FITCH AFFIRMS VOLCAN'S RATINGS AT 'BBB-'; OUTLOOK STABLE

Fitch Ratings-Chicago-07 December 2017: Fitch Ratings has affirmed the long-term foreign and local currency Issuer Default Rating (IDRs) of Volcan Compania Minera S.A.A. (Volcan) at 'BBB-'. Fitch has also affirmed the 'BBB-' rating on the company's USD600 million senior unsecured 5.375% notes due 2022. The Rating Outlook is Stable.

KEY RATING DRIVERS

Largest Peruvian Zinc, Lead and Silver Producer: Volcan'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 five mining units encompassing eight mines in operation, seven concentrator plants and one lixiviation plant (Ag oxides) across the Central Andes region. Volcan ranks as the largest zinc and lead producer, and second largest silver producer within Peru.

Polymetallic Diversification; Moderate Scale: Benefitting Volcan's ratings are the company's mineral production profile concentrated towards zinc and silver which compares favorably to more single-commodity mineral producers. Volcan's sales by metal as of the third quarter of 2017 (3Q17) were 55% zinc, 29% silver, 12% lead, 3% copper, and 1% gold. The distribution of sales by metal was impacted by higher zinc, lead, and copper prices during the quarter. In terms of scale of operations, Volcan was the fifth largest zinc producer, eighth largest silver producer, and 12th largest lead producer globally during 2016.

Competitive Cost Position: Volcan's consolidated operations exhibit competitive cost positions with a co-product C1 cash cost of $1,706 USD/MT for zinc and $11 USD/MT for silver credits as of Sept. 30, 2017, which allows the company to generate sound cash flow levels during periods of lower prices, absent significant capex and dividend payments. The company also generates material levels of cash flow from its by-products. Volcan's unit cost of production lowered 7.7% to $46.6 USD/MT for the nine months ended Sept. 30, 2017 due to increased volumes at its Alpamarca mine which diluted its fixed costs per unit coupled with lower-cost production from stockpiles at its Cerro de Pasco operations.

Improved Credit Metrics: Volcan's net debt / EBITDA improved to 1.9x for latest 12 months (LTM) Sept. 30, 2017 from 2.3x for 2016, and 3.1x for 2015 as a result of an improved metals price environment, depreciation of the Peruvian Nuevo sol, lower oil prices, and reductions in personnel, energy, and mining costs coupled with a USD40 million decline in its gross debt. Fitch expects Volcan to generate around USD360 million of EBITDA in 2017 and USD380 million in 2018, with net debt/EBITDA projected to reduce to 1.6x and 1.5x for 2017 and 2018, respectively. Volcan's willingness and ability to divest noncore assets would result in faster deleveraging.

New Ownership Credit Positive: Fitch views Glencore increasing its stake to up to 55% of Volcan's class A voting right shares as an overall credit positive for Volcan due to Glencore's global scale and stronger negotiating power. Glencore has been a shareholder in the company since 2004, and now holds 24% of the company considering both common A and common B shares. The change in ownership brings along for Volcan technical support due to Glencore's global mining expertise, the potential for financial support for large investment projects, and increased corporate governance and transparency.

Positive FCF: Volcan's cash flow generation will continue to benefit from improved commodity prices and an emphasis on stricter cost management, allowing the company to maintain positive free cash flow (FCF). Fitch's base case indicates positive FCF for 2017 of around USD120 million and to remain positive through 2019. Fitch expects Volcan to increase investments in brownfield and greenfield projects and mine development costs over the next 12-24 months in order to grow its resources and reserves of minerals. 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.

Low Life of Mine: Volcan's eight years of mine life at current production rates is low compared to Fitch's Mining Navigator rating factors and considered a constraint to the company's rating. Inclusive of reserves and inferred resources, Volcan's life of mine would be 19 years. Furthermore, Volcan owns 344,000 hectares of concessions across a region of significant geological reserves. The company is currently only exploiting 18% of its concessions, with a further 13% currently being explored. As of Dec. 31, 2016, Volcan had over 65 million metric tons of proven and probable reserves and over 273 million metric tons of additional resources (measured, indicated, and inferred).

DERIVATION SUMMARY

Volcan's 'BBB-'/Outlook Stable rating reflects its position as the largest zinc and lead producer and second largest silver producer in Peru, a country of vast mineral resources and favourable mining regulations. Volcan benefits from a fairly diversified production of base and precious metals similar to its peer Milpo (BBB-/Negative), and is more diversified than its peers Minsur (BBB-/Stable), and Hochschild (BB+/Stable). Volcan's scale of operations are larger than its peers Milpo and Minsur, however, Volcan has a weaker capital structure and cost position. Volcan's ratings also reflect its competitive cost position, moderate scale, adequate liquidity and an expectation of net debt / EBITDA to remain below 2.0x over the next four years. Like its peers, Volcan has demonstrated a willingness and ability to reduce development and exploration expenditures during periods of lower commodity prices to preserve cash flow. Volcan's consolidated life of mine of eight years of reserves is on the lower end when compared to its Peruvian mining peers.

KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:

--Average zinc price of USD2,731/tn in 2017, USD2,800/tn in 2018, and USD3,000/tn in 2019 & USD2,700/tn in 2020;
--Average silver price of USD17.2/oz in 2017, USD17.9/oz in 2018, USD18.3/oz in 2019 & USD18.7/oz in 2020;
--Average lead price of USD2,246/tn in 2017, USD2,264/tn in 2018, USD2,246/tn in 2019, and USD2,228/tn in 2020;
--Average copper price of USD6,017/tn in 2017, USD6,000/tn in 2018, USD6,200/tn in 2019 and USD6,500/tn in 2020;
--Average gold price of USD1,257/oz in 2017, USD1,200/oz thereafter;
--Mineral treatment of 8.2 million tn in 2017, 8.1 million tn in 2018, 8.0 million tn in 2019 and 8.0 million tn in 2020.
--Capex level of USD160 million in 2017, USD170 million in 2018, USD180 million in 2019 and USD180 million in 2020.

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action

--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.

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action
--Volcan's ratings could be downgraded should the company undertake significant capital expenditures in projects during periods of low commodity prices, resulting in net leverage remaining elevated above 2.5x.
--An unfavourable change to Volcan's financial or operational strategies following the change in ownership to Glencore which is detrimental to the financial health of Volcan could lead to a negative rating action.

LIQUIDITY

Volcan's liquidity is adequate, and the company holds a comfortable cash position. Fitch-calculated liquidity was USD175 million of as of Sept. 30, 2017, while short-term debt was USD178 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 USD213 million as Sept. 30, 2017. 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.

FULL LIST OF RATING ACTIONS

Fitch has affirmed Volcan Compania Minera S.A.A.'s ratings as follows:

--Foreign currency IDR at 'BBB-';
--Local currency IDR at 'BBB-';
--Senior unsecured long-term notes at 'BBB-'.

The Rating Outlook is Stable.

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Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable Criteria
Corporate Rating Criteria (pub. 07 Aug 2017)
https://www.fitchratings.com/site/re/901296