BEHIND THE NUMBERS
EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

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MOWI (MHGVY) 3Q'20 Update
Maintain BUY

3Q20 looked much like 2Q20 with MOWI suffering from lower pricing – down 11% in Europe and 20% in the Americas. **We are keeping our Buy recommendation as several levers appear close to balance and could move in MOWI's favor going forward.** In particular, the Biomass valuation adjustment went up in 3Q after two large mark-downs in 1Q and 2Q. This adjustment is made every quarter based on expected pricing, what the total cost to raise the fish will be, and estimated volume at the time of sale, Here are some signs of movement in the right direction:

- **Supply and Demand were essentially equal** – and within this are several other positives

Market Balance	3Q20	2Q20	1Q20	4Q19
Supply growth	4.8%	3.3%	2.3%	3.5%
Demand growth	4.8%	1.3%	0.4%	3.6%

  - Demand growth is accelerating through the year and the biggest markets – Europe and the US were up 7.2% and 14.3%.
  - The quarter was hurt due to problems in China and still a lack of air transport.
  - The largest source of supply was again Chile at 15.6%.
  - Going forward, Chile's supply growth should stall as their new stockings are down 2% y/y.
  - Forecasts for supply growth in 2021 are -1% to +3% and demand may be exceeding that

- **Lack of restaurants continued to hurt demand.** Many restaurants remained closed or only open for take-out or outdoor dining. Retail demand in home preparation or various consumer products like smoked salmon or sushi saw strong demand. Losing food service is a -5% to -10% loss of demand when netted against the rise in retail sales.

Cons Prod	3Q20	3Q19	2Q20	2Q19	Asia 2Q20	Asia 2Q19	Asia 2Q20	Asia 2Q19
Revenues	648.1	640.4	652.4	648.4	71.1	87.3	79.3	91.6
Op EBIT	21.2	13.8	23.3	7.5	1.5	1.9	1.1	2.6
Margin	3.3%	2.2%	3.6%	1.2%	2.1%	2.2%	1.4%	2.8%

Consumer products continue to show improving results even as the roll-out in the US is still very new. Plus, lack of air transport has hurt sales of consumer products in Asia just like sales of normal salmon. Given the history in Europe, Mowi believes it will hold higher sales of consumer products and recover sales in Asia and foodservice.

- **Pricing has a large amount of ground to recover, which should drive earnings along with a forecast that demand could exceed supply in 2021 and FX normalization.**
  - Salmon from Norway is normally €6-7/kg – it's in the €3's now but is starting to bounce up.
  - Salmon in the Americas is normally about $5/lb – it's about $3.50 now
  - Some of this is the excess supply also gets sold into the markets it's easiest to get to – Europe and the US. As more markets and transport become available – more supply will move to Asia and should boost prices in Europe and the US.
  - FX for Norway plays a role too. MOWI operates in Euros and many other players in NOK. The NOK depreciated against the Euro during COVID which allows others to sell at lower prices. It is starting to correct but is still 11 to 1 instead of the normal 9.5 to 1 ratio.
  - Over time, this nets to zero. The farmers using NOK will effectively see their feed costs rise more due to FX, but the fish they are selling take 3-years to grow and much of that cost occurred before the COVID impact on FX. During this year, MOWI was hurt by lower selling prices but enjoyed lower feed costs for future fish. This should lead to better margins going forward too.

Explanation of EQ Rating Scale

6- "Exceptionally Strong"	Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises
5- "Strong"	Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.
4- "Acceptable"	Indicates the company may have exhibited a minor "red flag", but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement
3- "Minor Concern"	Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.
2- "Weak"	Indicates the company's recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.
1- "Strong Concerns"	Indicates that the company's recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely.

In addition to the numerical rating, the EQ Review Rating may also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into the next quarter. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

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The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

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