

# Volcan Compania Minera S.A.A.

## Full Rating Report

### Ratings

#### Foreign Currency

Long-Term IDR BBB–  
Senior Unsecured BBB–

#### Local Currency

Long-Term IDR BBB–

IDR – Issuer Default Rating.

### Rating Outlook

Long-Term Foreign-Currency IDR Stable  
Long-Term Local-Currency IDR Stable

### Financial Data

#### Volcan Compania Minera S.A.A.

(USD Mil.)	LTM	
	9/30/16	12/31/15
Revenue	774	795
EBITDA	266	225
EBITDA Margin (%)	34.3	28.4
Funds from Operations	135	186
FCF	1	(26)
Cash and Marketable Securities	184	192
Total Adjusted Debt	862	836
Total Adjusted Debt/EBITDA (x)	3.2	3.7
FFO-Adjusted Leverage (x)	5.4	3.9
EBITDA/Interest Paid (x)	7.3	6.2

### Related Research

[2017 Outlook: Global Mining \(Slow, Challenging and Volatile Recovery\) \(December 2016\)](#)

[2017 Outlook: Latin America Metals and Mining \(Cash Flow Improvement Forthcoming\) \(December 2016\)](#)

[Fitch Affirms Volcan at 'BBB-'; Outlook Revised to Stable](#)

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### Key Rating Drivers

**Outlook Stable:** Volcan Compania Minera S.A.A.'s Stable Outlook reflects its improved financial performance following successful reductions in cash costs, coupled with lowered capital investments resulting in improved credit metrics in 2016. Volcan's capital structure has started to stabilize despite a period of weak commodity prices during the nine months ended Sept. 30, 2016, with zinc, copper, and lead prices down 4.7%, 16.4%, and 2.4%, respectively, over a year earlier, partially offset by a 5.6% improvement in silver prices.

**Improving Profitability:** Fitch Ratings projects Volcan to generate EBITDA of USD294 million for 2016 with EBITDA margins expanding to 36% from 28% in 2015. The company's EBITDA margin improvement is explained by the decline in production costs and the reduced low-margin volume of third-party concentrates over total sales. Fitch's revenue and EBITDA base case expectations for 2017 are around USD800 million and USD289 million, respectively.

**Strengthening Credit Metrics:** Fitch expects Volcan's efforts to deleverage will be sustainable over the next 12–24 months as the company's cost-cutting initiatives will coincide with a better metals pricing environment. For 2016 and 2017, Fitch expects net debt/EBITDA leverage to fall to 2.4x and 2.3x, respectively. Net debt/EBITDA was 2.7x in the LTM ended Sept. 30, 2016, a decline from 3.1x on Dec. 31, 2015.

**Positive FCF:** Fitch's base case indicates positive FCF for 2016 and 2017 of USD20 million–USD50 million, as a result of lower capex and a dividend payout similar to historical levels. Volcan completed its USD1.3 billion three-year investment program to expand production in mid-2015. The two main growth projects were the silver oxides plant at Cerro de Pasco and the new Alparmarca-Rio Pallanga Unit project. These projects were completed in May 2014 and in June 2015, respectively.

**Largest Peruvian Zinc, Lead and Silver Producer:** Volcan's operations are in Peru (BBB+/Stable), a country of vast mineral resources with a favorable mining jurisdiction. Volcan's revenues are diversified over 12 mining operations, seven concentrator plants and one lixiviation plant spread across the Central Andes region. According to Thomson Reuters GFMS, the company ranks as the sixth-largest zinc producer and seventh-largest silver producer globally.

**Adequate Liquidity:** Volcan's reported liquidity was USD184 million of as Sept. 30, 2016. Fitch restricts USD43 million of Volcan's marketable securities that are related to its estimated fair value of a 17.66% stake in Chilean cement company Cemento Polpaico S.A. Short-term debt was USD297 million, mainly consisting of short-term revolving credit lines for working capital purposes that are continuously repaid or rolled over.

### Rating Sensitivities

**Negative Actions:** Volcan's ratings could be downgraded should the company undertake significant capex amid low commodity prices without taking appropriate steps to preserve its capital structure, resulting in net leverage remaining elevated above 2.5x on a sustained basis.

**Positive Actions:** A positive rating action for Volcan is not anticipated in the near term following the revision of the Outlook to Stable. Substantial diversification of mines and revenues into other metals, combined with further geographical diversification and a lower consolidated cost of production, would be viewed favorably.

## Financial Overview

### Liquidity and Capital Structure

Volcan's liquidity is adequate and it holds a comfortable cash position. As of Sept. 30, 2016, Volcan's cash and marketable securities available for debt reduction was USD141 million while short-term debt was USD297 million, mainly comprised of short-term revolving credit lines for working capital purposes that are continuously repaid or rolled over.

Fitch restricts USD43 million of marketable securities from Volcan's liquidity position, which is related to its estimated fair value of a 17.66% stake in Cemento Polpaico valued at USD62.4 million. Volcan's reported liquidity was USD184 million as of Sept. 30, 2016. The company has low refinancing risk, with its next material debt maturity in 2022, when its outstanding USD535 million of senior unsecured notes are due.

For 2016 and 2017, Fitch expects net debt/EBITDA to reduce to 2.4x and 2.3x, respectively. Net debt/EBITDA was 2.7x in the LTM ended Sept. 30, 2016, a decline from 3.1x on Dec. 31, 2015. Higher than anticipated leverage for the LTM ended Sept. 30, 2016 reflected weaker cash collections and increased payments related to its hedged production of zinc and silver prices during the year. These hedges rolled off during third-quarter 2016, and the company is expected to benefit from strong cash flow generation in fourth-quarter 2016.

### Cash Flow Analysis

Volcan's revenues were USD774 million for the LTM ended Sept. 30, 2016, 2.5% less than in 2015 due to lower metal prices and volumes from third-party concentrates. During the nine months ended Sept. 30, 2016, the average zinc price fell to USD1,939/metric tonne (MT) from USD2,2034/MT, while the average silver price improved to USD16.9/ounce from USD16.0/ounce. Volcan registered a 3.4% decline in the volume of ore treated at its concentrating plants through Sept. 30, 2016 due to the reduction in production volume at its Yauli Unit and the suspension of operations at Cerro de Pasco Unit in November 2015.

EBITDA was USD266 million for the LTM ended Sept. 30, 2016, up from USD225 million during 2015 due to efforts on cost savings and improved operating efficiencies. Consolidated unit cost fell by 5.4%, from USD53.4/MT in third-quarter 2015 to USD50.5/MT in third-quarter 2016, due to operational measures to reduce costs. These measures include operating efficiency improvements, reductions in personnel expenses, supplies and services of specialized contractors, and energy and maintenance savings. Volcan's cost position also benefited from the Peruvian nuevo sol depreciation and drop in oil prices during 2016.

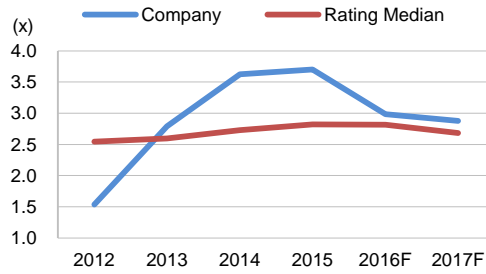
Volcan has historically generated strong cash flows as a result of its low-cost production position. In the last three years, the company's FCF was affected by lower prices and higher costs, as well as higher capex. In the LTM ended Sept. 30, 2016, Volcan's FCF was essentially neutral from cash flow from operations (CFFO) of USD136 million following dividends paid of USD15 million and capex of USD120 million. Dividends have been at around 30% of net profit over the last three years. FFO was USD135 million for the LTM ended Sept. 30, 2016, with a working capital inflow of USD2 million. CFFO and FFO were negatively affected by USD37 million of hedging contracts compared with zero payments for the prior-year period.

Fitch projects the company will generate CFFO of approximately USD177 million in 2016, with a capex slowdown at USD139 million and dividends paid at USD15 million, resulting in positive FCF of USD22 million.

### Related Criteria

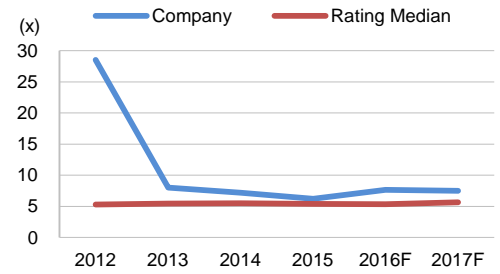
[Criteria for Rating Non-Financial Corporates \(September 2016\)](#)

### Leverage: Total Adjusted Debt/ Operating EBITDAR



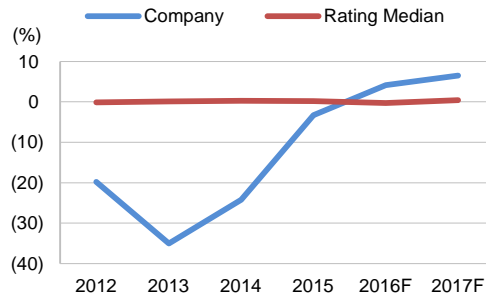
F – Forecast.  
Source: Company data, Fitch.

### Interest Coverage: Operating EBITDA/Gross Interest Expense



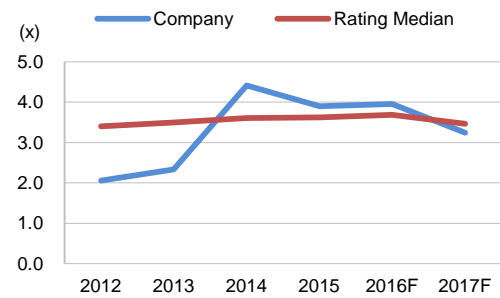
F – Forecast.  
Source: Company data, Fitch.

### FCF/Revenues



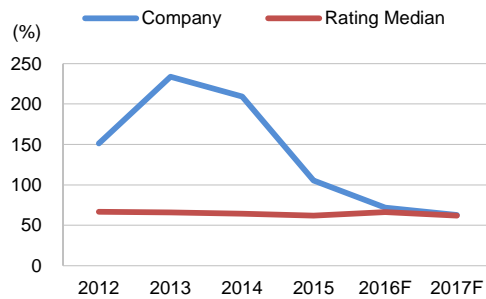
F – Forecast.  
Source: Company data, Fitch.

### FFO-Adjusted Leverage



F – Forecast.  
Source: Company data, Fitch.

### Capex/CFO

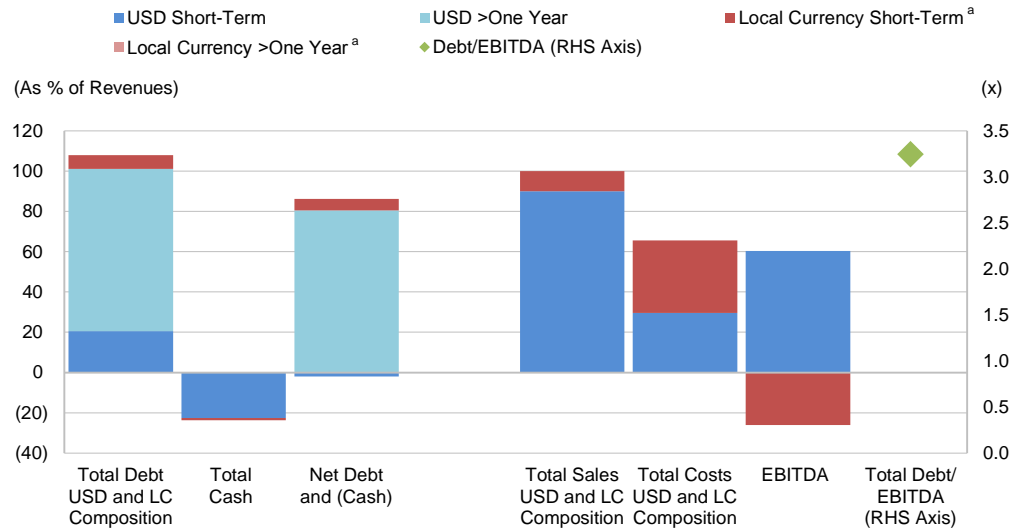


CFO – Cash flow from operations. F – Forecast.  
Source: Company data, Fitch.

FX Screener

Fitch FX Screener

(Volcan Compania Minera S.A.A. — BBB-/Stable, Sept. 30, 2016)



<sup>a</sup>Local currency depicted as USD equivalent. LC – Local Currency.  
Source: Fitch Ratings.

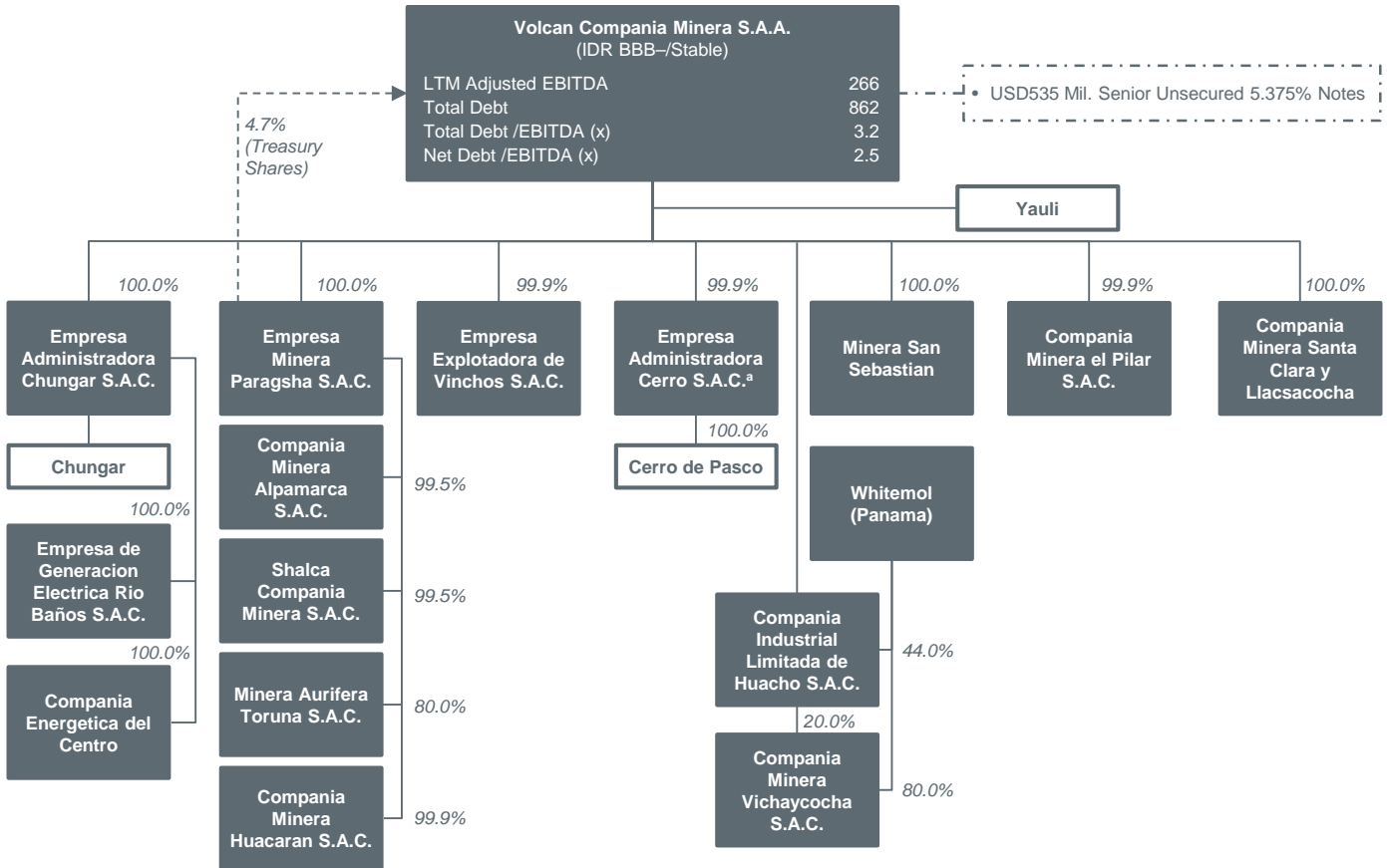
The *Fitch FX Screener* chart shows Fitch’s estimates of the foreign currency (FC) and local currency split between Volcan’s debt, sales and operating costs. It illustrates relative proportions rather than specific figures, thereby acknowledging the limitations of calculating the currency splits for a given financial year.

Fitch analysts make estimates, sometimes with information from management, as to the actual FC receipts or FC-linked income relative to costs. Within the chart’s debt columns, the short-term FC debt — usually in U.S. dollars — is highlighted because, in a volatile currency market, this debt has to be physically repaid with FC using cash or accommodative refinancing in the bond or bank market.

Volcan is naturally hedged against FX volatility, with most of the company’s revenue and long-term debt denominated in U.S. dollars. Approximately 55% of the company’s costs, such as labor expenses, are denominated in local currency, so local currency depreciation benefits cost reduction. A 10% depreciation of the Peruvian nuevo sol would decrease Volcan’s total debt/EBITDA ratio leverage by approximately 0.2x as of Sept. 30, 2016.

Organizational Structure

Organizational Structure — Volcan Compania Minera S.A.A.  
(USD Mil., As of Sept. 30, 2016)



Key Operating Assets

<sup>a</sup>Reorganization of the Cerro de Pasco Unit as of Feb. 1, 2011. IDR – Issuer Default Rating.  
Source: Company statements, Fitch.

**Key Forecast Assumptions**

- Average zinc price of USD2,083/metric tons (MT) in 2016, USD2,000/MT 2017–2018, and USD2,100/MT in 2019;
- Average silver price of USD17.0/ounce in 2016, USD17.0/ounce in 2017, USD17.3/ounce in 2018 and USD17.6/ounce in 2019;
- Average lead price of USD1,869/tn in 2016, USD2,274/MT in 2017, USD2264/MT in 2018, and USD2246/MT in 2019;
- Average copper price of USD4,899/MT in 2016, USD5,000/MT in 2017, USD5,500/MT in 2018 and USD6,000/MT in 2019;
- Average gold price of USD1,238/ounce in 2016, USD1,100/ounce thereafter;
- Mineral treatment of 7.77 million MT in 2016, 7.70 million MT in 2017, 8.0 million MT in 2018 and 8.0 million MT in 2019.
- Capex level of USD125 million in 2016, USD150 million in 2017, USD155 million in 2018 and USD165 million in 2019.

**Forecast Summary — Volcan Compania Minera S.A.A.**

(USD 000)	Historical		Fitch Forecast		
	12/31/14	12/31/15	12/31/16	12/31/17	12/31/18
<b>Summary Income Statement</b>					
Gross Revenue	1,027,256	794,514	807,622	799,717	822,322
Revenue Growth (%)	(0.8)	(22.7)	1.6	(1.0)	2.8
Operating EBITDA	231,161	225,312	294,013	288,784	292,859
Operating EBITDA Margin (%)	22.5	28.4	36.4	36.1	35.6
Operating EBITDAR	231,161	225,312	294,013	288,784	292,859
Operating EBITDAR Margin (%)	22.5	28.4	36.4	36.1	35.6
Operating EBIT	80,293	62,148	162,136	154,935	156,710
Operating EBIT Margin (%)	7.8	7.8	20.1	19.4	19.1
Gross Interest Expense	(29,668)	(43,763)	(38,574)	(38,500)	(37,958)
Pretax Income	74,543	(452,789)	123,562	116,436	118,751
<b>Summary Balance Sheet</b>					
Readily Available Cash	136,919	147,894	245,414	250,259	266,744
Total Debt with Equity Credit	838,095	836,276	877,674	830,308	826,362
Total Adjusted Debt with Equity Credit	838,095	836,276	877,674	830,308	826,362
Net Debt	701,176	688,382	632,260	580,049	559,618
<b>Summary Cash Flow Statement</b>					
Operating EBITDA	231,161	225,312	294,013	288,784	292,859
Recurring Associate Dividends Less Distributions to NCI	—	—	0	0	0
Cash Interest Paid	(32,250)	(36,179)	(38,574)	(38,500)	(37,958)
Implied Interest Cost (%)	4.1	4.3	4.5	4.5	4.6
Cash Interest Received	—	—	0	0	0
Cash Tax	(26,741)	(8,163)	(34,597)	(32,602)	(33,250)
Other Items Before FFO	(13,193)	5,434	(37,363)	(0)	0
Funds Flow from Operations	158,977	186,404	183,478	217,682	221,651
FFO Margin (%)	15.5	23.5	22.7	27.2	27.0
Change in Working Capital	38,826	(14,373)	(9,479)	21,690	(11,203)
Cash Flow from Operations (Fitch Defined)	197,803	172,031	173,999	239,372	210,448
Total Non-Operating/Nonrecurring Cash Flow	—	—	—	—	—
Capex	(414,272)	(181,577)	—	—	—
Capital Intensity (Capex/Revenue) (%)	40.3	22.9	—	—	—
Common Dividends	(32,619)	(16,684)	—	—	—
Net Acquisitions and Divestitures	—	—	—	—	—
Capex, Dividends, Acquisitions and Other Items Before FCF	(446,891)	(198,261)	(165,290)	(187,161)	(190,017)
FCF After Acquisitions and Divestitures	(249,088)	(26,230)	8,709	52,212	20,430
FCF Margin (After Net Acquisitions) (%)	(24.2)	(3.3)	1.1	6.5	2.5
Other Investing and Financing Cash Flow Items	(870)	7,938	3,000	0	0
Net Debt Proceeds	155,073	36,377	41,398	(47,366)	(3,946)
Net Equity Proceeds	(366)	(141)	0	0	0
Total Change in Cash	(95,251)	17,944	53,107	4,846	16,484
<b>Coverage Ratios (x)</b>					
FFO Interest Coverage	5.9	5.9	5.8	6.7	6.8
FFO Fixed-Charge Coverage	5.9	5.9	5.8	6.7	6.8
Operating EBITDAR/Gross Interest Expense + Rents <sup>a</sup>	7.8	5.1	7.6	7.5	7.7
Operating EBITDA/Gross Interest Expense <sup>a</sup>	7.2	6.2	7.6	7.5	7.7
<b>Leverage Ratios (x)</b>					
Total Adjusted Debt/Operating EBITDAR <sup>a</sup>	3.6	3.7	3.0	2.9	2.8
Total Adjusted Net Debt/Operating EBITDAR <sup>a</sup>	3.0	3.1	2.2	2.0	1.9
Total Debt with Equity Credit/Operating EBITDA <sup>a</sup>	3.6	3.7	3.0	2.9	2.8
FFO-Adjusted Leverage	4.4	3.9	4.0	3.2	3.2
FFO-Adjusted Net Leverage	3.7	3.2	2.8	2.3	2.2

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<sup>a</sup>EBITDA/R after dividends to associates and minorities. NCI – Noncontrolling interests.

Source: Company reports, Fitch.

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