

Research Update:

Pesquera Exalmar Upgraded To 'B' From 'B-' And Off Watch On Debt Refinancing And Improved Credit Metrics, Outlook Stable

April 15, 2019

Rating Action Overview

- During the first quarter of 2019, Peru-based fishing company Pesquera Exalmar S.A.A. (Exalmar) refinanced its senior unsecured notes for \$109 million due 2020 and posted stronger operating and financial performance due to higher-than-expected fishing quotas that have strengthened its capital structure and liquidity position.
- On April 15, 2019, S&P Global Ratings raised its global scale issuer credit and issue-level ratings on Exalmar to 'B' from 'B-' and removed them from CreditWatch, where we placed them with positive implications on Jan. 16, 2019.
- The stable outlook reflects our view that Exalmar will continue to deliver a solid operating and financial performance and cash flow generation thanks to favorable fishing conditions, higher purchases from third parties, and some operating efficiencies. We expect an improvement in Exalmar's liquidity and leverage metrics with a debt to EBITDA and EBITDA interest coverage below 4.0x and above 3.0x, respectively, in the next 12 months.

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Rating Action Rationale

After refinancing its senior unsecured notes for \$109 million due 2020, Exalmar has improved sharply its financial risk profile, capital structure, and liquidity position with a debt maturity profile above 3.5 years on a pro forma basis. Exalmar used a \$110 million five-year syndicated loan and cash on hand to refinance the senior unsecured notes due 2020 and repay a \$19 million syndicated loan. We believe the new syndicated loan will help the company reduce its debt at a faster pace than we had previously expected, given the manageable amortizations that the company would face for this loan.

The upgrade also reflects the company's better-than-expected operating and financial performance during the past 12 months due to a significant recovery in the fishing quotas in Peru since 2017 and higher purchases from third parties. The company posted EBITDA margins of around 35%, a debt-to-EBITDA ratio of 3.0x, and an EBITDA interest coverage of 4.4x as of Dec. 31,

2018. Given the refinancing and a robust EBITDA, we forecast these metrics below 4.0x and above 3.0x, respectively, in the next 12 months.

Our rating on Exalmar continues to reflect its 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, we believe the company has limited flexibility to withstand adverse dynamics beyond its control that could impair its performance. Exalmar is the third-largest producer of fishmeal and fish oil in Peru, with a 15% participation of the total biomass determined by the Institute of the Peruvian Sea (IMARPE); comprised of an anchovy extraction quota of 7.77% and third-party share of 7.23%. The company's current processing capacity and ability to buy third-party catch have increased its production, revenue, and EBITDA, strengthening its profitability in the past few quarters. We expect the company's EBITDA margins to remain between 25% and 30% in the next 12 months.

Outlook

The stable outlook reflects our view that Exalmar will continue to deliver a solid operating and financial performance and cash flow generation thanks to favorable fishing conditions, higher purchases from third parties, and some operating efficiencies. We expect Exalmar's EBITDA margins to be 25%-30%, leading to an improvement in liquidity, and debt to EBITDA and EBITDA interest coverage below 4.0x and above 3.0x, respectively, in the next 12 months.

Downside scenario

We could downgrade Exalmar in the next 12 months if its operating and financial performance weaken from our current expectations, stemming from adverse weather conditions or lower fishing quotas that could erode fishmeal production volumes, resulting in low cash flow generation and debt to EBITDA above 5.0x on a consistent basis. A deteriorating liquidity position could also trigger a negative rating action.

Upside scenario

A positive rating action is very unlikely in the next 12 months, but could occur after a sharp improvement in the operating conditions for the Peruvian fishing industry, including less volatile weather conditions that raise the annual fishing quotas above 4 million tons on a consistent basis. Under such conditions, we expect Exalmar to post stronger EBITDA, cash flow generation, and credit metrics, such as debt to EBITDA consistently below 3.0x and discretionary cash flow (DCF) to debt of more than 10%.

Company Description

Exalmar is a Peruvian fishing company engaged in the extraction, processing, and commercialization of hydro-biological resources for direct and indirect human consumption. It produces fishmeal for the growth of bovines, sheep, and pigs, as well as for the development of fish farming and poultry; and fish oil, which is primarily used as fish feed in the aquaculture industry. The company also processes various fish species, such as horse mackerel, mackerel, giant squid, and mahi-mahi. Exalmar operates five plants of fishmeal and fish oil, and two frozen plants for processing hydro-biological products for human consumption.

Our Base-Case Scenario

- China's GDP growth of 6.2% in 2019 and 2020, and Peru's GDP growth of 4.0% in 2019 and 4.1% in 2020. Inflation rate in Peru to remain close to 2.2% in both years, which will support consumption trends, benefiting Exalmar's sales of fishmeal.
- Peru's real exports to increase about 4%, supporting commercial trade. We expect Exalmar's exports to Asia to represent slightly more than 70% of total revenue.
- Recovering biomass reports suggest upcoming global fishing quotas above 4 million tons per year. We expect the north-center quota related to the first fishing season of 2019 to be 2.0-2.5 million tons.
- Exalmar's share of the global quota through owned quota and third-party purchases to increase to above 15%.
- Our volume sales estimate for 2019 includes almost \$50 million in inventory that was accumulated and held for sale at the end of 2018.
- Fishmeal to remain close to \$1,550 per ton and fish oil at around \$1,700 per ton for the forecasted period.
- Revenue growth of about 12% in 2019, mainly due to the high fishing quota at the end of 2018 and higher volumes from third parties, but declining 7% in 2020 amid expectations that upcoming quotas could be lower than the approved one for the second fishing season of 2019.
- Gradual improvement in profitability stemming from operating efficiencies on extracting fish.
- Capital expenditures (capex) of about \$20 million in 2019 and 2020, mostly for maintenance of the vessel fleet and processing plants.
- Dividend distributions in 2019 of \$20 million and none in 2020.
- Relatively stable debt level of \$240 million on average.

Based on these assumptions, we arrive at the following credit metrics for 2019 and 2020:

- EBITDA margin of 25%-30%;
- Debt to EBITDA below 4.0x; and
- EBITDA interest coverage above 3.0x.

Liquidity

We revised our liquidity assessment on Exalmar to less than adequate from weak after the recent refinancing and our expectation of solid operating performance and cash flows. We expect its sources to uses of cash to remain below 1.2x in the next 12 months given the company's short-term debt maturities and capex. Moreover, we believe Exalmar has sound relationships with banks, as seen in the recent refinancing. For the first time since 2015, Exalmar announced it would be paying discretionary dividends for \$20 million in 2019, signaling the improved liquidity.

Principal Liquidity Sources:

- Cash and cash equivalents of \$33.1 million as of Dec. 31, 2018;
- Cash FFO of about \$65 million for the next 12 months;

- Working capital inflows (including intra-year seasonal requirements) of about \$5 million for the next 12 months; and
- Net amount of \$1 million, stemming from the syndicated loan of \$110 million minus the payment of the senior unsecured notes due 2020 of about \$109 million.

Principal Liquidity Uses:

- Short-term debt maturities of \$70 million as of Dec. 31, 2018;
- Capex of \$20 million in the next 12 months; and
- Dividend payment of \$20 million in the next 12 months.

Covenants

The covenant under the senior unsecured notes due 2025 is of incurrence with a maximum debt to EBITDA of 3.5x, which the company was in compliance as of March 31, 2019. We expect Exalmar to maintain headroom above 30% in the next 12 months on this limitation. Additionally, the company has financial covenants to comply under the new syndicated loan for \$110 million. As of March 31, 2019, Exalmar was in compliance with these financial covenants, and we expect the same trend in the next 12 months.

Environmental, Social, And Governance

Environmental factors are relevant to Exalmar's credit quality. The fishing industry is highly exposed to environmental risk factors. The magnitude of weather phenomenon, known as El Niño, could change water temperatures and as a result disperse biomass, which has occurred in the past few years, hampering Exalmar's results. The government's quotas for each fishing season have been volatile in the past years, which has directly affected Exalmar's results in recent years. Exalmar actively cooperates for the preservation of marine resources, abiding by anchovy size restrictions for fishing, fishing vetoes, and quotas. We believe that continuous fishing vetoes and decreases in quotas well below 4 million tons per year could take a toll on Exalmar's operating performance, profitability, and credit metrics.

The fishing industry is gradually becoming less labor intensive, and gradual automatization has created discontent among workers. However, Exalmar works to create and maintain strong relationships with the community, purchasing more than half of its processed fish from third parties including artisan fishermen, which has improved Exalmar's EBITDA.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of Dec. 31, 2018, Exalmar's capital structure mainly consisted of the \$109 million global senior unsecured notes due 2020, the \$60.922 million senior unsecured notes due 2025, the \$70 million short-term bank loans, and a \$19 million syndicated loan. Exalmar used the proceeds from the \$110 million five-year syndicated loan and cash on hand to refinance the senior unsecured notes due 2020 and repay the \$19 million syndicated loan.

Analytical conclusions

Although the \$110 million syndicated loan is secured with around 50% of Exalmar's fishing quota and two production plants, we believe that the existing senior unsecured notes for \$60.922 million due 2025 are not subordinated to the new debt, given that the other half of Exalmar's fishing quota and five other production plants are still available in case of any event of default, mitigating any potential subordination risk. Therefore, we rate Exalmar's senior unsecured notes due 2025 at 'B', the same level as the issuer credit rating.

Ratings Score Snapshot

	To	From
Corporate Credit Rating	B/Stable/--	B-/Watch Pos/--
Business Risk	Vulnerable	Vulnerable
Country Risk	Moderately High	Moderately High
Industry Risk	Intermediate	Intermediate
Competitive Position	Vulnerable	Vulnerable
Financial Risk	Aggressive	Highly Leveraged
Cash Flow/Leverage	Aggressive	Highly Leveraged
Anchor	b	b-
Modifiers		
Diversification/Portfolio effect	Neutral: no impact	Neutral: no impact
Capital structure	Neutral: no impact	Neutral: no impact
Financial policy	Neutral: no impact	Neutral: no impact
Liquidity	Less Than Adequate: no impact	Weak: no impact
Management and Governance	Fair: no impact	Fair: no impact
Comparable rating analysis	Neutral: no impact	Neutral: no impact

Related Criteria

- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- 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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013

- Criteria | Corporates | General: Corporate Methodology, 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

Upgraded; CreditWatch/Outlook Action

	To	From
Pesquera Exalmar S.A.A.		
Issuer Credit Rating	B/Stable/--	B-/Watch Pos/--
Senior Unsecured	B	B-/Watch Pos

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