BEHIND
THE NUMBERS
Quality of Earnings Analysis

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MOWI ASA (MHGVY)
Earnings Quality Update- 9/21 Qtr.

6- Exceptionally Strong
5- Strong
4- Acceptable
3- Minor Concern
2- Weak
1- Strong Concern
+ quality improving
- quality deteriorating

We are raising our earnings quality rating of MHGVY to 5+ (Strong).

For an explanation of the EQ Review Rating scale, please refer to the end of this report.

Summary

MOWI continues to show a strong recovery with several areas still to improve. This includes Asian and China deliveries still not being fully recovered yet and new sources of production volume still to come. Demand exceeded supply in 3Q and supply for 4Q is forecast at -7% industry-wide which bodes well for more strength in pricing. The company declared a 3Q dividend of 0.93 NOK and is paying a 0.47 extraordinary dividend as well. We expect the dividend to be lumpy and based on 50% of net income. However, we still believe there are several areas for additional earnings and dividend growth going forward. We have noted in the past that MOWI was paying 2.6 NOK pre-Covid which would be a 4.4% yield.

- Growth over the medium term will be helped by investments in longer-term fresh-water raised smolts. What this does is raise the fish in a controlled environment until they are larger. This reduces biologic issues and costs such as sea lice and others and they release larger and stronger fish into the sea pens.
    - **This means fish spend one year less in the sea pens and that effectively boosts the amount of volume that can be produced in the current sea pens,**

as the turnover of salmon reaching 4-6kg will increase as they start with a larger smolt.

  - The fish grow faster in the pens, mortality issues decline, lost feeding days decline too from fewer potential biologic problems.
  - Most smolts being released into sea pens have been < 100 grams in size. The focus of longer freshwater raising is to release smolts > 500 grams in size.
  - The goal is to reach 70% of salmon smolt in Norway being > 500 grams when put in seawater by 2026. In 2020, it was 17% of smolts being > 250 grams.
  - With forecasts showing demand for salmon exceeding supply for many years, this type of investment that will boost volumes from existing pens should bode well for MOWI growth. The higher volumes should start appearing in 2024.

- Capital spending for the freshwater expansion is expected to be €400 million from 2021-26 in this area. That should actually not be a major increase in capital spending which is expected to be €265 million in 2021 (including these new projects) compared to €286-309 million for 2019 and 2020. Some of the past spending went into growth projects too such as feed operations. Cash from operations should be > than €650 million. Freshwater operations have more costs involved so the ROI will be lower than the rest of the farming business. However, if the sea pens will be able to harvest more salmon without additional capital spending – that should boost ROI there. Stronger fish should also mean more volume is sold at premiums to market prices. That would further boost ROI too.

- In 2021, MOWI opted to lock in a lower percentage of its sales with price contracts. That allowed it to capture more of the upward movement in salmon prices as the market recovered from Covid issues. On the earnings call, contracts will cover about 31% of 4Q21 volume up from 22% in 3Q and implied that 2022 could see more contracted volume at a substantially higher price than 2021. That should help boost earnings further next year and also smooth out some of the volatility.

- From an Earnings Quality standpoint, it takes a long time to grow a salmon. And the additional freshwater pens will take more years to build too. Thus, there will be more capital tied up early in this process. Also, the company does not get paid until it sells the salmon, which are eating for years, and employees are monitoring and working with the fish. All of those costs grow the inventory known as Biomass. In the 4Q, MOWI expects to see working capital investment rise €80 million to reflect Biomass growth and higher receivables near the end of the quarter. That is down from prior forecasts of €110 million.

- Also on EQ, MOWI expects a lower tax bill and it may see some of the Covid supply issues impact its ability to fully spend its €265 million in Cap-Ex this year due to delays in

receiving products. The end result is that free cash flow forecasts are rising for MOWI for 4Q.

- Canada continues to provide the bulk of the negative issues. MOWI is forecasting 460,000 tons of salmon for 2022 against 455,000 tons in 2021. They have lowered Canadian production forecasts by 6,000 tons (Canada normal production is 12,000 to 13,000 tons or 3% of the total). Issues continue:
    - Biologic issues in Canada are hurting the profitability of that operation. This led MOWI to slow production in Eastern Canada next year. The company took a €23 million impairment on assets there.
    - Salmon farming is a high fixed cost operation and profits require larger volumes at harvest to spread over the fixed costs.
    - MOWI focused on right-sizing the cost structure to better match the smaller operations in Canada. So far that has shown good signs in Canada West.
    - Canada East may take longer to improve.

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 Concern)- 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 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 upcoming quarters. 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.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

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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