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	Negative
Long-Term Local-Currency IDR	Negative

Financial Data

Volcan Compania Minera S.A.A.

(USD Mil.)	12/31/15	12/31/14
Revenue	795	1,027
EBITDA	217	231
EBITDA Margin (%)	27	23
Funds from Operations	144	285
FCF	(2)	(249)
Cash and Market. Securities	192	174
Total Adjusted Debt	836	838
Total Adjusted Debt/EBITDAR (x)	3.8	3.6
FFO-Adjusted Leverage (x)	4.8	2.7
EBITDA/Gross Interest Expense (x)	6.0	7.8

Related Research

2016 Outlook: Latin American Metals and Mining (Survival of the Fittest) (December 2015)

Fitch Affirms Volcan Compania Minera S.A.A. at 'BBB–'; Outlook Remains Negative (December 2015)

Peruvian Corporate Review (Liquidity Remains Strong) (September 2015)

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Key Rating Drivers

Negative Outlook: Volcan Compania Minera S.A.A.'s (Volcan) Negative Outlook continues to reflect weaker than expected financial performance and a corresponding delayed recovery in credit metrics. During the past year, declining metal prices have offset the company's efforts to reduce operating costs to increase low-cost production and efficiency.

Cost Reductions to Continue: Fitch Ratings expects Volcan to exhibit a downward trend for production costs and improved margins during 2016 due to the suspension of high-cost Cerro de Pasco production, replaced by greater production of all metals from other units, including the silver contribution from the Oxides plant. Volcan's consolidated unit cost fell by almost 16% to USD53.7/metric tonne in 2015 from USD63.9/metric tonne in 2014.

Deleveraging Expected: Fitch expects Volcan to deleverage from current elevated debt ratio levels as the company's EBITDA generation improves and FCF generation becomes positive following lower capex closer to maintenance levels. A net debt/EBITDA ratio of 2.5x or below is expected during the midcycle. Net debt/EBITDA was 3.0x at December 2015, similar to December 2014.

Neutral to Positive FCF: Fitch's base case indicates positive FCF generation for 2016 and 2017, as a result of more modest investments. Capex has been scaled down to around USD120 million for 2016 and USD126 million for 2017. Volcan's large investment program to expand production of approximately USD1.3 billion since 2012 was concluded in mid-2015.

Largest Peruvian Zinc, Lead and Silver Producer: Volcan's operations are located in Peru (Long-Term Issuer Default Rating 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 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 2015 decreased to USD795 million, from USD1 billion in 2014, due to lower sales from third parties and depressed prices. Volcan's 2015 revenues consisted of zinc (45%), silver (42%), lead (10%), copper (2%) and gold (1%). The sales distribution reflects an increased contribution from silver as a result of growing production of fines and ore from new projects. Volcan's copper growth strategy continues to be a priority, focused on greenfield exploration.

Rating Sensitivities

Negative Actions: 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 have consistently negative FCF, a downgrade could follow.

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

Financial Overview

Liquidity and Capital Structure

Volcan has a good track record of making early prepayments of debt and holding a comfortable cash position to maintain strong liquidity. As of Dec. 31, 2015, Volcan's cash and marketable securities was USD192 million while short-term debt was USD213 million, mainly consisting 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.

Debt Maturities and Liquidity

(USD 000, As of Dec. 31, 2015)	Amount
Current Maturity	212,705
Two Year	13,715
Three Year	4,510
Four Year	2,630
Five Year	2,716
Beyond Five Years	600,000
Cash Flow from Operations	196,504
Cash	192,307
Undrawn Committed Facilities	0

Source: Company reports.

Fitch expects Volcan will maintain a net debt/EBITDA ratio of 2.5x or below through the commodity price cycle. As of December 2015, the company's total debt/EBITDA ratio was 3.8x and net debt/EBITDA ratio was 3.0x.

Cash Flow Analysis

Volcan's revenues were USD795 million in 2015, 23% less than 2014 due to lower metal prices and volumes from third-party concentrates. During 2015, the average silver price fell to USD15.6/ounce from USD19.1/ounce in 2014, while the average zinc price fell to USD1,917/metric tonne from USD2,143/metric tonne. These declines were partially offset by greater sales of the company's own production. The volume of ore treated by Volcan in 2015 grew by 7.0% over 2014, and the production of fine zinc, lead, copper and silver contents rose 1.5%, 4.6%, 25.3% and 10.2%, respectively, in the period.

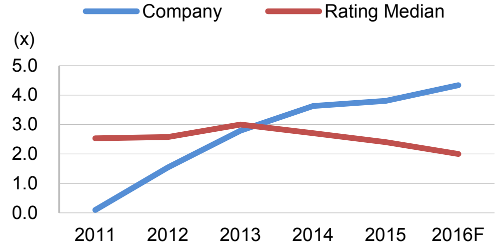
In 2015, EBITDA was USD217 million, with a margin increase to 27.4% from 22.5% in 2014. The company's EBITDA margin improvement is explained by the decline in production costs and the reduced low-margin volume of third-party concentrates over total sales (to 10% from 24%). For 2016, the company's third-party concentrate sales will be further reduced and are not expected to generate profits due to current low prices, while ore treated will decline to 2% due to the suspension of production at Cerro de Pasco. These reductions would be offset by low-cost 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.

FCF is expected to be positive in 2016 and 2017 following years of large investments. 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 the new projects should jointly contribute approximately 4 million–6 million ounces of silver per year. As a result, capex for 2015 was reduced to around USD180 million and capex for 2016 and 2017 have been scaled down to around USD120 million and USD126 million, respectively.

Related Criteria

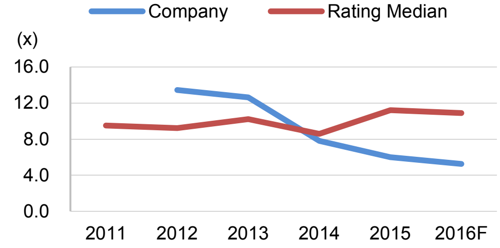
Corporate Rating Methodology — Including Short-Term Ratings and Parent and Subsidiary Linkage (August 2015)

Leverage: Total Adjusted Debt/ Operating EBITDAR



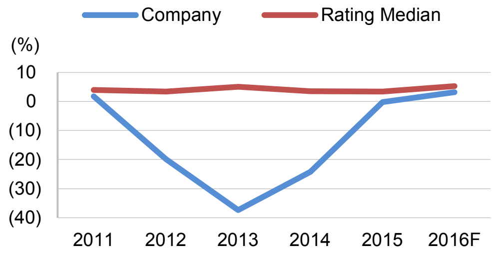
F – Forecast.
Source: Company data, Fitch.

Interest Coverage: Operating EBITDA/ Gross Interest Expense



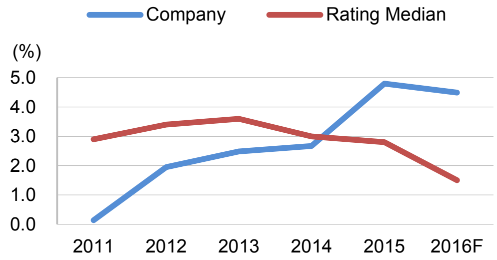
F – Forecast.
Source: Company data, Fitch.

FCF/Revenues



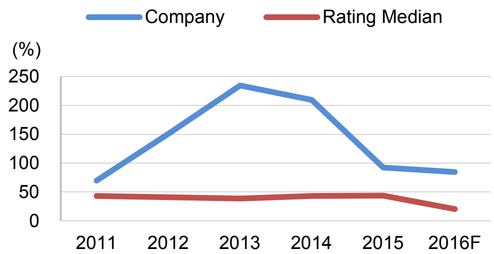
F – Forecast.
Source: Company data, Fitch.

FFO/Debt



F – Forecast.
Source: Company data, Fitch.

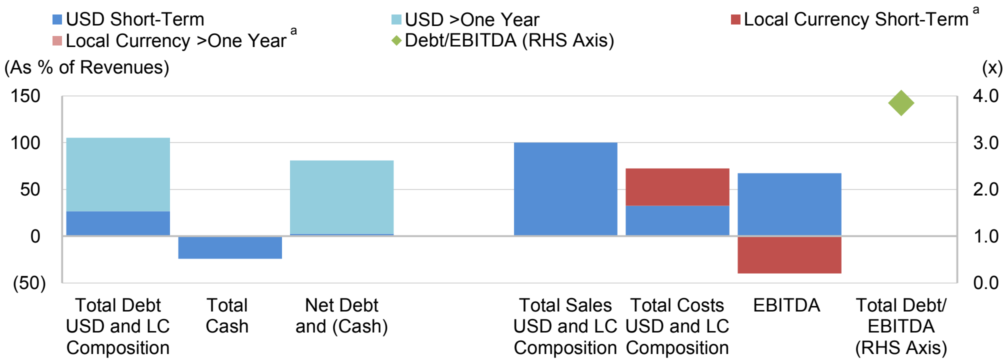
Capex/CFO



CFO – Cash flow from operations. F – Forecast.
Source: Company data, Fitch.

FX Screener

Fitch FX Screener
(Volcan Compania Minera S.A.A. — BBB–/Negative, As of Dec. 31, 2015)



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

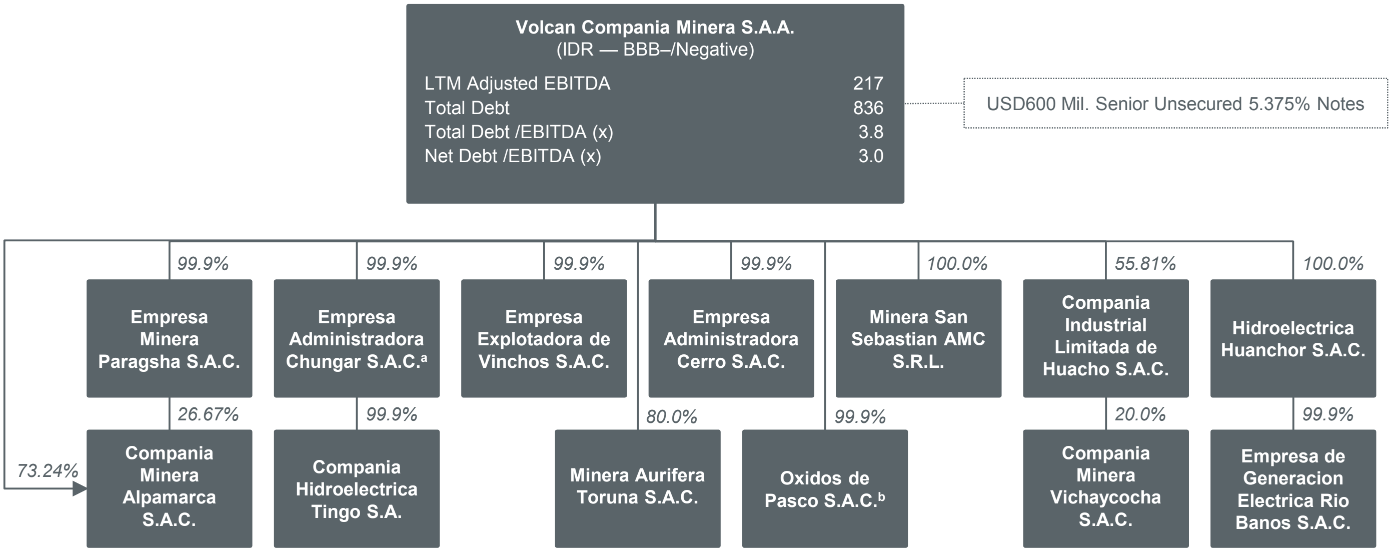
The FX risk screener show Fitch's estimates of the foreign currency (FC) and local currency (LC) split among Volcan's debt, sales and operating costs. This chart illustrates the relative proportions rather than specific figures, thereby acknowledging the limitations of calculating the currency splits 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 (usually U.S. dollar) debt is highlighted since, 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 devaluation benefits cost reduction.

Organizational Structure

Organizational Structure — Volcan Compania Minera S.A.A.
(USD Mil., As of Dec. 31, 2015)



[a]Merger of Compañía Minera El Pilar S.A.C, Shalca Compañía Minera S.A.C., Compañía Minera Huascarán S.A.C. Cía Minera Santa Clara y Llacsacocha S.A., Recursos Troy S.A.C and Empresa Administradora Chungar S.A.C.(survivor company) as of Sept. 1, 2015. [b]Assets and Liabilities from Cerro de Pasco Unit related to the Oxides plant as of Oct. 1, 2015. IDR – Issuer Default Rating.
Source: Volcan Compania Minera S.A.A., Fitch.

Key Forecast Assumptions

- Average zinc price of USD1,625/metric tonne (MT) in 2016, USD1,800/MT in 2017 and USD1,900/MT in 2018;
- Average silver price of USD14/ounce in 2016 and USD 15/ounce in 2017 and 2018;
- Average lead price of USD1,800/MT in 2016, USD2,000/MT in 2017 and USD2,100/MT in 2018;
- Average copper price of USD4,800/MT in 2016, USD5,200/MT in 2017, and USD6,000/MT in 2018;
- Average gold price of USD1,050/ounce in 2016 and USD1,000/ounce thereafter;
- Mineral treatment of around 7.8 million MT in 2016, 7.9 million MT in 2017 and 8 million MT in 2018;
- Consolidated unit cost of production around USD50/MT for 2016–2018;
- Capex of approximately USD120 million in 2016 and USD126 million thereafter;
- Dividends at 30% of net profits.

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

	Historical		Fitch Forecast		
(USD 000, As of Dec. 31)	2014	2015	2016	2017	2018
Summary Income Statement					
Gross Revenue	1,027,256	794,514	689,838	732,758	774,919
Revenue Growth (%)	(0.8)	(22.7)	(13.2)	6.2	5.8
Operating EBITDA	231,161	217,415	189,431	277,826	315,954
Operating EBITDA Margin (%)	22.5	27.4	27.5	37.9	40.8
Operating EBITDAR	231,161	217,415	189,431	277,826	315,954
Operating EBITDAR Margin (%)	22.5	27.4	27.5	37.9	40.8
Operating EBIT	80,293	62,148	58,126	147,098	185,741
Operating EBIT Margin (%)	7.8	7.8	8.4	20.1	24.0
Gross Interest Expense	(29,668)	(36,179)	(36,019)	(35,776)	(35,626)
Pretax Income	74,543	(452,789)	22,107	111,322	150,115
Summary Balance Sheet					
Readily Available Cash	174,363	192,307	198,500	221,723	277,001
Total Debt with Equity Credit	838,095	836,276	820,571	806,856	802,346
Total Adjusted Debt with Equity Credit	838,095	836,276	820,571	806,856	802,346
Net Debt	663,732	643,969	622,071	585,133	525,345
Summary Cash Flow Statement					
Operating EBITDA	231,161	217,415	189,431	277,826	315,954
Cash Interest	—	(36,179)	(36,019)	(35,776)	(35,626)
Implied Interest Cost %	0.0	4.3	4.3	4.4	4.4
Cash Tax	—	—	(6,632)	(33,397)	(45,034)
Associate Dividends Less Distributions to NCI	—	—	0	0	0
Other Items Before FFO	54,023	(36,782)	0	0	0
Funds Flow from Operations	285,184	144,454	146,780	208,653	235,294
FFO Margin (%)	0	0	0	0	0
Change in Working Capital	(87,381)	52,050	(4,882)	(41,072)	(26,129)
Cash Flow from Operations (Fitch Defined)	197,803	196,504	141,898	167,581	209,165
Total Non-Operating/Nonrecurring Cash Flow	—	—	—	—	—
Capex	(414,272)	(181,577)	—	—	—
Capital Intensity (Capex/Revenue) (%)	0	0	—	—	—
Common Dividends	(32,619)	(16,684)	—	—	—
Net Acquisitions and Divestitures	—	—	—	—	—
Capex, Dividends, Acquisitions and Other Items Before FCF	(446,891)	(198,261)	(120,000)	(130,643)	(149,378)
FCF After Acquisitions and Divestitures	(249,088)	(1,757)	21,898	36,938	59,788
FCF Margin (After Net Acquisitions) (%)	(24.2)	(0.2)	3.2	5.0	7.7
Other Investing and Financing Cash Flow Items	(870)	7,938	0	0	0
Net Debt Proceeds	155,073	11,904	(15,705)	(13,715)	(4,510)
Net Equity Proceeds	(366)	(141)	0	0	0
Total Change in Cash	(95,251)	17,944	6,193	23,223	55,278
Coverage Ratios (x)					
FFO Interest Coverage	10.6	4.8	5.1	6.8	7.6
FFO Fixed Charge Coverage	10.6	4.8	5.1	6.8	7.6
Operating EBITDAR/Gross Interest Expense + Rents	7.8	6.0	5.3	7.8	8.9
Operating EBITDA/Gross Interest Expense	7.8	6.0	5.3	7.8	8.9
Leverage Ratios (x)					
Total Adjusted Debt/Operating EBITDAR	3.6	3.8	4.3	2.9	2.5
Total Adjusted Net Debt/Operating EBITDAR	2.9	3.0	3.3	2.1	1.7
Total Debt with Equity Credit/Operating EBITDA	3.6	3.8	4.3	2.9	2.5
FFO-Adjusted Leverage	2.7	4.8	4.5	3.3	3.0
FFO-Adjusted Net Leverage	2.1	4.0	3.4	2.4	1.9

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NCI – Noncontrolling interest.

Source: Fitch, company reports.

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