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MOWI 2Q20 Update

We are maintaining our BUY rating on MOWI (MHGVY). As expected, pricing remained weak in 2Q due to so many restaurants being closed for COVID which hurt demand. About 40%-45% of salmon is eaten in restaurants worldwide. At-home consumption grew, but in the end, demand in volume rose about 1% worldwide while supply rose 3%. Also, flight cancelations made it difficult to move salmon from its primary production areas like Norway and Chile (where supply grew 10%) to end markets meaning some markets were overly glutted and others under-supplied. We believe as economies reopen, much of this imbalance will correct itself and 2Q represents the worst of the situation. There will be a 3Q headwind as the market needs to work down frozen inventories in Chile.

There are several reasons to again point to long-term fundamentals remaining intact. The growth in MOWI's consumer products has continued to increase despite delaying a marketing campaign in the US as a result of COVID. Long-term demand for salmon should continue to increase as the situation normalizes and there is not a surge of new supply coming. Much of what is needed here is simply to have pricing bounce of multi-year lows.

- **Pricing fell 20%-30% in 2Q20. Closed restaurants and lack of air transport to markets in Asia created additional problems for pricing in other markets that suddenly had to absorb even greater supply.**

- **Demand for salmon still grew as retail sales picked up slack for closed foodservice channels. The 1% global demand growth was met with a 3% increase in supply.**

- **Chile was the big issue where supply grew 10%. It is a supplier to Brazil where retail purchases did not offset closed foodservice options and demand fell 24%. Without Chile, supply and demand may have been more closely balanced.**

- **Falling pricing quickly hurts results. Many costs in salmon farming are fixed and do not change as rapidly. Fish still grow and need to be harvested too. 2Q saw**

volumes increase at MOWI, which boosted costs overall as farming revenue dropped 14% on lower pricing. The reverse situation is true during times when pricing increases and fixed costs leverage.

- **Pricing also hurts biomass valuations. This is a recurring non-cash adjustment to the value of growing salmon.** Changes in assumptions for the cost of feed, the costs of health-related treatments, and pricing can raise or lower the biomass valuation. While 1Q had several weeks of very strong pricing that helped actual profits, the steep decline in pricing at the end of the quarter caused a much larger mark-down in biomass valuation than 2Q.

- **Pricing should recover. It has already bounced off the July lows but remains below pre-COVID levels. The forecasts for supply are for growth to decrease in 2H20 and only rise 1% in 2021.** With more foodservice open, demand should also increase.

- **Chile was the source of supply/demand imbalance. It needs to work off frozen inventories that rose in 2Q. However, after a large increase in 2Q harvest, the 2H20 is expected to show much more restrained growth in Chile. Also, new smolt placements that will be next future salmon are down 12% YTD in Chile.**

- **MOWI's liquidity still looks capable of getting the company through the COVID issues. It has no debt maturities for two years. Credit lines and cash on hand are > €650 million. Even using 2Q's impaired EBITDA * 4, the Debt/EBITDA is 2.46x. On a more normalized EBITDA, the ratio is 1.58x.**

- **Even with the steep pricing declines of 2Q, free cash flow was still positive. That also included a sizeable headwind for working capital increases.**

- **Cash needs for 2H20 should be about €110-130 million greater than 1H20. Much of that will occur in 3Q for more working capital build, a tax payment that was deferred from 2Q to 3Q, and €29 million spent to acquire new licenses in Norway. We expect MOWI to have negative free cash flow in 3Q** as pricing dropped further in July before starting to recover. 4Q should see improvements on pricing and lower cash needs and we believe MOWI's liquidity can easily cover a 3Q dip.

- **Consumer products responded well to the lockdowns. The Americas unit had income levels equal to Europe on one-quarter of the sales.** It should continue to grow as MOWI rolls out its delayed marketing blitz. Asia suffered from lack of product due

to air transit issues. Europe lost some foodservice sales and also had to absorb higher supply – yet still grew income.

- **Cost reductions are getting more attention.** MOWI already spends heavily annually to emphasize technology to lower costs. Its current goal is to reduce its second-largest cost – labor – by 10% per unit produced. Other ongoing investments in improving salmon health also help lower costs and boost revenue.

- **The 50% JV in DESS may be monetized.** Part of MOWI's past investing in tech created a fleet of well-boats to boost automation, carry live fish, speed harvesting, and produce fresh water that can help mitigate sea lice. With salmon farming volumes increasing, demand for well-boats has been rising too. MOWI may unlock some cash from this investment and is exploring that possibility.

Salmon Pricing Dropped Noticeably in All Markets in 2Q as Expected

MOWI produces salmon in six areas of the world. The major reference prices all showed a steep decline for salmon prices y/y in 2Q20:

Salmon Ref. Prices	2Q20	decline
Norway	€5.24	-19%
Chile	€3.73	-34%
North Am.	€4.49	-27%

There are several reasons for this – most notably that restaurants and foodservice normally account for 40%-45% of total salmon purchases. Many of those businesses were closed during parts of 2Q. Toward the end of 2Q and into 3Q, more restaurants have reopened which should help demand.

In addition, airlines reduced flights on many international routes or canceled service completely. The salmon are raised in areas with relatively small populations such as Norway, Chile, Scotland, Canada, Ireland, and the Faroe Islands. The consumption of salmon occurs in the U.S., China, Japan, Russia, Brazil, and Continental Europe. Getting shipments from Canada to the US or Norway to Europe is not a major issue. However, out of Chile to the US or Brazil had issues. From the UK and Norway to Russia or China

certainly was. If you look at the y/y changes in volumes to specific markets – you can see the COVID issues of closed restaurants and where air transportation was spotty.

Salmon Demand y/y Chg	2Q20	1Q20	4Q19
EU	2.7%	2.1%	6.4%
Russia	-18.2%	7.3%	-8.6%
US	2.8%	5.2%	8.2%
Brazil	-24.4%	-4.4%	8.9%
China	6.9%	-29.8%	9.7%
Japan	21.1%	0.0%	-1.9%
South Korea	16.5%	15.2%	-0.7%
Other markets	0.0%	-13.2%	-6.6%

The end result for pricing for all of this comes down to simple supply vs. demand:

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

This was compounded in 2Q20 because Chile had a supply growth of 9.7% y/y. Chilean salmon goes to the US market where demand was up 2.8% and Brazil where demand fell 24.4%, other North/South American markets were down 5.7%.

Lower Pricing Quickly Lowers Operating Income in Two Ways

When we look at the farming operation for MOWI, there are many fixed costs associated with raising salmon. The price and cost per fish also vary by fish size. Think of it like an airline flight – much of the labor and fees occur on the ground, take-off, and landing. When those costs are spread over a shorter flight, the cost per mile rises more than for a longer flight. With a salmon, there are fairly equal fixed costs of raising a 3kg fish vs. a 6kg fish too. In fact, the 3kg fish may have higher costs as it likely had parasite issues like lice that had to be dealt with which slowed its eating and growth. Plus, the 6kg fish may have commanded a premium price of more than twice the 3kg fish.

In 2Q20, the volume was up about 6%, but revenue for farming fell by 14% due to lower pricing. In 1Q20, pricing was really only starting to get hurt in Chile, but volume and revenue both fell 20%. The fixed cost aspects showed up in both quarters. Costs rose 10% in 2Q on the 6% volume increase and only fell 10% in 1Q on the 20% volume drop.

Farming	2Q20	change	%	1Q20	change	%
Revenue	€548.4	-€91.5	-14%	€510.6	-€128.9	-20%
Op. Costs	€492.5	€44.6	10%	€409.2	-€46.2	-10%
Op. EBIT	€55.9	-€136.8	-71%	€101.4	-€82.7	-45%
EBIT	€6.4	-€195.8	-97%	-€44.7	-€272.6	-120%

So lower prices create negative leverage on fixed costs is the first problem with falling prices. This is evident with the rate of income decline exceeding the rate of revenue decline as prices fall.

The second pricing issue relates to Biomass. This is similar to a mark-to-market charge and it relates to the inventory of growing salmon. MOWI has assumptions in place on how much the fish will cost over its full life to feed, manage, harvest plus the time it will take and the eventual weight and selling price.

This is a non-cash item. When pricing is rising, the biomass value can increase due to that. When pricing is falling, it can see a significant write-down. That was the case in 1Q and 2Q. The table above shows Operational EBIT and reported EBIT. The primary difference between these two figures are biomass estimate changes, JVs, Gains/Losses on derivatives, and changes in internal – here are the primary changes:

Farming	2Q20	1Q20
Op. EBIT	€55.9	€101.4
Gains/Losses	-€5.3	€11.6
Biomass	-€41.7	-€160.6
JVs	€4.4	€1.5
EBIT	€6.4	-€44.7

As COVID caused a large slump in prices at the end of the 1Q, the write-down was higher, even though pricing over the full 1Q was up. In the 2Q, pricing was lower across the board but the write-down in 1Q already reflected much of the lower pricing impact and the write-down was significant but only one-fourth of the prior quarter.

Positives and Negatives for Pricing Going Forward

- **Prices for salmon fell further in July but appear to have bottomed and are now recovering.** Salmon from Chile to Miami fell about 35% with COVID and has now rallied about 30% off the July lows. The price index for Norway has recovered about 6% in recent weeks.

- **There is more air transport possible to markets that have seen rising demand and lockdowns ease.** That should help meet demand in Asia and the US which was hurt lost sales to foodservice businesses.

- Brazil's 3Q is unlikely to be improving as much as other markets in 3Q. Brazil is about 4% of the salmon market and a destination for Chilean salmon.

- **The other problem with Chile was its inventories expanded last quarter. The estimate is about Chile now has 50,000-60,000 tons in frozen inventories.** That is equal to about 10% of one-quarter's sales worldwide. Chile is not going to take inventories to zero – but it is likely to work them down in 3Q creating a headwind.

- **MOWI noted on the earnings call that it is holding almost no frozen inventories – which should have it in good shape:** "*I'd also like to take opportunity to say that we are carrying limited frozen inventory. If you take out the inventory, which is sold then we're close to zero.*"
- The supply growth for 2020 is expected to be 4%. As we noted earlier, demand has been running 200bp below supply growth. Reopening restaurants and air transports should create a closer balance for the rest of 2020.

- **It is worth noting that without the sizeable growth in supply from Chile – 2020's total supply growth would likely be flat or negative. For the 2H of 2020, Chile's harvests should be lower, which should help balance supply and demand further.**

- **For 2021, Chile has cut new smolts by 12% through July 2020, so that indicates less supply growth going forward. The forecast is for only 1% supply growth in 2021.**

Our conclusion is 3Q will be ugly on pricing too from a y/y basis. However, the market should start to balance out better and pricing should improve through 3Q vs 2Q. Pricing is the key metric to driving margins and cash flow. MOWI should be past the worst of things in our view and 4Q should be better than 3Q and improvements should be pronounced in 2021 on small supply growth for the world salmon market.

Even with Impaired Cash Flow, MOWI's Leverage is Not High and Liquidity is High

We still believe MOWI is carrying low leverage on the balance sheet and has ample liquidity.

- Cash is €104 million with another €550 million available on credit lines

- No debt is due until 2Q22

- Debt is €1.5 billion, net of cash and 4x 2Q20 EBITDA of €140 million – Debt to EBITDA is 2.46x. That's obviously impacted by COVID and the pricing issues. EBITDA should rise simply with pricing returning. Based on pre-COVID figures, Debt to EBITDA is 1.58x.

Even with 2Q20's drop-off, MOWI was still free cash flow positive.

Cash Flow	2Q20	1Q20	2019
Cash from Ops	€108.4	€225.5	€759.0
Cap-Ex	€62.3	€75.1	€292.7
FCF	€46.1	€150.4	€466.3
Work Cap	-€73.5	€75.9	-€103.9

- 2Q20 had a drag from working capital in the quarter too. MOWI is guiding to a full year of working capital drag of €90 million as it uses more feed in the 2H and feed is higher cost. Based on 1H results, essentially the full €90 million drag will show up in 2H20 and heavily in 3Q.

- 2Q20 benefited from having €36 million in taxes pushed into 3Q as part of COVID-relief programs. Total taxes for the year are expected to be €140 million and so far, €62 million have been paid.

- 2Q20 has been on pace for the €265 million in cap-ex guidance. There is about half left and it is not clear if MOWI is counting the new licenses it bought in 3Q as part of that. That is another €29 million. Capital spending may be a slightly larger cash need in 2H20.

- We believe cash flow will recover through 3Q but will need to build through the period. It may come in below €100 million with another large drag from working capital and more taxes. 4Q should look much better in our view due to higher seasonal sales and a longer period with firmer pricing.

The company is also conserving cash by suspending the dividend at this time. The board noted this in 2Q results:

> *"Distributing dividends to its shareholders is an essential part of Mowi's financial strategy. At the same time the Board considers it of utmost importance to maintain a strong financial position, particularly in light of the ongoing Covid-19 pandemic. Hence, under the prevailing circumstances the Board has not found it appropriate to distribute a quarterly dividend for the first and second quarter."*

The dividend is normally €137.5 million per quarter. The decline in pricing in 2Q cost MOWI more than that in operating income. We believe the dividend will return with more normalized pricing. Also, MOWI has the liquidity on hand to cover its cash needs from operations in our view. **The cash needs in 2H20 will be higher than 1H20, but the level of increase is easily covered with cash on hand, improved 4Q results, and/or available credit lines.**

Three Other Positive Issues to Consider

Consumer Products has responded well to the lockdowns as consumers bought more salmon at retail rather than restaurants of late.

Cons Prod	2Q20	2Q19	Eur 20	Eur 19	Am 20	Am 19	Asia 20	Asia 19
Revenues	652.4	648.7	458.4	457.8	114.6	99.3	79.3	91.6
Op EBIT	23.3	7.5	11.0	1.1	11.3	3.8	1.1	2.6
Margin	3.6%	1.2%	2.4%	0.2%	9.9%	3.8%	1.4%	2.8%

The first two columns show the y/y growth for the full unit. Then the three markets served: Europe, the Americas, and Asia complete the table.

- Europe is more established and it also sells to foodservice locations. So, lockdowns hurt sales in that area. Also, the lack of air transport to many markets meant Europe had more supply. Even with lower salmon costs to help margins, the glutted market meant lower retail prices too. So, Europe ended up with some pressure on sales that likely would have dropped straight to income under a more normalized shipping time.
- The Americas benefited from growing demand and lower salmon prices. It actually out-earned Europe with one-quarter of the revenue.
- Asia suffered from lack of transport and not getting enough product.

We think the Americas can become much larger than Europe. MOWI has the infrastructure in place and is getting into retailers. It had a big marketing push planned for 2020 that they delayed due to COVID. That effort should be coming in later 2020 and in 2021 now. We think this region for Consumer Products can become a steady source of revenues and profits.

Cost reduction has been a focus that is getting even more attention. MOWI spends money on new technology to breed healthier fish – that will require less medical attention. MOWI has invested in new pen designs, light treatments to ward off parasites like sea lice, freshwater rearing pens where the fish can avoid parasites, and well-boats that can store fish in water that is continually cleaned and makes harvesting easier. Essentially, healthier fish eat better, put on weight faster, and require less incremental costs for lice removal or vaccines. It has built its own feed operations, which can lower costs and improve pricing as it gives them a longer list of data points on the chain of custody for each salmon. A new area being focused on is reducing labor as a percentage of total costs. Currently labor is 16% of the total and MOWI believes it can adopt more automation to reduce that percentage as it expands the total volumes.

The focus will be to cut 10% of labor cost per unit going forward. Also, continued focus will be on solving more of the biology issues (parasites and fish diseases). MOWI is expecting

some tougher cost issues in that area in Scotland for 3Q. However, it has seen 2019 generation fish as being less troublesome overall than 2018 generation.

DESS Aquaculture spinoff is possible. One of the technological advancements has been a JV that MOWI has built over the last 4-years has been a fleet of well-boats. These boats supply fish pens, harvest fish, carry live fish, and produce freshwater from seawater to help combat sea lice on the fish. As salmon farming has increased, rates to contract well-boats has been increasing. There are more boats coming so this JV continues to grow and has a place in boosting technology to lower salmon farming costs. MOWI owns 50% of this venture and is starting to explore ways to monetize this investment.

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.
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