and our performance expectations, Exalmar has a "less-than-adequate" liquidity profile. Our assessment incorporates high working capital requirements associated with greater efforts to rebuild inventory levels in a context of low raw fish availability, and the lack of committed credit facilities. Other factors we considered in our assessment of Exalmar's liquidity include the following:

- Estimated sources of liquidity to fall short of estimated uses by about 25% in 2015. However, we believe sources will exceed uses in the first half of 2016 if global anchovy fishing quota recovers as expected;
- Positive track record of bank credit lines availability for working capital funding purposes (about \$140 million of uncommitted lines undrawn as of Sept. 30, 2014); and
- The company faces a smooth debt maturity profile for the coming years.

Main sources of liquidity for 2015 include cash holdings of about \$25 million as of the end of 2014, and estimated FFO of \$20 million - \$25 million. Cash uses would mainly include working capital needs and maintaining capital outlays of \$45 million - \$50 million and \$15 million, respectively, and no significant debt maturities, since we expect the company to continue rolling

over its working capital credit lines. In this regard, we believe Exalmar will fill a funding gap of about \$20 million with the undrawn portion of its bank lines or through the new committed line under negotiation.

The company faces a debt incurrence covenant consisting of a leverage ratio that should not be greater than 3.5x (without incorporating short-term financial obligations that have been contracted under warrants). Under our base-case forecast for 2015, we believe the company will breach this covenant, thus constraining its ability to raise additional debt.

## Outlook

The negative outlook reflects the potential for further deterioration of Exalmar's key financial ratios and cash flow generation if weather conditions and, therefore, anchovy population don't recover as expected, leading to a global quota less than 2 million tons on average for the coming fishing seasons. We could lower the ratings in the next 12 months if extended fishing ban periods, low quota assignments, or adverse market dynamics impair the company's cash flow compromising its liquidity. We could also lower the ratings if Exalmar reports debt to EBITDA consistently above 5.0x, or if FFO to debt falls below 10% on a constant basis.

## Upside Scenario

We could revise our outlook on the company back to stable if a sustained recovery of the global anchovy quota, amid favorable market conditions for fishing activities, contributes to the improvement of its key credit measures and cash flow generation. In such a case, we would expect Exalmar's credit metrics to be fully consistent with its rating level, with debt to EBITDA close to 4.0x and FFO to debt exceeding 15%.

## Ratings Score Snapshot

Corporate credit rating: B+/Negative/--

Business risk: Weak

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

Financial risk: Aggressive

- Cash flow/leverage: Aggressive

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

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Agribusiness And Commodity Foods Industry, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

Ratings Affirmed; Outlook Action

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

Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com) and at [www.spcapitaliq.com](http://www.spcapitaliq.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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