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 Outlooks

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

Financial Data

Volcan Compania Minera S.A.A.

(USD Mil.)	12/31/16	12/31/15
Revenue	822	795
EBITDA	305	228
EBITDA Margin (%)	37.0	28.0
FFO	116	186
FCF	84	(26)
Cash and Marketable Securities	162	148
Total Adjusted Debt	854	852
Total Adjusted Debt/ EBITDAR (x)	2.3	3.1
FFO-Adjusted Leverage (x)	4.7	3.3
EBITDA/Gross Interest Expense (x)	8.2	6.2

Related Research

2017 Outlook: Global Mining (December 2016)

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

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Key Rating Drivers

Largest Peruvian Zinc, Lead and Silver Producer: Volcan Compania Minera S.A.A.'s investment-grade rating is supported by its operations in Peru (BBB+/Stable), a country of vast mineral resources and a favorable mining jurisdiction. Volcan's 'BBB–' rating reflects its diversified revenues from 12 mining operations, seven concentrator plants and one lixiviation plant 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.

First Quartile Position: Volcan's first quartile position in C1 zinc and silver cash costs allow the company to generate reasonable cash flow levels during periods of lower prices, absent significant capex and dividend payments. Volcan improved its financial position in 2016 following reductions in cash costs, coupled with lowered capital investments, resulting in improved credit metrics. Capex is likely to increase, but cash flow generation will benefit from a better pricing environment.

Strengthening Credit Metrics: Fitch Ratings expects Volcan will benefit from a better metals price environment over the next 24 months, allowing the company to generate around USD340 million of EBITDA in 2017 and 2018. Fitch projects net debt/EBITDA to reduce to 1.9x and 1.7x for 2017 and 2018, respectively, as a result of improved cash flow. Net debt/EBITDA was 2.2x in 2016, a decline from 3.1x during 2015. Volcan's willingness to divest noncore assets would result in faster deleveraging.

Adequate Liquidity: Fitch-calculated liquidity was USD162 million of as of Dec. 31, 2016. Fitch restricts USD42 million of Volcan's marketable securities 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.

Positive FCF: Fitch's base case indicates positive FCF for 2017 and 2018 of USD50 million–USD62 million. Fitch expects Volcan to increase investments in brownfield and greenfield projects over the next 12–24 months in order to grow its resources and reserves of minerals. In addition, Volcan plans to reduce its gross debt during 2017. Volcan's ability to generate enough FCF over the next two years to reduce gross debt is important to enhancing its financial flexibility amid an environment of lower prices.

Rating Sensitivities

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

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

Financial Overview

Liquidity and Capital Structure

Volcan's liquidity is adequate, and the company holds a comfortable cash position. As of Dec. 31, 2016, Volcan's cash and marketable securities available for debt reduction was USD162 million, while short-term debt was USD281 million, mainly consisting of short-term revolving credit lines for working capital purposes that are continuously repaid or rolled over. Volcan issued a five-year bank loan of USD70 million to refinance part of its short-term debt in January 2017.

Fitch restricts USD42 million of marketable securities from Volcan's liquidity position, which is related to its estimated fair value of a 17.66% stake in Chilean cement company Cemento Polpaica valued at USD62.4 million. Volcan's reported liquidity was USD203 million as Dec, 31, 2016. The company has fairly low refinancing risk despite its strategy of utilizing short-term debt and rolling over maturities, due to its adequate access to local bank financing.

Cash Flow Analysis

EBITDA was USD304 million during 2016, compared with USD225 million in 2015 due to efforts on cost savings and improved operating efficiencies such as personnel reduction, energy usage and a focus on mining methods. Consolidated unit cost fell to USD49.5/metric tonne in 2016 from USD53.7/metric tonne in 2015 and USD63.9/metric tonne in 2014. Volcan's cost position also benefited from the Peruvian Nuevo sol depreciation and drop in oil prices during 2016. Fitch expects Volcan will continue to benefit from reduced operating costs in 2017, driving EBITDA margins to around 40% for the year.

Volcan has historically generated strong cash flows as a result of its low-cost production position in zinc and silver. Volcan generated USD84 million in FCF from cash flow from operations (CFFO) of USD213 million following dividends paid of USD15 million and capex of USD114 million. Dividends have been approximately 30% of net profit over the last three years. 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 USD228 million in 2017 with capex increasing to around USD160 million in part to fund brownfield and greenfield exploration efforts. Despite the higher projected capex, Volcan should deliver around USD50 million of FCF, which the company can use for gross debt reduction.

Scheduled Debt Maturities

(USD 000, As of Dec. 31, 2016)

12/31/17	271,809
12/31/18	4,995
12/31/19	8,044
12/31/20	0
12/31/21	23,571
Thereafter	535,264
Total Debt Maturities	**843,683**

Source: Company filings, Fitch.

Related Criteria

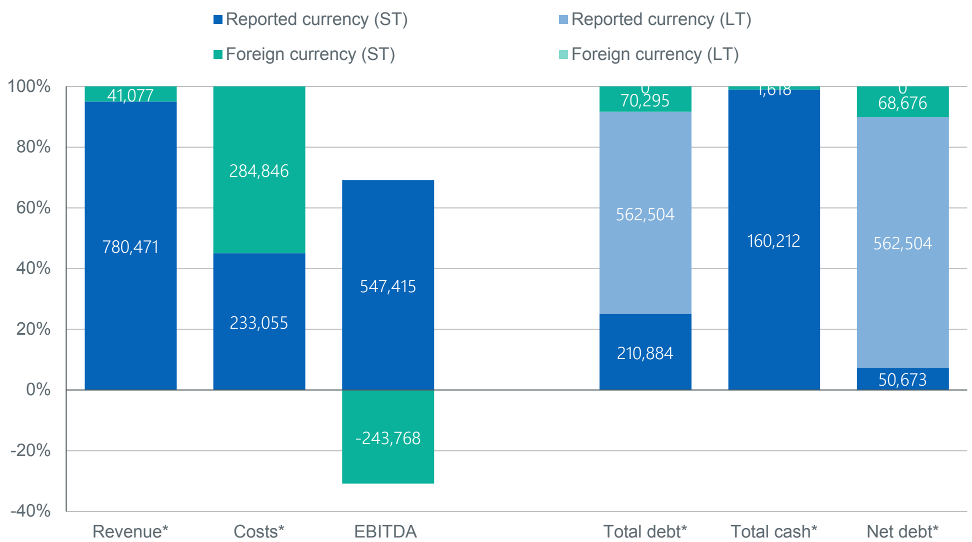
Criteria for Rating Non-Financial Corporates (March 2017)

FX Screener

The *Fitch FX Screener* chart below shows Fitch's estimates of the reported currency and foreign currency split between Volcan's debt, sales and operating costs. Fitch analysts make estimates, sometimes with information from management, as to the actual USD receipts or USD-linked income relative to costs.

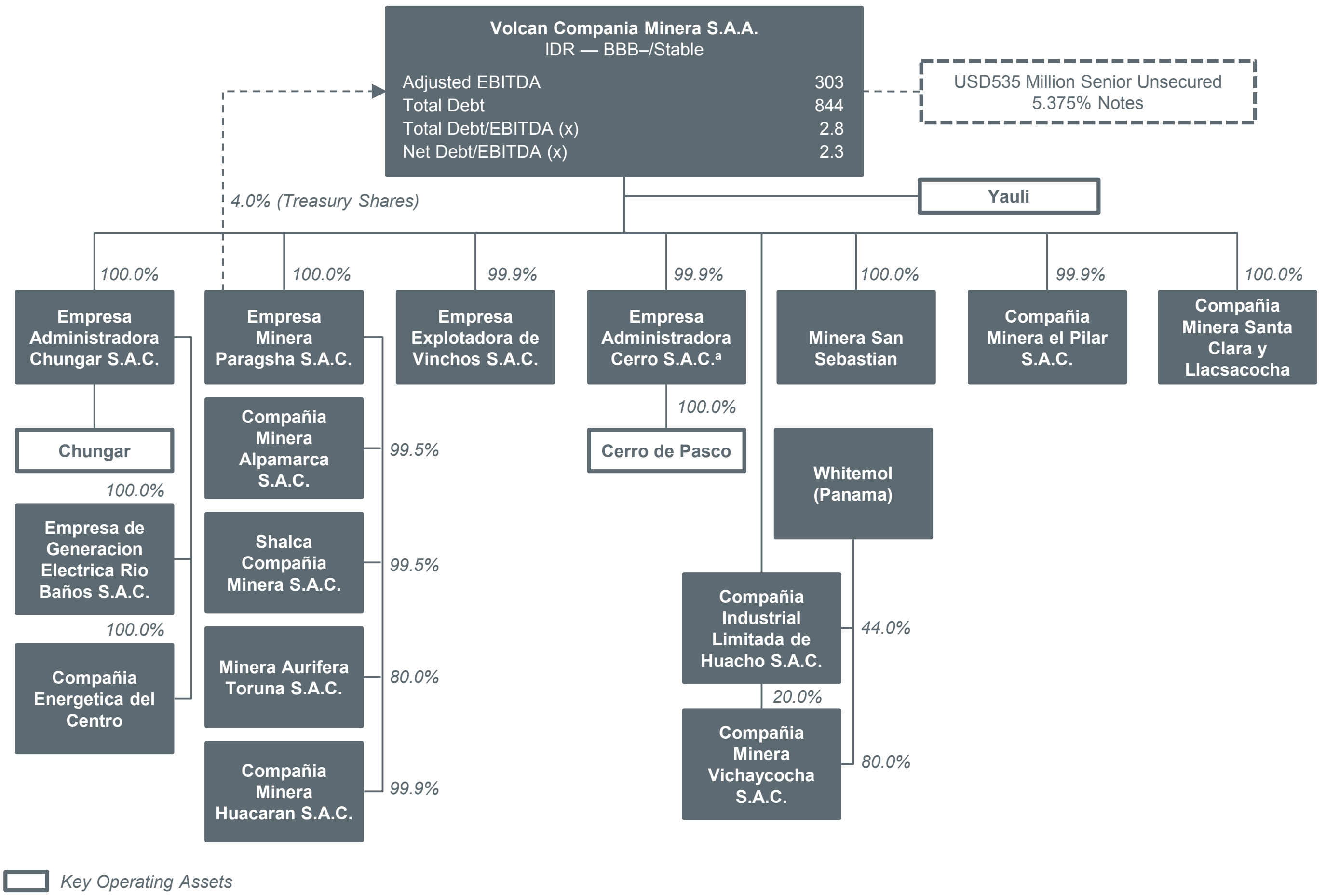
Volcan is naturally hedged against FX volatility, with most of its revenue and long-term debt denominated in U.S. dollars. Approximately 55% of the company's costs, such as labor expenses, are denominated in local currency, so local currency depreciation benefits cost reduction. A 10% depreciation of the Peruvian nuevo sol would decrease Volcan's total debt/EBITDA ratio by approximately 0.2x as of Dec. 31, 2016.

Fitch FX Screener
(Volcan Compania Minera S.A.A. — BBB-/Stable, Dec-16, USDth)



*Post hedge, absolute figures displayed are Fitch's analytical estimates, based on publicly available information
Source: Fitch

Organizational Structure — Volcan Compania Minera S.A.A.
(USD Mil., As of Dec. 31, 2016)



[a]Reorganization of the Cerro de Pasco Unit as of Feb. 1, 2011. IDR – Issuer Default Rating.
Source: Volcan Compania Minera S.A.A., Fitch.

Key Forecast Assumptions

- Average zinc price of USD2,400/tonne in 2017, USD2,800 in 2018, and USD3,000 in 2019;
- Average silver price ofUSD17.5/ounce in 2017, USD17.9/ounce in 2018 and USD18.3/ounce in 2019;
- Average lead price of USD2,274/tonne in 2017, USD2264/tonne in 2018, and USD2246/tonne in 2019;
- Average copper price of USD5,500/tonne in 2017, USD6,000/tonne in 2018 and USD6,200/tonne in 2019;
- Average gold price of USD1,100/ounce through 2017–2019;
- Mineral treatment of 7.70 million tonnes in 2017, 8 million tonnes in 2018 and 8 million tonnes in 2019.
- Capex of USD160 million in 2017, USD165 million in 2018 and USD170 million in 2019.

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

	Historical		Fitch Forecast		
(USD 000)	12/31/15	12/31/16	12/31/17	12/31/18	12/31/19
Summary Income Statement					
Revenue	794,514	821,548	854,209	871,497	892,941
Revenue Growth (%)	(22.7)	3.4	4.0	2.0	2.5
Operating EBITDA	225,312	303,647	343,276	342,034	362,336
Operating EBITDA Margin (%)	28.4	37.0	40.2	39.2	40.6
Operating EBITDAR	227,608	305,187	344,877	343,668	364,010
Operating EBITDAR Margin (%)	28.6	37.1	40.4	39.4	40.8
Operating EBIT	62,148	169,683	211,466	206,522	222,976
Operating EBIT Margin (%)	7.8	20.7	24.8	23.7	25.0
Gross Interest Expense	(43,763)	(37,198)	(37,754)	(36,254)	(35,571)
Pretax Income	(452,789)	133,450	173,712	170,267	187,405
Summary Balance Sheet					
Readily Available Cash	147,894	161,830	171,513	208,104	253,833
Total Debt with Equity Credit	836,276	843,683	802,130	777,135	749,091
Total Adjusted Debt with Equity Credit	852,348	854,463	810,136	785,303	757,460
Net Debt	688,382	681,853	630,617	569,031	495,258
Summary Cash Flow Statement					
Operating EBITDA	225,312	303,647	343,276	342,034	362,336
Recurring Associate Dividends Less Distributions to NCI	—	304	0	0	0
Cash Interest Paid	(36,179)	(37,090)	(37,754)	(36,254)	(35,571)
Implied Interest Cost %	4.3	4.4	4.6	4.6	4.7
Cash Interest Received	—	—	0	0	0
Cash Tax	(8,163)	(9,548)	(48,639)	(47,675)	(52,473)
Other Items before FFO	5,434	(141,300)	0	(0)	0
Funds Flow from Operations	186,404	116,013	256,883	258,105	274,292
FFO Margin (%)	23.5	14.1	30.1	29.6	30.7
Change in Working Capital	(14,373)	96,980	(28,788)	1,442	1,789
Cash Flow from Operations (Fitch Defined)	172,031	212,993	228,095	259,548	276,081
Total Non-Operating/Nonrecurring Cash Flow	—	—	—	—	—
Capex	(181,577)	(113,626)	—	—	—
Capital Intensity (Capex/Revenue) (%)	22.9	13.8	—	—	—
Common Dividends	(16,684)	(15,136)	—	—	—
Net Acquisitions and Divestitures	—	—	—	—	—
Capex, Dividends, Acquisitions, Other Items Before FCF	(198,261)	(128,762)	(175,380)	(197,961)	(202,308)
FCF After Acquisitions and Divestitures	(26,230)	84,231	52,715	61,586	73,773
FCF Margin (After Net Acquisitions) (%)	(3.3)	10.3	6.2	7.1	8.3
Other Investing and Financing Cash Flow Items	7,938	(41,572)	(1,479)	0	0
Net Debt Proceeds	36,377	(31,617)	(41,553)	(24,995)	(28,044)
Net Equity Proceeds	(141)	2	0	0	0
Total Change in Cash	17,944	11,044	9,683	36,591	45,729
Coverage Ratios (x)					
FFO Interest Coverage	5.9	4.0	7.8	8.1	8.7
FFO Fixed-Charge Coverage	5.6	3.8	7.5	7.8	8.4
Operating EBITDAR/Interest Paid + Rents[a]	5.9	7.9	8.8	9.1	9.8
Operating EBITDA/Interest Paid[a]	6.2	8.2	9.1	9.4	10.2
Leverage Ratios (x)					
Total Adjusted Debt/Operating EBITDAR[a]	3.7	2.8	2.3	2.3	2.1
Total Adjusted Net Debt/Operating EBITDAR[a]	3.1	2.3	1.9	1.7	1.4
Total Debt with Equity Credit/Operating EBITDA[a]	3.7	2.8	2.3	2.3	2.1
FFO-Adjusted Leverage	3.9	5.8	2.7	2.7	2.4
FFO-Adjusted Net Leverage	3.3	4.7	2.2	2.0	1.6

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[a]EBITDA/R after dividends to associates and minorities. NCI – Noncontrolling interests.
Source: Company data, Fitch.

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