

Volcan

Volcan Compania Minera S.A.A. Full Rating Report

Funds from Operations	250	355
Free Cash Flow (FCF)	(426)	(220)
Cash and Mkt. Securities	300	575
Total Adj. Debt	730	706
Total Adj. Debt/EBITDA	2.4	1.5
FFO Adjusted Leverage	2.6	1.8
EBITDA/Gross Interest Expense	11.9	13.9 ^e

Financial Data

Volcan Compania Minera S.A.A.

USD Mil.	LTM	
	9/30/13	12/31/12
Revenue	1,105	1,161
EBITDA	307	460
EBITDA Margin (%)	28	40
Funds from Operations	250	355
Free Cash Flow (FCF)	(426)	(220)
Cash and Mkt. Securities	300	575
Total Adj. Debt	730	706
Total Adj. Debt/EBITDA	2.4	1.5
FFO Adjusted Leverage	2.6	1.8
EBITDA/Gross Interest Expense	11.9	13.9

Related Research

[2014 Outlook: Latin American Metals & Mining \(December 2013\)](#)

[2014 Outlook: Metals and Mining \(December 2013\)](#)

[Metals and Mining Chartbook \(December 2013\)](#)

Analysts

Jay Djemal
+1 312 368-3134
jay.djemal@fitchratings.com

Josseline Jenssen
+59 1 2277-4470
josseline.jenssen@fitchratings.com

Key Rating Drivers

Challenging Period of Operations: Volcan has reviewed its large investment plan originally set at USD1.1 billion from 2011 to 2015 and scaled it down to around USD780 million in response to lower commodity prices, in line with the actions taken by the global mining industry. The company's plans to diversify more heavily into copper through its Rondoni project changed during 2013 due to the changing economics for the red metal and related cost of the Greenfield project.

Conservative Debt Management: Volcan has historically maintained a very low leverage position with an average total debt-to-EBITDA ratio from 2011 to 2007 of just 0.3x. The company's LTM to Sept. 30, 2013 total debt-to-EBITDA and net debt-to-EBITDA ratios increased to 2.4x and 1.4x, respectively, due to lower profitability and the increase in debt following its issuance of USD600 million 5.375% notes in February 2012. LTM FFO adjusted leverage was 1.8x, unchanged from the year-end 2012 ratio.

Polymetal Diversification: Volcan's revenues are diversified over ten mining operations, seven concentrator plants and one lixiviation plant spread across the Cerro de Pasco, Yauli, Chungar and Alpamarca regions of the Peruvian Central Highlands. Volcan has exhibited revenue growth to over USD1 billion for the LTM to Sept. 30, 2013 from the trough of USD627 million in 2008, although revenues declined in the last two years compared to 2011, mainly due to lower prices. In 2013, zinc is expected to account for 41% of total sales, silver 41%, lead 12%, copper 5% and gold 1%.

Negative FCF Expected: Fitch Ratings expects the company to exhibit negative free cash flow (FCF) in 2013 and 2014 as a result of the revised investment plan that has been extended to 2017 in order to better manage annual expenditures. Due to lower prices, FCF is not expected to turn positive until 2015. Positive FCF may be achieved sooner should dividends and capex be scaled-down. Volcan has historically generated strong cash flows as a result of its low-cost production position. This should result in the continuation of robust FFO generation in the medium term.

Rating Outlook: Volcan's projected leverage and debt coverage ratios remain consistent with its rating profile through-the-cycle, reflecting its Stable Outlook.

Rating Sensitivities

Key Rating Risks: Deterioration in the company's net debt-to-EBITDA ratio above 2.5x over a sustained period or a structural decline in profitability due to increased fixed costs could result in a downgrade or Negative Outlook. The company is also exposed to the inherent risks of the mining industry of cyclical demand, price volatility, event risk, labor strikes and rising operating costs.

Positive Rating Momentum Events: Swift deleveraging of total debt-to-EBITDA below 1.0x combined with successful execution of diversification of mines and revenues substantially into other metals, combined with further geographical diversification and low cost of production, could lead to a Positive Outlook or rating upgrade.

Financial Overview

Liquidity and Debt Structure

Volcan has low refinancing risk and low leverage. The company's debt maturity profile is very comfortable with the only major amortization due relating to the USD600 million 5.375% senior unsecured notes bullet repayment due in 2022.

Volcan's approach to leverage has been very conservative historically, as illustrated by its average total debt-to-EBITDA ratio from 2011 to 2007 of 0.3x. The company's LTM to Sept. 30, 2013 total debt-to-EBITDA and net debt-to-EBITDA ratios increased to 2.4x and 1.4x, respectively, mainly due to falling zinc and silver prices and the debt increase that related to the issuance of USD600 million senior unsecured notes that took place in February 2012. The company's LTM to Sep. 30, 2013 FFO adjusted leverage ratio was low for the rating category at 1.8x, and remained unchanged from year-end 2012.

The company has a good track record of making early prepayments of debt and holding a comfortable cash position to maintain strong liquidity. Cash and marketable securities held as of Sept. 30, 2013 was USD300 million, with the balance mostly relating to the 2012 senior unsecured notes issuance. Fitch expects Volcan to exhibit a significant cash cushion during its investment program to 2015.

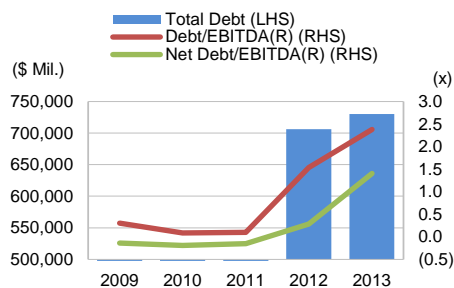
Volcan's operations are located in Peru (LT IDR of 'BBB+'/Stable), a country of vast mineral resources with a favorable mining jurisdiction. According to Thomson Reuters GFMS, the company ranks as the sixth largest zinc producer and seventh largest silver producer globally.

Debt Maturities and Liquidity

As of Sep. 30, 2013	USD Thousand
Current Maturity	116,792
Two Year	0
Three Year	0
Four Year	0
Five Year	0
Beyond Five Years	600,000
CFO	123,652
Cash	299,746

Source: Volcan.

Total Debt and Leverage Ratios



Cash Flow Analysis

Volcan has historically generated strong cash flows as a result of its low-cost production position. In the last two years, the company's FCF was affected by lower prices and higher costs as well as higher capex. As of the LTM to Sept. 2013, the company FCF was negative of USD305 million from CFFO of USD244 million following dividends paid of USD70 million and capex of USD480 million. Dividends have been at around 30% of net profit over the last three years. FFO was USD370 million for the LTM period ended Sept. 30, 2013 with a working capital outflow of USD130 million.

Fitch projects that the company will generate CFFO in the region of USD244 million in 2013 from which capex will be USD603 million and dividends paid will be USD69 million, resulting in negative FCF of USD428 million. Negative FCF would be funded by the remaining cash from the bond issuance. Fitch expects FCF to remain negative until 2015 depending on its expansion capex program and dividend payments. During the third quarter of 2012 and first

Related Criteria

[Corporate Rating Methodology \(August 2013\)](#)

[Parent and Subsidiary Rating Linkage \(August 2013\)](#)

[Evaluating Corporate Governance \(December 2012\)](#)

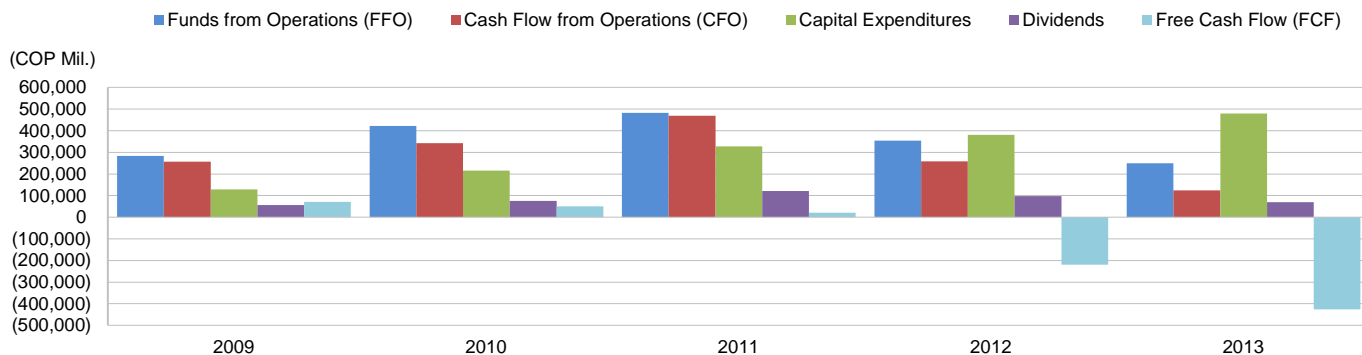
half of 2013, commodity prices declined and production costs increased to over USD70/MT from around USD50—USD55/MT previously due to the lower production from the Cerro de Pasco unit.

Fitch uses an adjusted EBITDA in its calculations that excludes the USD120 million relating to hedging activities during the third quarter of 2013 that the company reported under IFRS as a revenue source. Adjusted EBITDA for the LTM to Sept. 30, 2013 decreased to USD307 million resulting in a decrease in the company's EBITDA margin to below 30%. In the past, revenue growth has been fueled by strong commodity demand, especially from China, and a sustained period of high prices. Volcan exhibited high EBITDA margins historically, averaging around 49% for the last four years.

Fitch expects Volcan's savings implementation program and new low-cost production to allow for a recovery in profit margins from 2015. As of the third quarter of 2013, Volcan's consolidated cash cost of production improved to below USD60/MT, closer to historical levels. Fitch's base case scenario for adjusted EBITDA generation in 2013 is around USD300 million excluding hedging activities, with total debt expected at around USD730 million. Fitch's revenue and EBITDA base case expectations for 2014 are around USD1 billion and USD330–USD350 million, respectively. Fitch expects a deleveraging process to take place from 2015 when the company increases low-cost production and becomes 100% self-sufficient in energy in accordance with its expansion plans.

The company's sales are mostly made through stable long-term contracts around four years in length, with the contract prices adjusted annually based on average prices for the year. The company's largest customer is Glencore, accounting for 42% of sales estimated for 2013, which is also a minority shareholder in Volcan and holds a seat on the company's board of directors.

Cash Flow Performance



Source: Company reports, Fitch.

Peer Group

Issuer	Country
BBB	
Compania Minera Milpo S.A.A.	Peru
Compania de Minas Buenaventura S.A.A	Peru
BBB-	
Volcan Compania Minera S.A.A.	Peru
BB+	
Hochschild Mining Plc	United Kingdom

Source: Fitch.

Issuer Rating History

Date	LT IDR (FC)	Outlook/ Watch
Dec. 20, 2013	BBB-	Stable
Jan. 8, 2013	BBB-	Stable
Jan. 17, 2012	BBB-	Stable
Oct. 31, 2011	BBB-	Stable

LT IDR – Long-term Issuer Default Rating.
 FC – Foreign currency. NR – Not rated.
 Source: Fitch.

Peer and Sector Analysis

Peer Group Analysis

USD Millions	Volcan Compania Minera S.A.A.	Compania Minera Milpo S.A.A.	Compania de Minas Buenaventura S.A.A.*	Hochschild Mining Plc
LTM as of	12/31/12	9/30/12	12/31/12	12/31/12
Long-Term IDR	BBB-	BBB	BBB	BB+
Outlook	Rating Outlook Stable	Rating Outlook Stable	Rating Outlook Stable	Rating Outlook Stable

Financial Statistics

Revenue	1,105	714	1,410	682
YoY Revenue Growth (%)	(4.8)	7.4	(8.5)	(16.7)
EBITDA	307	239	398	202
EBITDA Margin (%)	27.8	33.4	28.2	29.7
Free Cash Flow	(306)	82	(337)	(419)
Total Adjusted Debt	730	379	261	202
Cash and Cash Equivalents	300	309	104	273
Funds Flow from Operations	370	218	246	163
Capex	(480)	(119)	(490)	(546)

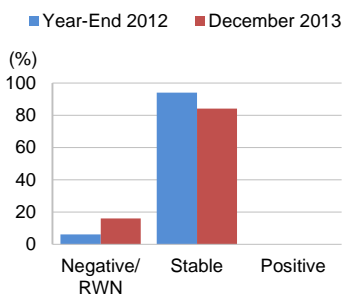
Credit Metrics (x)

EBITDA/Gross Interest Coverage	11.9	17.7	30.4	16.5
FFO Adjusted Leverage	1.8	1.6	1.0	1.2
Adjusted Debt/EBITDAR	2.4	1.6	0.7	1.0
FFO Interest Coverage	15.4	17.2	19.7	14.3

IDR – Issuer Default Rating. YoY – Year over year. * Direct operations only.
 Source: Fitch.

Volcan's closest peer amongst the Peruvian mining companies rated by Fitch is the polymetal miner Compania Minera Milpo S.A.A. (Milpo) — a material subsidiary of Votorantim Participacoes S.A. (VPAR: LT IDR: BBB/Negative). The other peers in the country include Compania de Minas Buenaventura S.A.A. (Buenaventura), the largest Peruvian precious metals miner; Minsur S.A. (Minsur: LT IDR: BBB-/Stable), the world's third largest by volume and lowest cost producer of tin; and Hochschild Mining Plc (Hochschild: LT IDR: BB+/Stable), a silver mining company. Southern Copper Corporation (SCC: LT IDR: BBB+/Stable) also has a substantial presence in Peru including its headquarters, with approximately half of its mining operations based in the country and half in Mexico.

Sector Outlook Distribution



RWN – Rating Watch Negative.
 Source: Fitch.

Key Rating Issues

Change in Capex Plan

Volcan's strategy is to increase its diversification into copper and gold, although the contribution expected from these metals will be lower than originally anticipated. Following the revision of its large investment plan of USD1.1 billion to around USD780 million in response to expected lower prices for zinc, silver and copper, Volcan is now pursuing its copper growth strategy through the low-cost copper project at Cerro de Pasco's west face of its Raul Rojas open-pit mine. As a result, copper is expected to comprise around 10% of revenues by 2017 as opposed to around 20% as originally envisaged with the Rondoni project.

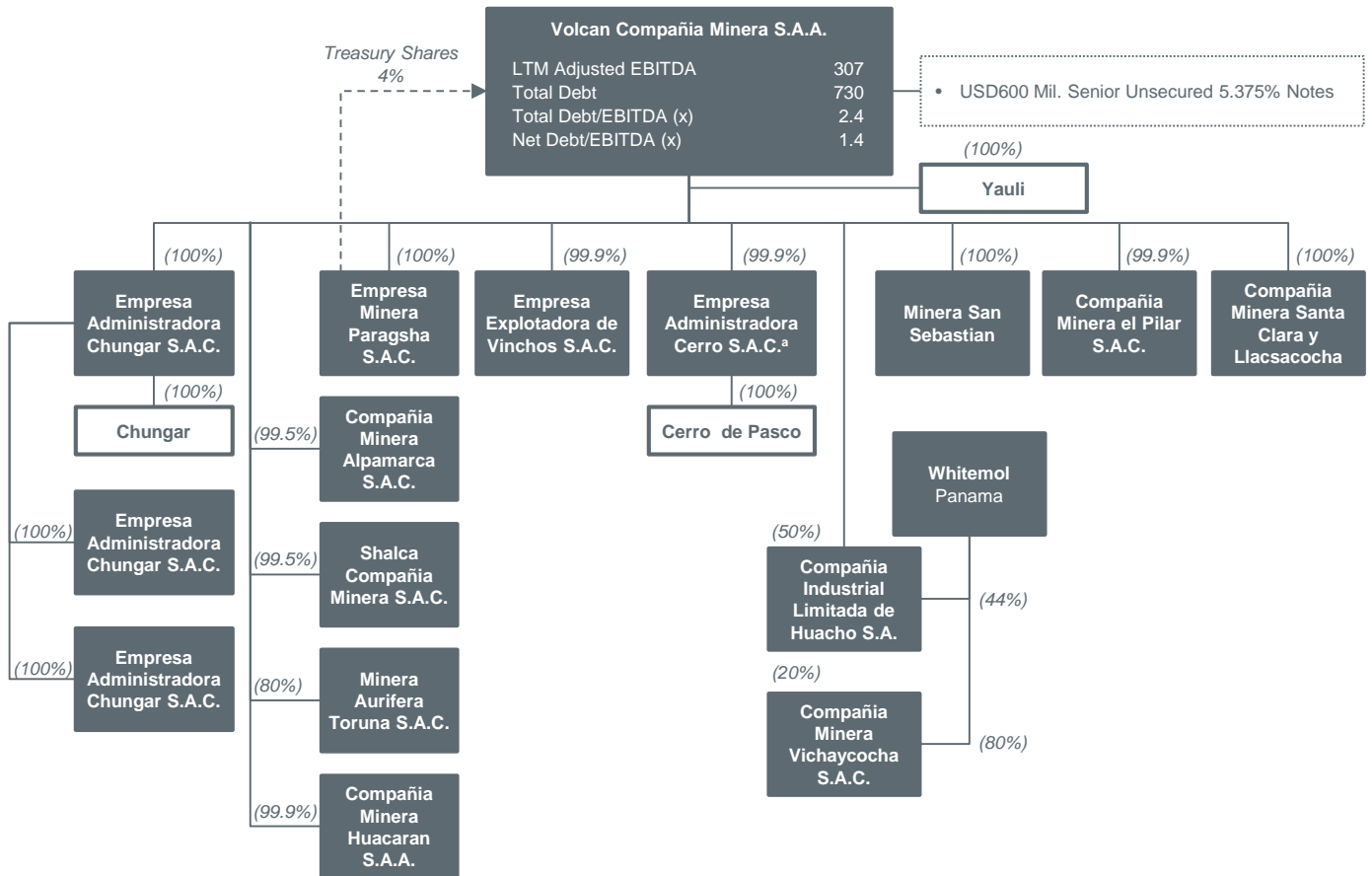
This essential capex revision has resulted in a change to the company's growth plan that is lower than Fitch's previous expectations. Fitch's revised base case indicates that the company will exhibit a peak in total debt-to-EBITDA and net debt-to-EBITDA at around 2.4x and 1.8x in 2013, respectively, declining thereafter. Funds from operations (FFO) adjusted leverage is expected to peak at around 2.8x in 2013, declining to around 2.2x in 2014 and 1.7x in 2015.

These expected credit metrics remain consistent with Volcan's rating category through-the-cycle. Should Volcan's credit metrics deteriorate from these levels, a Negative Outlook or rating downgrade could follow.

Organizational Structure

Organizational Structure — Volcan Compañía Minera S.A.A.

(As of Sept. 30, 2013, USD Mil.)



□ Key Operating Assets

^aReorganization of the Cerro de Pasco Unit as of February 1, 2011.
Source: Fitch and Volcan Compañía Minera S.A.A. financial statements.

Definitions

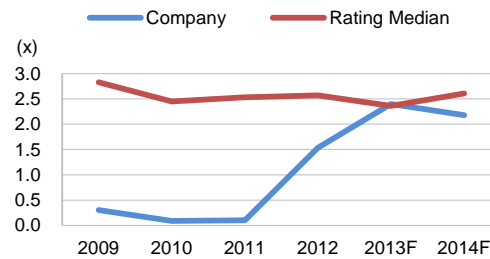
- **Leverage:** Gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus gross interest paid plus preferred dividends plus rental expense.
- **Interest Cover:** FFO plus gross interest paid plus preferred dividends divided by gross interest paid plus preferred dividends.
- **FCF/Revenue:** FCF after dividends divided by revenue.
- **FFO/Debt:** FFO divided by gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock.

Fitch's expectations are based on the agency's internally produced, conservative rating case forecasts. They do not represent the forecasts of rated issuers individually or in aggregate. Key Fitch forecasts assumptions include:

- Commodity prices follow Fitch's mid-cycle assumptions.
- Zinc concentrate volume growth around 3% per year.
- Silver concentrates increasing to 20 mil. oz in 2014.
- Increasing COGS in line with volumes and inflation.

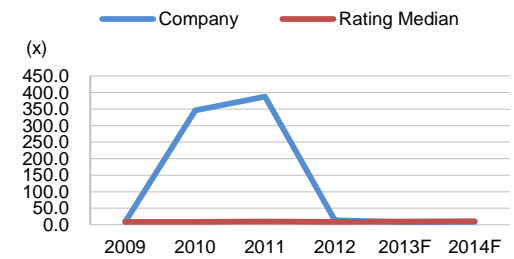
Key Metrics

Leverage: Total Adjusted Debt/ Operating EBITDAR



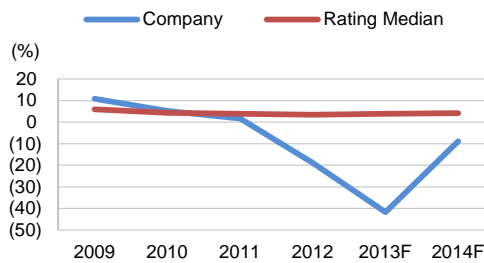
F — Forecast.
Source: Company data, Fitch.

Interest Coverage: Operating EBITDA/ Gross Interest Expense



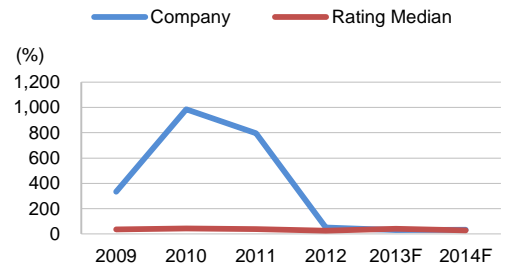
F — Forecast.
Source: Company data, Fitch.

FCF/Revenues



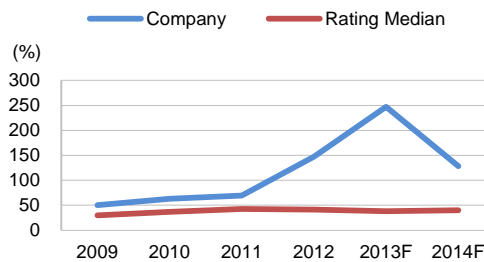
F — Forecast.
Source: Company data, Fitch.

FFO/Debt



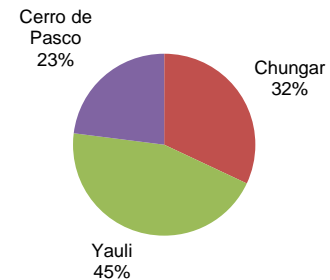
F — Forecast.
Source: Company data, Fitch.

Capex/CFO



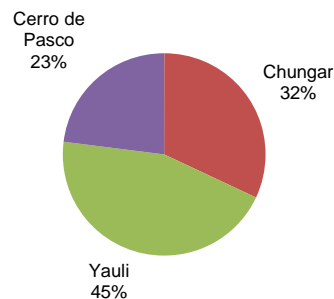
F — Forecast.
Source: Company data, Fitch.

Sales by Mining Unit 3Q12



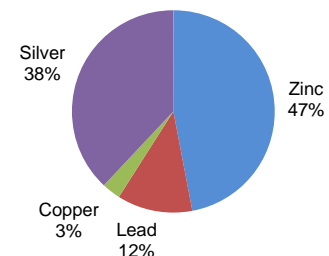
Source: Volcan.

Sales by Mining Unit 3Q12



Source: Volcan.

Sales by Metal 3Q12



Source: Volcan.

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

USD 000, Year Ending Dec. 31

	LTM				
	Sep. 30, 2013	2012	2011	2010	2009
Profitability					
EBITDA	306,964	459,509	614,259	490,420	280,218
EBITDAR	306,964	459,509	614,259	490,420	280,218
EBITDA Margin (%)	27.8	39.6	50.7	50.0	42.3
EBITDAR Margin (%)	27.8	39.6	50.7	50.0	42.3
FFO Return on Adjusted Capital (%)	12.5	18.6	37.2	39.9	32.1
Free Cash Flow Margin (%)	(38.5)	(18.9)	1.7	5.2	10.8
Return on Average Equity (%)	6.0	16.1	29.1	26.4	19.1
Coverage (x)					
FFO Interest Coverage	10.7	11.7	304.9	299.1	9.8
EBITDA/Gross Interest Expense	11.9	13.9	387.1	345.9	8.7
EBITDAR/Interest Expense + Rents	11.9	13.9	387.1	345.9	8.7
EBITDA/Debt-Service Coverage	2.2	3.6	13.0	12.6	3.5
EBITDAR/Debt-Service Coverage	2.2	3.6	13.0	12.6	3.5
FFO Fixed Charge Coverage	10.7	11.7	304.9	299.1	9.8
FCF Debt Service Coverage	(2.8)	(1.5)	0.5	1.3	1.3
(FCF+Cash and Marketable Securities)/Debt-Service Coverage	(0.7)	3.1	3.7	4.8	2.8
Cash Flow from Operations/Capital Expenditures	0.3	0.7	1.4	1.6	2.0
Leverage (x)					
FFO Adjusted Leverage	2.6	1.8	0.1	0.1	0.3
Total Debt with Equity Credit/EBITDA	2.4	1.5	0.1	0.1	0.3
Total Net Debt with Equity Credit/EBITDA	1.4	0.3	(0.2)	(0.2)	(0.1)
Total Adjusted Debt/EBITDAR	2.4	1.5	0.1	0.1	0.3
Total Adjusted Net Debt/EBITDAR	1.4	0.3	(0.2)	(0.2)	(0.1)
Implied Cost of Funds (%)	3.6	8.6	3.1	2.2	22.3
Secured Debt/Total Debt	—	—	—	—	—
Short-term Debt/Total Debt	0.2	0.1	0.8	0.9	0.6
Balance Sheet					
Total Assets	2,750,908	2,643,213	1,782,530	1,501,566	1,288,062
Cash and Marketable Securities	299,746	574,855	154,123	135,390	124,513
Short-Term Debt	116,792	92,903	45,538	37,450	48,674
Long-term Debt	613,554	613,242	14,965	5,461	36,000
Total Debt	730,346	706,145	60,503	42,911	84,674
Total Equity	1,471,340	1,376,942	1,238,893	1,020,756	896,517
Total Adjusted Capital	2,201,686	2,083,087	1,299,396	1,063,667	981,191
Cash Flow					
Funds from Operations	249,967	354,644	482,241	422,692	283,190
Change in Working Capital	(126,315)	(95,983)	(12,326)	(80,197)	(26,856)
Cash Flow from Operations	123,652	258,661	469,915	342,495	256,334
Total Non-Operating/Non-Recurring Cash Flow	—	—	—	—	—
Capital Expenditures	(479,919)	(380,798)	(327,388)	(215,558)	(128,669)
Common Dividends	(69,244)	(97,482)	(121,716)	(75,967)	(55,906)
Free Cash Flow (FCF)	(425,511)	(219,619)	20,811	50,970	71,759
Net Acquisitions and Divestitures	(1,293)	(5,162)	—	—	—
Other Investments, Net	—	—	—	—	(13,985)
Net Debt Proceeds	1,994	645,642	17,592	(41,763)	(117,645)
Net Equity Proceeds	(2,005)	(129)	(19,670)	1,670	(265)
Other (Investments and Financings)	—	—	—	—	—
Total Change in Cash	(426,815)	420,732	18,733	10,877	(60,136)
Income Statement					
Revenue	1,104,983	1,160,785	1,211,614	980,600	662,477
Revenue Growth (%)	(4.8)	(4.2)	23.6	48.0	5.6
EBIT	184,882	339,559	510,355	381,265	213,318
Gross Interest Expense	25,690	33,017	1,587	1,418	32,063
Rental Expense	—	—	—	—	—
Net Income	84,233	210,950	328,900	253,414	170,229

Source: Company Report.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](http://fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2014 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. One State Street Plaza, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings, Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion is based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at anytime for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.