

Research Update:

Pesquera Exalmar S.A.A. Ratings Lowered To 'CCC+' On Tight Liquidity; Outlook Negative

July 14, 2020

Rating Action Overview

- Peru-based fishing company Pesquera Exalmar S.A.A. (Exalmar) faces significant shortcomings of cash sources relative to its short-term needs, including sizeable debt maturities.
- While this situation is related to Exalmar's cash flow cycle and liquidity could gradually improve in the coming months, the company's high exposure to refinancing risk comes during high global economic uncertainty and generally unfavorable financing conditions in the market.
- On July 14, 2020, S&P Global Ratings lowered its global scale issuer credit and issue-level ratings on Exalmar to 'CCC+' from 'B-', and revised the outlook to negative.
- The negative outlook reflects Exalmar's high exposure to refinancing risk on short-term debt maturities of about \$135 million as of March 31, 2020, of which \$32.8 million are warranted with inventories and does not present refinancing risk. In our view, continued liquidity shortcomings in the next six months could indicate a structural intra-year weakness that could trigger another downgrade.

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Rating Action Rationale

The downgrade reflects Exalmar's tight liquidity and increasing refinancing risks. Exalmar faces an important liquidity shortfall relative to its short-term needs, which include sizeable debt maturities. As of March 31, 2020, Exalmar posted about \$135 million in short-term debt, which includes bank debt secured by fishmeal inventory, unsecured bank loans, and about \$17.7 million of amortization related to its syndicated loan. This figure is significantly larger than the company's cash balance of \$12.2 million at the end of March, and our expected operating cash flow generation of about \$65 million in the next 12 months. Moreover, Exalmar doesn't have any committed revolving credit facility available (as it used to have in recent years) to provide a liquidity cushion. As a result, Exalmar's liquidity shortcomings and exposure to refinancing risk isn't consistent with the previous rating level in the 'B' category. In addition, the company recently breached one of its covenants, but got waiver approvals from its banks for the first and second quarters of 2020. In our view, this signals weak operating conditions for the company related to the poor second fishing season in 2019 (with around 35% catch of the approved quota), but

ongoing support from banks.

Although Exalmar has a long track record of sound relationships with local banks and healthy access to working capital funding, our liquidity assessment of the company's cash sources doesn't incorporate refinancing assumptions, per our criteria. Instead, we only consider monetary flows that provide a liquidity cushion with a high degree of certainty, including existing cash reserves and cash flow streams in our base-case scenario.

Exalmar recently increased the draw down under its short-term working capital facilities to support its operations and improved its liquidity because of the poor second fishing season in 2019, and the uncertainty from COVID-19 at the beginning of the year. Moreover, the company increased fish purchases from third parties in recent months to historical high levels.

Exalmar's cash flows remain exposed to downside risks related to the inherent cyclicality of Peru's fishing industry, while the company has become increasingly dependent on external funding to refinance its short-term debt maturities. Since the COVID-19 outbreak began, Exalmar has been able to maintain business continuity although with some restrictions imposed by the Peruvian government, including smaller crews on each ship to reduce the contagion risk. The company has maintained its fishmeal and fish oil production while shipping its products to its main customers in Asia, although at a slower pace due to distribution and logistics restrictions given the pandemic.

In our updated base-case scenario, we expect Exalmar's cash flow generation to improve in the next 12 months for two key reasons. First, because the overall first fishing season of 2020 has a quota of about 2.4 million tons, and we expect Exalmar to reach a market share of about 17% (including third party purchases), we forecast the company's effective catch to reach close to 100% of its quota for the season. Second, we assumed 2 million tons of global fishing activity for the second season of 2020 while the company would maintain market share. However, as seen in recent years, the company's results remain exposed to the inherent cyclicality of the Peruvian fishing industry, with volatile fishing quotas and catches. In our view, if external conditions become unfavorable, particularly for the second fishing season of 2020 and the next, it would rapidly increase downside risks for the company's liquidity and its refinancing risk exposure.

Thus, we believe Exalmar is currently vulnerable and depends on favorable business, financial, and economic conditions, as well as on successful debt refinancing to meet its financial obligations.

Environmental, social, and governance (ESG) factors relevant to the rating action:

- Natural conditions factors.

Outlook

The negative outlook reflects Exalmar's high exposure to refinancing risk related to its short-term debt maturities of about \$135 million as of March 31, 2020 of which \$32.8 million are warranted with inventories and does not present refinancing risk. In our view, continued liquidity shortcomings in the next six months could illustrate a structural intra-year weakness that could trigger another downgrade.

Downside scenario

We could lower the ratings in the next six to 12 months if we see increasing risk of a near-term

payment crisis or default. This could happen if:

The second fishing season of 2020 is below 2 million tons or if Exalmar's effective fishing catch doesn't reach our expectation, which would pressure its cash flows;

Exalmar is unable to refinance its short- and medium-term debt obligations; and

There is an increasing probability of debt restructuring that we would view as distressed and tantamount to default.

Upside scenario

We could revise the outlook to stable in the next six to 12 months if Exalmar's liquidity significantly improves through higher cash flows assuming 100% fishing catch during the first and second season of 2020, while it reduces its short-term debt position and eliminates its refinancing risks.

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 of processing hydro-biological products for human consumption.

Our Base-Case Scenario

Assumptions

- China's GDP growth of 1.2% in 2020 and 7.4% in 2021, respectively;
- Peru's GDP to contract 12% in 2020 and then to grow 10.5% in 2021;
- Exalmar's exports to China to continue representing more than 60% of total revenue;
- Current biomass reports suggest upcoming global fishing quotas of about 4 million tons per year (the north-center quota related to the first fishing season of 2020 was 2.4 million tons);
- 100% fishing catch for both 2020 and 2021 seasons;
- Exalmar's market share of Peru's total quota, through own-quota and third-party purchases, to be about 17% in 2020 and 15% in 2021;
- Fishmeal volume sales of about 132,300 MT (metric tons) in 2020 and 148,500 MT in 2021. Fish oil volumes of about 17,400 MT in 2020 and 23,500 MT in 2021;
- Average fishmeal price of about \$1,440/ton in 2020 and \$1,500/ton in 2021. Average fish oil prices above \$2,200/ton in 2020 and near \$2,000/ton in 2021;
- Revenues of about \$250 million in 2020 and \$270 million in 2021;
- Capital expenditures (capex) of about \$9.7 million in 2020 and \$12.0 million in 2021; and
- No dividend payments in 2020 and 2021.

Key metrics for 2020 and 2021:

	2020	2021
EBITDA margins (%)	About 27%	About 25%
Debt to EBITDA (x)	About 4.0x	Slightly below 4.0x
EBITDA interest coverage (x)	About 3.5x	Above 3.5x

Liquidity

We continue to assess Exalmar's liquidity as weak because we expect a substantial cash deficit to cover liquidity uses for the next 12 months. Our liquidity analysis also includes qualitative factors such as our view that the currently volatile market conditions could crimp the company's access to capital, particularly to fund working capital requirements and refinance short-term debt obligations, including the syndicated loan in the next 12 months.

Principal Liquidity Sources:

- Cash and cash equivalent of \$12.2 million as of March 2020;
- Expected FFO of about \$55 million for the next 12 months; and
- Working capital inflows of about \$10 million for the next 12 months.

Principal Liquidity Uses:

- Short-term debt of \$135 million as of March 2020; and
- Capex of around \$10 million for the next 12 months.

Covenants

Under its \$104 million syndicated loan agreement, Exalmar is subject to several financial maintenance covenants, including:

- Consolidated leverage ratio of maximum of 1.5x;
- Debt (without warrant) to EBITDA of maximum of 5.5x in the second quarter of 2020 and 3.5x from third quarter 2020 and onward;
- Minimum debt service coverage ratio of 1.2x; and
- Liquidity ratio of minimum of 0.8x.

As of March 31, 2020, Exalmar didn't comply with its minimum debt service coverage ratio, but it obtained waivers for the first and second quarter of 2020. From September 2020 and on, we expect Exalmar to comply with all of its covenants, although with tight headroom.

Moreover, under its senior unsecured notes due 2025 indenture, Exalmar is subject to a maximum debt to EBITDA of 3.5x financial incurrence covenants should it seek to incur additional debt. We

expect the company to keep complying with this covenant.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of March 31, 2020, Exalmar's capital structure mainly consisted of the \$60 million senior unsecured notes due 2025, the \$104 million syndicated loan, and about \$115 million of short-term bank loans related to working capital financings, of which \$32.8 million are warranted with inventories.

Analytical conclusions

Although the \$104 million syndicated loan is secured with two production plants and vessels, we believe that the existing senior unsecured notes of \$60 million due 2025 are not subordinated to the syndicated loan, because the company has other five production plants that 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 'CCC+', the same level as the issuer credit rating.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- 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
- 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, Nov. 13, 2012
- General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Pesquera Exalmar S.A.A. Ratings Lowered To 'B-' From 'B' And Placed On CreditWatch Negative On Weak Liquidity , April 2, 2020.

Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
Pesquera Exalmar S.A.A.		
Issuer Credit Rating	CCC+/Negative/--	B-/Watch Neg/--
Pesquera Exalmar S.A.A.		
Senior Unsecured	CCC+	B-/Watch Neg

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