# 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/ EBITDAR (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 Alpamarca-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.

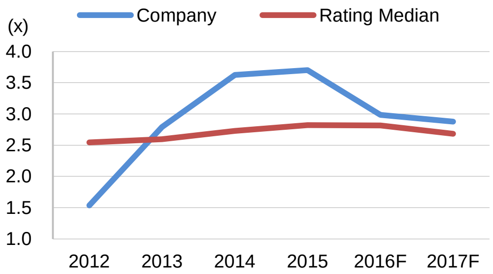
Volcan has historically generated strong cash flows as a result of its low-cost production position. In the last three years, the company's FCF was affected by lower prices and higher costs, as well as higher capex. In the LTM ended Sept. 30, 2016, Volcan's FCF was essentially neutral from cash flow 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**

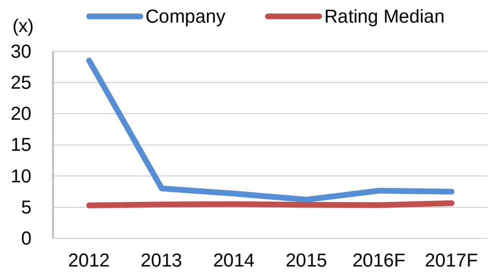
Criteria for Rating Non-Financial Corporates (September 2016)

**Leverage: Total Adjusted Debt/ Operating EBITDAR**



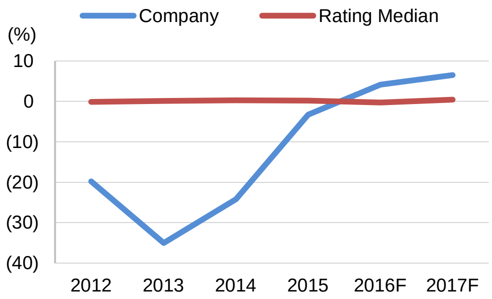

F – Forecast.
Source: Company data, Fitch.

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



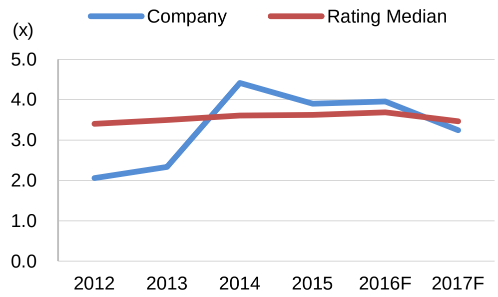

F – Forecast.
Source: Company data, Fitch.

**FCF/Revenues**



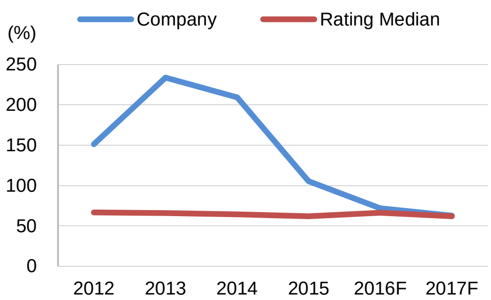

F – Forecast.
Source: Company data, Fitch.

**FFO-Adjusted Leverage**




F – Forecast.
Source: Company data, Fitch.

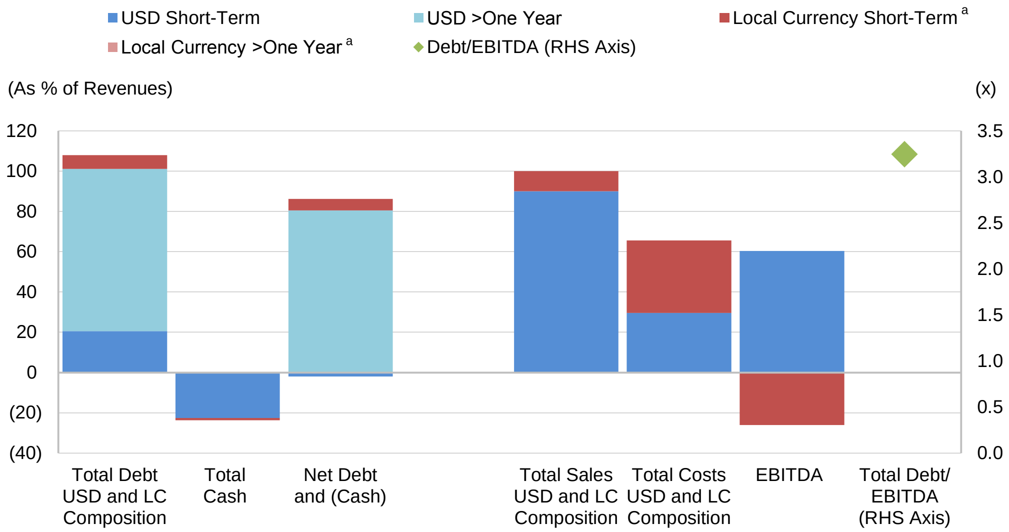
**Capex/CFO**




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)




[a]Local currency depicted as USD equivalent. LC – Local Currency.
Source: Fitch Ratings.

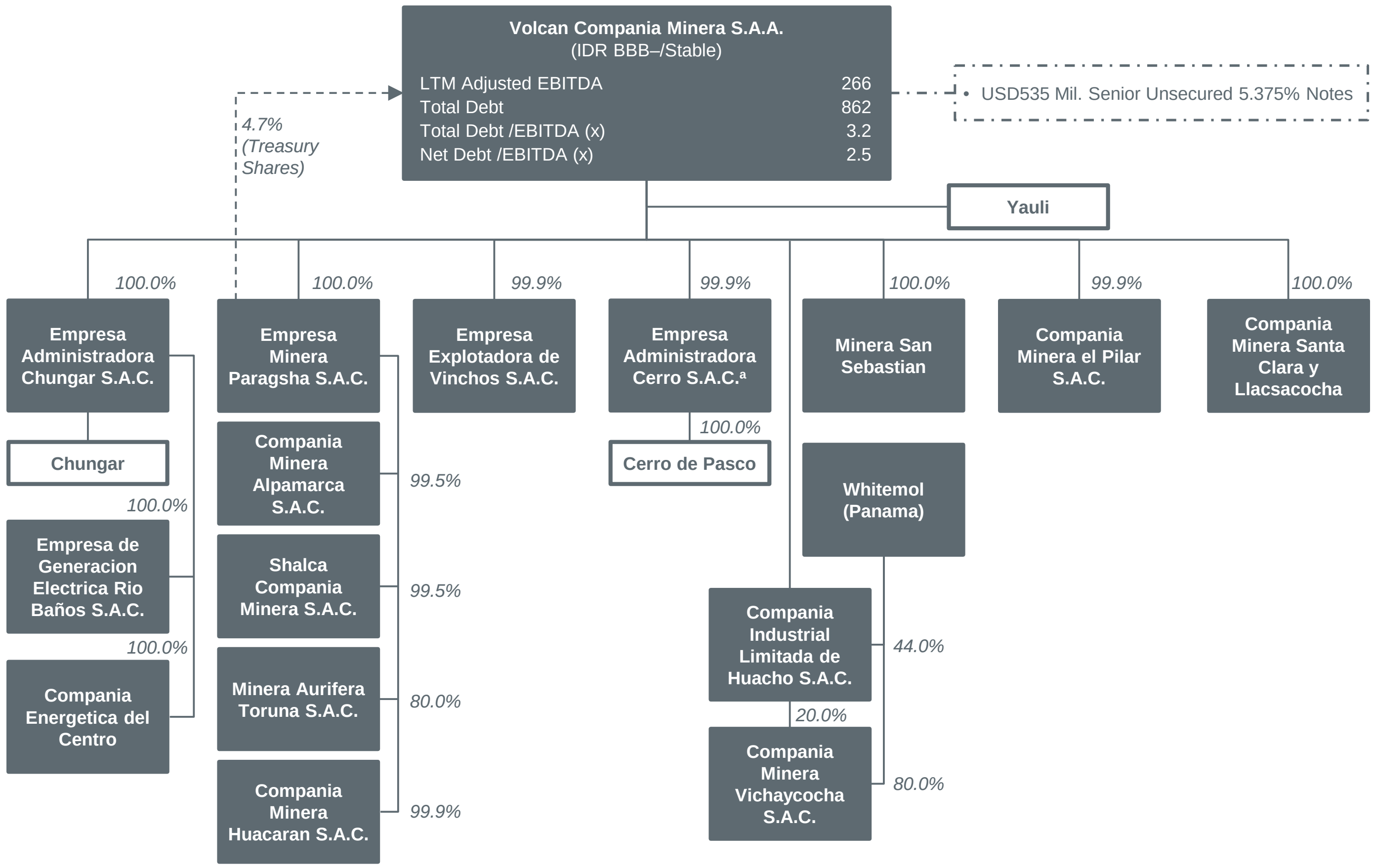
The *Fitch FX Screener* chart shows Fitch's estimates of the foreign currency (FC) and local currency split between Volcan's debt, sales and operating costs. It illustrates relative proportions rather than specific figures, thereby acknowledging the limitations of calculating the currency splits for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

[a]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.

| | Historical | | Fitch Forecast | | |
|---|---|---|---|---|---|
| (USD 000) | 12/31/14 | 12/31/15 | 12/31/16 | 12/31/17 | 12/31/18 |
| **Summary Income Statement** | | | | | |
| 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 |
| **Summary Balance Sheet** | | | | | |
| 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 |
| **Summary Cash Flow Statement** | | | | | |
| 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 |
| **Coverage Ratios (x)** | | | | | |
| 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[a] | 7.8 | 5.1 | 7.6 | 7.5 | 7.7 |
| Operating EBITDA/Gross Interest Expense[a] | 7.2 | 6.2 | 7.6 | 7.5 | 7.7 |
| **Leverage Ratios (x)** | | | | | |
| Total Adjusted Debt/Operating EBITDAR[a] | 3.6 | 3.7 | 3.0 | 2.9 | 2.8 |
| Total Adjusted Net Debt/Operating EBITDAR[a] | 3.0 | 3.1 | 2.2 | 2.0 | 1.9 |
| Total Debt with Equity Credit/Operating EBITDA[a] | 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 |

**HOW TO INTERPRET THE FORECAST PRESENTED:** The forecast presented is based on the agency's internally produced, conservative rating case forecast. It does not represent the forecast of the rated issuer. The forecast set out above is only one component used by Fitch to assign a rating or determine a rating outlook, and the information in the forecast reflects material but not exhaustive elements of Fitch's rating assumptions for the issuer's financial performance. As such, it cannot be used to establish a rating, and it should not be relied on for that purpose. Fitch's forecasts are constructed using a proprietary internal forecasting tool, which employs Fitch's own assumptions on operating and financial performance that may not reflect the assumptions that you would make. Fitch's own definitions of financial terms such as EBITDA, debt or free cash flow may differ from your own such definitions. Fitch may be granted access, from time to time, to confidential information on certain elements of the issuer's forward planning. Certain elements of such information may be omitted from this forecast, even where they are included in Fitch's own internal deliberations, where Fitch, at its sole discretion, considers the data may be potentially sensitive in a commercial, legal or regulatory context. The forecast (as with the entirety of this report) is produced strictly subject to the disclaimers set out at the end of this report. Fitch may update the forecast in future reports but assumes no responsibility to do so.
[a]EBITDA/R after dividends to associates and minorities. NCI – Noncontrolling interests.
Source: Company reports, Fitch.

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