

Global Credit Research - 04 Nov 2015

Peru

### Ratings

| Category                | Moody's Rating |
|-------------------------|----------------|
| Outlook                 | Negative       |
| Corporate Family Rating | B3             |
| Senior Unsecured        | B3             |

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### Key Indicators

| [1]Pesquera Exalmar S.A.A. | 6/30/2015(L) | 12/31/2014 | 12/31/2013 | 12/31/2012 | 12/31/2011 |
|----------------------------|--------------|------------|------------|------------|------------|
| Total Sales (USD Billion)  | \$0.2        | \$0.2      | \$0.2      | \$0.2      | \$0.2      |
| CFO / Net Debt             | -2.0%        | 31.3%      | -13.4%     | 21.2%      | 15.5%      |
| Debt / EBITDA              | 7.2x         | 4.2x       | 7.7x       | 3.6x       | 2.2x       |
| EBITA / Interest Expense   | 1.0x         | 2.2x       | 0.7x       | 4.4x       | 8.7x       |
| Debt / Book Capitalization | 52.4%        | 52.3%      | 53.9%      | 43.5%      | 35.5%      |

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Source: Moody's Financial Metrics

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

### Opinion

#### Rating Drivers

- One of the largest Peruvian producers of fishmeal and fish oil
- Small scale relative to peers and limited product and raw material diversification
- Cash flow sensitive to regulation, climatic conditions and biomass location, as well as fishing quota levels that affect fishmeal and fish oil prices
- Potential to diversify its revenue stream by growing its direct human consumption business

#### Corporate Profile

Founded in 1992, Pesquera Exalmar, S.A.A. (Exalmar) is a Peruvian fishing company which produces fishmeal and fish oil used for indirect human consumption. In addition, Exalmar also sells fresh and frozen fish (mackerel,

horse mackerel, giant squid, and mahi-mahi) for direct human consumption. Exalmar's sales of fresh and frozen fish for direct human consumption represented around 18% of total revenues in the twelve months ended June 30, 2015. According to the company, the plan is to have the segment representing close to 25% of total revenues by 2017.

Exalmar has a 6.54% assigned quota in the north-center and 4.46% in the south of Peru and the ability to process third-party catch, which increases its overall participation in the market. This positions the company as the 3rd. largest fishing player in Peru in terms of processed anchovy. Exalmar is vertically integrated and currently operates 22 vessels and six processing plants along the Peruvian coast.

Exalmar is majority owned (70.7%) and controlled by its founder, Victor Matta Curotto, and the 24.2% balance is publicly traded in the Lima stock exchange. For the twelve months ended September 30, 2015, the company reported revenues of USD169 million and EBITDA of 36.2 million.

## **SUMMARY RATING RATIONALE**

Exalmar's ratings reflect its current weak credit metrics and our expectation that they will further tighten as a result of the high likelihood that a modest to strong El Niño led the Peruvian authorities to reduce the 2nd fishing season of 2015. This will impact Exalmar's revenues and profitability leading its leverage to remain around 6.5 times in the next 12-18 months.

Exalmar's ratings incorporate the company's limited operating scale and modest business diversification compared to regional peers as well as other seafood and protein-industry companies; its exposure to volatile volume and price trends of the commoditized global fishmeal and fish oil market; the sensitivity of cash flows to climatic conditions and regulation; and a pronounced cash flow seasonality. These credit negatives are to some extent offset by Exalmar's position as the third largest fishmeal producer in Peru, the world's leading fishmeal nation; a successful operating history in its current business configuration; and some revenue diversification from its growing direct human consumption business.

## **DETAILED RATING CONSIDERATIONS**

### **SMALL SCALE AND LIMITED PRODUCT AND RAW MATERIAL DIVERSIFICATION**

Exalmar's main focus on fishmeal and fish oil production exposes the company to relatively few end-markets. These primarily relate to the aquaculture (fish farming) and hog and poultry farming industries in Asia (particularly China) and Europe. While the aquaculture industry has exhibited solid growth rates over the past decades and has thus helped grow fishmeal and fish oil demand and increase prices, temporary demand disruptions in key markets, for example because of disease outbreaks or import restrictions, could affect cash flows.

Exalmar's narrow product focus and geographic sourcing concentration is partially offset by its sales diversification, as it exports most of its production. The most important region is Asia with around 52% of its fishmeal sales volumes exported to China. As the food industry is fairly defensive against the economic cycles we would expect that Exalmar's revenues will not be materially affected by slowing GDP growth in China as its products are employed as feed for animals that are ultimately used for human consumption, which will still experience growing demand. Moody's forecast of China's real GDP growth is to remain at 6.8% in 2015 and 6.3% in 2016.

### **VOLUMES AND CASH FLOW SENSITIVE TO REGULATION AND CLIMATIC CONDITIONS**

Exalmar's volumes and thus its cash flow critically depend on the level of the catch of anchovies, the company's main raw material, which varies with the total allowable catch set prior to each fishing season by PRODUCE, the Peruvian Ministry of Production (MoP). Anchovy catch levels vary because of changing climatic conditions, in particular the El Niño effect.

In 2014 a modest El Niño affected the Peruvian waters diminishing anchovy availability. As a result, the MoP canceled the 2nd fishing season of 2014 due to the high presence of juveniles in the anchovy biomass in the center-north fishing regions of Peru. While this strategy is successful to preserve biomass, it had a negative impact on the financial results of the companies in the sector; in particular during the first quarter of 2015.

According to ENFEN (Peruvian Committee for the National Study of El Niño), there is a 35% likelihood of the development of a modest El Niño during December 2015 to March 2016 and a 40% probability of the development of a strong El Niño, there were an increased chances that the MoP would reduce the 2nd fishing season of 2015 and under our base case scenario the cancellation of the quota. As a result, the MoP allow only 1.1 million ton

quota for the second fishing season of 2015, as compared of a normal quota of around 2 million ton.

As Peru is the largest exporter of fishmeal, producing about 30% of worldwide supply, the suspension of a fishing season leads to a rise in fishmeal prices. While the increase in prices partly offsets the decline in sales volumes the net effect is still negative for the companies in the sector.

Exalmar's debt/EBITDA has remained over 7 times during 2015 and was 7.2 times as of September 30, 2015. Under our base case scenario that assumes the cancellation of the second fishing season of this year, we estimate leverage to remain between 6.5 times and 7 times by year end 2015 and above 6.5 times by year-end 2016.

## POTENTIAL TO GROW IN THE DIRECT HUMAN CONSUMPTION BUSINESS

In 2010 the company began developing its direct human consumption business and invested USD40 million to build two new plants (Tambo de Mora and Paíta) for frozen fish processing and to provide six of its vessels with refrigeration systems (RSW). As of today, the company has an installed capacity of 683 MT/day in its DHC business.

Exalmar plans to benefit from the increasing importance of fish for direct human consumption industry, as according to the Food and Agriculture Organization over 75% of the global fish production is used for DHC. We note that, despite the growth potential of the human consumption fishing industry in Peru, the process of assigning quotas and monitoring biomass in this market is not as sophisticated as that used in the Peruvian anchovy fishing industry, or in many other fisheries around the world, which creates potential for uncertainty about fishing rights and biomass health going forward, possibly leading to revenue volatility.

Exalmar's DHC business could provide it with some revenue diversification as it could represent up to 25% of total revenues by 2017, according to the company. In addition it will allow the company to strengthen its competitive position against other larger Peruvian fishing companies which also have DHC businesses.

### Liquidity

Exalmar's liquidity is negatively affected by cash flow seasonality caused by the working capital build-up that tends to occur during Peru's two anchovy fishing seasons in the second and fourth calendar quarters and the subsequent cash inflow when inventories are shipped in the first and third quarters. Exalmar typically funds these working capital needs with uncommitted credit facilities with local and international banks. In addition, the company has a USD20 million 2-year committed credit facility. We note that the use of committed credit facilities is not a common practice in Latin America so we positively view Exalmar's actions to ensure a strong alternate source of liquidity.

Exalmar reported cash on hand of USD8.8 million as of September 30, 2015 that can cover only 16% short-term debt. Short-term debt is mostly comprised by working capital related debt that is secured by inventory and receivables. If we consider cash plus inventory plus receivables they cover 1.6 times short term debt. The company has a conservative debt maturity profile with no major debt amortizations until 2020 when the USD200 million global notes are due.

### Rating Outlook

The negative ratings outlook reflects the potential impact on Exalmar's weak credit metrics and liquidity from weather events that could affect fishing quotas in Peru. The outlook could be stabilized if Exalmar's operations, liquidity and credit metrics show improvement despite the reduction of the second fishing season in 2015.

### What Could Change the Rating - Up

In the long term, upward ratings pressure could emerge if the company is able to maintain positive cash flow generation while maintaining robust credit metrics and strong liquidity on a sustainable basis with debt/EBITDA below 4.0 times.

### What Could Change the Rating - Down

A prolonged period of negative free cash flow generation with material additional external funding needs, for example because of the impacts of quotas cancellation, an abrupt deterioration of global fishmeal demand or anchovy supply or because a debt financed quota acquisition could cause downward pressure on the ratings. An increase in adj. debt/EBITDA over 7.0 times for a prolonged period of time could also lead to a downgrade.

## Rating Factors

### Pesquera Exalmar S.A.A.

| Protein and Agriculture Industry Grid [1][2]        | Current LTM 6/30/2015 |              |
|---|-----------------------|--------------|
| <b>Factor 1 : SCALE &amp; DIVERSIFICATION (20%)</b> | <b>Measure</b>        | <b>Score</b> |
| a) Total Sales (USD Billion)                        | \$0.2                 | Ca           |
| b) Geographic Diversification                       | B                     | B            |
| c) Segment Diversification                          | Caa                   | Caa          |
| <b>Factor 2 : BUSINESS POSITION (25%)</b>           |                       |              |
| a) Market Share                                     | B                     | B            |
| b) Product Portfolio Profile                        | B                     | B            |
| c) Earnings Stability                               | Ba                    | Ba           |
| <b>Factor 3 : FINANCIAL POLICY (15%)</b>            |                       |              |
| a) Financial Policy                                 | B                     | B            |
| <b>Factor 4 : LEVERAGE &amp; COVERAGE (40%)</b>     |                       |              |
| a) CFO / Net Debt                                   | -2.0%                 | Ca           |
| b) Debt / EBITDA                                    | 7.2x                  | Caa          |
| c) EBITA / Interest Expense                         | 1.0x                  | B            |
| d) Debt / Book Capitalization                       | 52.4%                 | Ba           |
| <b>Rating:</b>                                      |                       |              |
| a) Indicated Rating from Grid                       |                       | B3           |
| b) Actual Rating Assigned                           |                       |              |

| [3]Moody's 12-18 Month Forward ViewAs of 11/3/2015 |              |
|--|--------------|
| <b>Measure</b>                                     | <b>Score</b> |
| \$0.2  | Ca           |
| B  | B            |
| Caa  | Caa          |
| B  | B            |
| B  | B            |
| B  | B            |
| B  | B            |
| B  | B            |
| -11.9%   | Ca           |
| 6.7x   | Caa          |
| 1.3x   | B            |
| 58.2%  | Ba           |
|  | B3           |
|  | B3           |

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 6/30/2015(L); Source: Moody's Financial Metrics [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

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