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**Research Update:**

## **Pesquera Exalmar S.A.A. 'B-' Corporate Credit And Issue-Level Ratings Affirmed; Outlook Still Negative**

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## Research Update:

# Pesquera Exalmar S.A.A. 'B-' Corporate Credit And Issue-Level Ratings Affirmed; Outlook Still Negative

## Overview

- Exalmar's cash flow generation prospects are improving amid expectations that normalizing fishing conditions in Peru could support global fishing quotas above 4 million tons a year.
- However, the company's tight liquidity remains exposed to the inherent cyclicality of the Peruvian fishing industry, as well as to the debt maturity on its \$172 million senior unsecured notes due January 2020.
- We're affirming our 'B-' ratings on Peru-based fishing company Exalmar.
- The negative outlook reflects Exalmar's tight liquidity in the context that the company has a short time-horizon to execute a liability management plan to address the debt maturity on its senior unsecured notes due January 2020. Failure to execute such a liability management plan within nine months would result in a higher refinancing risk, and therefore would trigger a rating downgrade.

## Rating Action

On Oct. 2, 2017, S&P Global Ratings affirmed its 'B-' corporate credit and issue-level ratings on Pesquera Exalmar S.A.A. (Exalmar). The outlook on the corporate credit rating remains negative.

## Rationale

Exalmar's cash flow generation prospects are improving amid our expectations that normalizing fishing conditions in Peru will support global fishing quotas above 4 million tons a year. However, although business conditions have improved, Exalmar's tight liquidity remains exposed to the inherent cyclicality of the Peruvian fishing industry, as well as to the debt maturity on its \$172 million senior unsecured notes due January 2020. In our view, Exalmar's refinancing risk could escalate by the second quarter of 2018 if the company cannot successfully execute a liability management that extends its debt maturity profile.

Exalmar remains the third largest producer of fishmeal and fish oil in Peru, with a 14.4% participation of the total biomass determined by the Institute of the Peruvian Sea (IMARPE); comprised of an anchovy extraction quota of 6.67% and third party participation of 7.7%. The company's current processing capacity and ability to buy third party catch has increased its production

share and has compensated for fishing seasons with low quotas.

Although in 2016 Exalmar's profitability was negatively affected by declining production volumes and somewhat lower fishmeal and fish oil prices, we anticipate that normalizing fishing conditions in 2017 and 2018 will support higher production volumes and operating margins.

Exalmar's key credit metrics were negatively affected when in 2014 the climate pattern El Niño dented the biomass of anchovy along the Peruvian coast. Consequently, Peruvian authorities reduced fishing quotas for subsequent seasons and constrained production volumes for the industry up until last year. During the first fishing season of 2017, Exalmar realized 86% of its share of the 2.8 million ton approved quota. Based on the aforementioned factors, Exalmar's current inventory levels, and current fishing conditions, we expect the company to improve its cash flow generation and deleverage its capital structure over the next 12 months with its debt to EBITDA trending towards 4.0x.

Our base-case scenario assumes the following factors for 2017 and 2018:

- China's GDP growth of 6.7% and 6.3% respectively;
- Peru's GDP growth of 2.6% and 3.5%, respectively;
- Consumer Price Index (CPI) in Peru to remain close to 3.0%;
- Peru's real exports to increase by about 8% and 5% respectively, supporting commercial trade. We expect Exalmar's exports to Asia to continue representing more than 70% of total revenue;
- Current biomass reports suggest upcoming global fishing quotas above 4 million tons a year (the north-center quota related to the first fishing season of 2017 was of 2.8 million tons);
- Exalmar's participation in the global quota through owned quota and third-party purchases to remain in line with 2016, for a total market share of about 14%;
- Our volume sales estimate for 2017 includes \$69 million in inventory that was produced in the second season of 2016, and was held (not sold).
- Fishmeal and fish oil prices to remain close to US\$1,500/ton, over the forecasted period;
- Revenue growth of about 83% in 2017, slightly declining in 2018 amid expectations that upcoming quotas will be lower than the approved quota for the first fishing season of 2017;
- Capital expenditures (capex) between US\$12 million and US\$15 million; and
- Dividend payments to resume in 2018, amounting to about US\$10 million per year.

Based on these assumptions, we arrive at the following metrics for 2017 and 2018:

- EBITDA margins above 25%;
- Debt to EBITDA of 4.1x and 3.8x, respectively;
- Funds from operations (FFO) in excess of 12%; and
- EBITDA interest coverage of 3.3x and 3.5x, respectively.

## **Liquidity**

Exalmar's liquidity remains weak because we anticipate sources over uses of cash to continue presenting a deficit in the next 12 months. This is mainly due to the company's reduced cash balance as of June 30, 2017, and to short-term debt drawn to fund working capital needs during the second quarter of 2017. However, we expect the \$65 million of marketable inventories to help restore the company's liquidity in upcoming quarters.

Principal liquidity sources:

- Cash and liquid investments of US\$3.1 million as of June 30, 2017;
- FFO of about US\$37 million for the next 12 months; and
- Committed credit facility of US\$20 million, of which only US\$15 million is fully available as of June 2017.

Principal liquidity uses:

- Debt maturities of US\$53.6 million as of June 30, 2017, mainly related to bank notes;
- Working capital requirements of about US\$5.7 million;
- Capex of about US\$13.5 million for the next 12 months; and
- Dividend distributions of about \$10 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 to last for at least the next 12 months. However, the provision under its financing documents, which allows Exalmar to access working capital debt to fund its operations, provides the company with some financial flexibility.

## **Outlook**

The negative outlook reflects Exalmar's tight liquidity in the context that the company has a short time period to execute a liability management plan to address the debt maturity on its senior unsecured notes due January 2020. Failure to execute such a liability management plan within nine months would result in a higher refinancing risk, and therefore would trigger a rating downgrade.

## **Upside scenario**

We could revise the outlook to stable in the next 12 months if the company successfully refinances its senior unsecured notes due 2020 and improves its liquidity, which could occur if fishing conditions continue to support the timely commencement of seasons and fishing quotas above 4 million tons a year. Under such a scenario, the company's debt to EBITDA would trend below 4.0x and discretionary cash flows would be positive.

## Ratings Score Snapshot

Corporate credit rating: B-/Negative/--

Business risk: Vulnerable

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

Financial risk: Highly Leveraged

- Cash flow/Leverage: Highly Leveraged

Anchor: b-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Weak (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

## Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Corporates - Industrials: Key Credit Factors For The Agribusiness And Commodity Foods Industry, Jan. 29, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

Ratings Affirmed

Pesquera Exalmar S.A.A.

Corporate Credit Rating	B-/Negative/--
Senior Unsecured	B-

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](http://www.standardandpoors.com) for further information. 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 the S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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