FitchRatings

FITCH AFFIRMS VOLCAN COMPANIA MINERA S.A.A. AT 'BBB-'; OUTLOOK REMAINS NEGATIVE

Fitch Ratings-Chicago-11 December 2015: 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 remains Negative.

A full list of rating actions follows at the end of this press release.

KEY RATING DRIVERS

Negative Outlook

Volcan's Negative Outlook continues to reflect weaker than expected financial performance and corresponding delayed recovery in credit metrics. During the last year, the declining metal prices have offset the company's efforts to reduce costs and increase efficiency. Fitch believes measures taken by Volcan, including capex reduction, will alleviate pressure on cash flow generation during 2016. FCF is expected to be relatively neutral for 2015 and positive in 2016 following three years of large investments. Fitch's expectations include that Volcan maintains a net debt-to-EBITDA ratio of 2.5x or below through the commodity price cycle. A rating downgrade could follow should Volcan not maintain a significant cash cushion and generate FCF to the degree required to achieve this ratio target by year-end 2016.

Production Increase Offset by Low Prices

Fitch expects revenues at around USD820 million during 2015, 20% less than 2014 due to lower metal prices and low margin volumes from third-party concentrates. During 3Q15, the average silver price fell to USD15/Oz from USD19.60/Oz in 3Q14, while the average zinc price fell to USD1,833/MT from USD2,281MT over the same period. These declines were partially offset by greater sales of the company's own production. The volume of ore treated by Volcan during 9M15 grew by 9.8%, compared to the same period in 2014 and the production of fine zinc, silver, lead, and copper contents rose by 1.9%, 12.6%, 4.0%, and 21.8%, respectively, in the same period. Such increases are mainly due to greater production of all metals at the Yauli Unit and the silver contribution from the Oxides Plant, which has been operating at 100% of its capacity since June 2015.

Higher Profitability

Fitch projects an EBITDA of USD225 million for 2015 following an EBITDA margin improvement to 27.5% from 22.5% in 2014. 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 (to 10% from 21%). For 2016, the company's third-party concentrate sales will be reduced and are not expected to generate profits due to current low prices while ore treated will reduce to 2% due to lower Cerro de Pasco production. These reductions would be compensated by a low-cost of production. Volcan has been able to replace Cerro de Pasco's production with higher polymetallic volumes at the Yauli and Chungar units and new silver volumes from the Oxides plant and Alpamarca unit. Fitch's revenue and EBITDA base case expectations for 2016 are around USD730 million and USD230 million, respectively.

Cost Reductions to Continue

Fitch expects Volcan to exhibit a downward trend for its production costs during 2016 due to the lower contribution expected from high-cost Cerro de Pasco, alongside continued efforts on savings and cost reductions including the company's goal to become 100% energy self-sufficient in the medium term. Volcan' consolidated unit cost fell by almost 16% to USD53.4/MT in 3Q15 from USD63.5/MT in 3Q14, as a consequence of the measures implemented to reduce costs across all operating units. These measures encompass operating efficiency improvements, reductions in personnel expenses, supplies, services of specialized contractors, energy and maintenance savings, among others. This program has been implemented for the last two years and continues as metals prices fall.

Deleveraging Expected

Fitch expects Volcan to deleverage from current elevated debt ratio levels post-2015 when the company's EBITDA generation improves and FCF generation becomes positive following lower capex closer to maintenance levels with a net debt to-EBITDA ratio of 2.5x or below during the mid-cycle. The company held a net debt-neutral or positive cash after debt position prior to its February 2012 issuance of USD600 million notes which comprises 70% of its total debt. Net debt-to EBITDA was 2.9x at LTM Sept. 30, 2015, similar to December 2014. During the LTM Sept. 30, 2015, Volcan's funds from operations (FFO) adjusted leverage was 3.0x. For 2016 and 2017, Fitch expects Net debt-to EBITDA leverage to reduce to around 2.5x and 2.0x, respectively.

Neutral to Positive FCF

Volcan's large investment program to expand production for approximately USD1.3 billion since 2012 was concluded in mid-2015. The two main growth projects were the Silver Oxides plant at Cerro de Pasco and the new Alpamarca Unit projects. These projects have been completed with the Alpamarca unit starting operations in May 2014, while the Silver Oxides plant was 100% operational in June 2015. Alpamarca should add zinc and lead and both new projects should jointly contribute approximately 4 to 6 million ounces of silver per year. As a result, capex for 2015 is expected to reduce to around USD180 million. Volcan's copper growth strategy continues to be a priority for the company focused mainly on Greenfield exploration. Capex has been scaled down to be around USD130 million per year for 2016 and 2017. Fitch's Base Case indicates a positive FCF generation for 2016 and 2017 of around USD50-80 million, as a result of these more modest investments.

Largest Peruvian Zinc, Lead and Silver Producer

Volcan's operations are located in Peru (Fitch LT IDR of 'BBB+'/Stable Outlook), 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 Peruvian Central Highlands. According to Thomson Reuters GFMS, the company ranks as the sixth largest zinc producer and seventh largest silver producer globally.

Polymetal Diversification

Volcan's revenues for the LTM Sept. 30, 2015 decreased to USD868 million compared to USD1 billion in 2014 due to lower sales from third-parties and depressed prices. LTM Sept. 30, 2015 EBITDA was USD230 million, similar to 2014 due to efforts on cost savings and higher efficiencies. Volcan's 3Q15 revenues are diversified into zinc 45%, silver 42%, lead 10%, copper 2% and gold 1%. The distribution of sales by metal reflects an increased contribution of silver as a result of the rise in the production of fines and ore from its new projects. Volcan's medium-term strategy is to diversify into copper and gold, although the contribution expected to materialize later than originally anticipated.

KEY ASSUMPTIONS

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

--Average zinc price of USD2,000/MT in 2015, USD2,100/MT thereafter;
--Average silver price of USD15.8/oz in 2015, USD14/oz in 2016, USD15/oz in 2017 & 2018;
--Average lead price of USD1,800/MT in 2015 and 2016, USD2,000/MT in 2017 and USD2,100/MT in 2018;
--Average copper price of USD5,250/MT in 2015, USD5,500/MT in 2016 and USD6,000/MT in 2017 and 2018;
--Average gold price of USD$1,176/oz in 2015, USD1,200/oz thereafter;
--Mineral treatment of around 7.9 million MT in 2015, 7.8 million MT in 2016, 7.9 million MT in 2017 and 8 million MT in 2018;
--Capex of around USD180 million in 2015, USD126 million in 2016, USD132 million in 2017 and USD134 million in 2018;
--Dividends at 30% of net profits.

RATING SENSITIVITIES

Following Volcan's drive to significantly lower its cost structure for zinc on a by-product basis, Fitch has increased its net leverage threshold for the company back to 2.5x through-the-cycle. Fitch previously noted this achievement as a driver to increase the leverage tolerance for the company from 2.0x as it finalized its capex program. Should Volcan fail to deleverage to around this target by the end of 2016 and with consistently negative FCF, a downgrade could follow.

An upgrade of Volcan's credit ratings is not expected at this time.

LIQUIDITY

Volcan has a good track record of making early prepayments of debt and holding a comfortable cash position to maintain strong liquidity. As of Sept. 30, 2015, Volcan's cash and marketable securities was USD188 million while short-term debt was USD199 million, mainly comprised of short-term revolving credit lines for working capital purposes that are continuously repaid or rolled over. Volcan has low refinancing risk with its next material debt maturity falling due in 2022 when its USD600 million senior unsecured notes are due.

FULL LIST OF RATING ACTIONS

Fitch has affirmed the following ratings:

Volcan Compania Minera S.A.A.
--Foreign currency IDR at 'BBB-';
--Local currency IDR at 'BBB-'.
--Senior unsecured notes at 'BBB-'.

The Rating Outlook remains Negative.

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Date of Relevant Rating Committee: Dec. 10, 2015.

Additional information is available on www.fitchratings.com.

Applicable Criteria
Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage (pub. 17 Aug 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869362