

Volcan Compania Minera S.A.A. (/gws/en/esp/issr/90778091)



Fitch Affirms Volcan at 'BBB-'; Outlook Revised to Stable

Fitch Ratings-Chicago-08 December 2016: 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 has been revised to Stable from Negative.

Volcan's Stable Outlook reflects the company's improved financial performance following successful reductions in its cash costs, coupled with lowered capital investments resulting in improved credit metrics during 2016. Volcan's recovering capital structure has started to stabilize despite a period of weak commodity prices during the 9 months ended Sept. 30, 2016, with zinc, copper, and lead prices down 4.7%, 16.4%, and 2.4%, respectively, partially offset by a 5.6% improvement in silver prices compared to the prior year period. Fitch believes measures taken by Volcan are sustainable over the medium term, with net leverage being maintained at or below 2.5x over the projected period. Fitch calculated adjusted leverage was 2.7x as of Sept. 30, 2016 and expects stronger performance during 4Q16 as price hedges dropped off during August.

KEY RATING DRIVERS

Improving Profitability

Fitch projects an EBITDA of USD294 million for 2016 with EBITDA margins expanding to 36% from 28% in 2015. 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. Fitch's revenue and EBITDA base case expectations for 2017 are around USD800 million and USD289 million, respectively, with net leverage declining to 2.3x and are based on Fitch's mid-cycle commodity pricing assumptions. Should zinc prices remain at their elevated price of 2,800/tn during 2017, Fitch calculates EBITDA and net leverage would be USD366 million and 1.7x, respectively.

Strengthening Credit Metrics

Fitch expects Volcan's efforts to deleverage will be sustainable over the next 12-24 months as the company's cost cutting initiatives will coincide with a better metals pricing environment. For 2016 and 2017, Fitch expects Net Debt-to-EBITDA leverage to reduce to 2.4x and 2.3x, respectively. Net debt-to-EBITDA was 2.7x at LTM Sept. 30, 2016, a decline from 3.1x on Dec. 31, 2015; higher than anticipated leverage for the LTM Sept. 30, 2016 reflected weaker cash collections and increased payments related to its hedged production of zinc and silver prices during the year. These hedges rolled off during 3Q16, and the company is expected to benefit from strong cash flow generation in 4Q16.

Positive FCF

Volcan's completed its USD1.3 billion three year investment program to expand production in mid-2015. The two main growth projects were the Silver Oxides plant at Cerro de Pasco and the new Alpamarca-Rio Pallanga Unit projects. These projects have been completed with the Alpamarca-Rio Pallanga unit starting operations in May 2014, while the Silver Oxides plant was 100% operational in June 2015. As a result, capex for 2016 has been scaled down to around USD125 million in 2016 and increasing to around USD150 million for 2017. Fitch's Base Case indicates a positive FCF generation for 2016 and 2017 of around USD30-50 million, as a result of lower capex and a dividend payout similar to historical levels.

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 Central Andes region. According to Thomson Reuters GFMS, the company ranks as the sixth largest zinc producer and seventh largest silver producer globally.

KEY ASSUMPTIONS

- Average zinc price of USD2,083/tn in 2016, USD2,000/tn 2017-2018, and USD2,100 in 2019;
- Average silver price of USD17.0/oz in 2016, USD17.0/oz in 2017, USD17.3/oz in 2018 & USD17.6/oz in 2019;
- Average lead price of USD1,869/tn in 2016, USD2,274/tn in 2017, USD2264/tn in 2018, and USD2246/tn in 2019;
- Average copper price of USD4,899/tn in 2016, USD5,000/tn in 2017, USD5,500/tn in 2018 and USD6,000/tn in 2019;
- Average gold price of USD\$1,238/oz in 2016, USD1,100/oz thereafter;
- Mineral treatment of 7.77 million tn in 2016, 7.70 million tn in 2017, 8 million tn in 2018 and 8 million tn in 2019.
- Capex level of USD125 million in 2016, USD150 million in 2017, USD155 million in 2018 and USD165 million in 2019.

RATING SENSITIVITIES

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

A positive rating action for Volcan is not anticipated in the near term following the revised Outlook to Stable. 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.

LIQUIDITY

Volcan's liquidity is adequate and holds a comfortable cash position. As of Sept. 30, 2016, Volcan's cash and marketable securities available for debt reduction was USD141 million while short-term debt was USD297 million, mainly comprised of short-term revolving credit lines for working capital purposes that are continuously repaid or rolled over. Fitch restricts USD43 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 USD184 million as of Sept. 30, 2016. The company has low refinancing risk with its next material debt maturity falling due in 2022 when its outstanding USD535 million of senior unsecured notes are due.

FULL LIST OF RATING ACTIONS

Volcan Compania Minera S.A.A.
--Foreign currency IDR at 'BBB-';

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

The Rating Outlook is Stable.

Contact:

Primary Analyst
 Phillip Wrenn
 Associate Director
 +1-312-368-2075
 Fitch Ratings, Inc.
 70 W. Madison St.
 Chicago, IL 60602

Secondary Analyst
 Josseline Jenssen
 Director
 +51-999-108-046

Committee Chairperson
 Daniel Kastholm, CFA
 Managing Director
 +1-312-368-2070

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Date of Relevant Rating Committee: Dec. 7, 2016

Additional information is available on www.fitchratings.com.

Applicable Criteria

Criteria for Rating Non-Financial Corporates (pub. 27 Sep 2016) (<https://www.fitchratings.com/site/re/885629>)

Additional Disclosures

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