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

Fitch Ratings-Chicago-14 December 2018: Fitch Ratings has affirmed the Long-Term Foreign and Local Currency Issuer Default Rating (IDRs) of Volcan Compania Minera S.A.A. 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.

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 Peru's leading lead producer, second-largest zinc producer, and third-largest silver producer.

KEY RATING DRIVERS

Polymetallic Diversification; Moderate Scale: Volcan's ratings benefit from the company's mineral production profile concentrated toward zinc and silver, which compares favorably with single-commodity mineral producers. Volcan's sales by metal as of third-quarter 2018 were 58% zinc, 27% silver, 11% lead, 2% copper, and 2% gold. The distribution of sales by metal was affected by lower zinc production during the nine months ended Sept. 30, 2018 coupled with weaker zinc prices during the second half of 2018. Fitch considers Volcan's scale to be moderate and benefit from weaker economies of scale when compared to larger miners which generate over USD1.0 billion of EBITDA annually.

Competitive Cost Position: The company's consolidated operations exhibited a competitive cost positions with a co-product C1 cash cost of USD1,765/metric ton (MT) for zinc and USD10.40/ per ounce for silver during 2017. This allows Volcan to generate sound cash flow 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 consolidated unit cost of production lowered 2.6% to $47.2 USD/MT for the nine months ended Sept. 30, 2018 due to an increase in the processing of low-cost stockpile volumes at Cerro de Pasco coupled with a reformulation of mining plans at its Yauli operations. Volcan has experienced a unit cost decrease of over 39% since 1Q13 across its operations through a focus on cost cutting initiatives.

Adequate Credit Metrics: Fitch projects Volcan's capital structure to slightly deteriorate during 2019 amid a scenario of weaker zinc prices; however the company's net debt/EBITDA is expected to remain below 2.5x over the next four years. Fitch projects Volcan to report net debt/EBITDA of 2.4x for 2018 and 2019 compared to 2.0x in 2017, primarily due to a softer commodity price environment, partially offset by manageable cash outflows. Volcan's earnings are highly sensitive to zinc prices. Should zinc prices remain flat during 2019 then Volcan would record net debt/EBITDA of around 1.8x. Fitch excludes any asset sales from its assumptions; however delivery of asset sales over the next 12-18 months would support gross debt reduction.

Glencore Ownership Credit Positive: Fitch views Glencore PLC 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 Volcan technical support due to Glencore's global mining expertise, the potential for financial support for large investment projects, and improved corporate governance and transparency.

Weaker Cash Flow Generation Amid Lower Prices: Fitch projects Volcan's FCF generation to remain neutral/slightly positive during 2018 and 2019, as weaker zinc prices will restrict cash flow growth. Based on Fitch's mid-cycle commodity zinc price of $2,700/tonne for 2018 and $2,400/tonne for 2019, Volcan will generate around USD280 million of EBITDA in 2018 and USD277 million in 2019. Should zinc prices remain flat at around $2,700/tonne in 2019, Fitch projects Volcan's EBITDA will be over USD330 million. Upcoming capital expenditures are expected to be around USD190 million in 2019 and USD200 million in 2020. This includes a total of USD50 million related to its Palma project to be spent during 2019 and 2020. Capital allocations overall should remain low, with minimal dividends over the investment cycle, allowing FCF to remain slightly positive over the next two years.

Low Life of Mine: Volcan's eight years of mine life at current production rates is low compared with Fitch's mining Navigator rating factors and is 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 only exploiting 18% of its concessions, with a further 13% being explored. As of Dec. 31, 2017, Volcan had over 50 million metric tons of proven and probable reserves and over 294 million metric tons of additional resources (measured, indicated, and inferred).

DERIVATION SUMMARY

Volcan's rating reflects its position as the leading lead producer, second-largest zinc producer, and third-largest silver producer in Peru, a country of vast mineral resources and favorable mining regulations. Volcan benefits from a fairly diversified production of base and precious metals, similar to peers BVN and Nexa, and is more diversified than Minsur. The company's scale of operations is larger than Nexa and Minsur. However, Volcan historically has had a weaker capital structure and cost position.

The company's ratings reflect a competitive cost position, moderate scale, adequate liquidity and an expectation of net debt/EBITDA to remain below 2.5x over the next four years. Similar to peers, Volcan demonstrated a willingness and ability to reduce development and exploration expenditure during periods of lower commodity prices to preserve cash flow. The company's consolidated life of mine of eight years of reserves is on the lower end, when compared to Peruvian and its global mining peers.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer:

- Average zinc price of USD2,700/tonne in 2018, and USD2,400/tonne in 2019 and USD2,300/tonne in 2020;
- Average silver price of USD16.50/ounce (oz) in 2018, USD17.00/oz in 2019 and USD17.00/oz in 2020;
- Average lead price of USD2,264/tonne in 2018, USD2,246/tonne in 2019, and USD2,228/tonne in 2020;
- Average copper price of USD6,600/tonne in 2018, USD6,500/tonne in 2019 and USD6,800/tonne in 2020;
- Average gold price of USD1,200/oz in 2018 and thereafter;
- Mineral treatment of 8.3 million tonnes in 2018, 9.1 million tonnes in 2019 and 9.2 million tonnes in 2020.
- Capex level of USD225 million in 2018, USD190 million in 2019 and USD200 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.

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action
- Significant capex in projects during periods of low commodity prices, resulting in net leverage remaining elevated above 2.5x;
- An unfavorable change to Volcan's financial or operational strategies following the change in ownership to Glencore that is detrimental to the financial health of Volcan.

LIQUIDITY

Adequate Liquidity: Volcan's liquidity is adequate, and the company holds a comfortable cash position. Fitch-calculated liquidity was USD116 million of as of Sept. 30, 2018, while short-term debt was USD195 million, mainly consisting of short-term revolving credit lines for working capital purposes that are continuously repaid or rolled over.

Fitch restricts around USD30 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. 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 the following ratings:
Volcan Compania Minera S.A.A.
--Long-Term Foreign Currency IDR at 'BBB-';
--Long-Term 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.

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Applicable Criteria
Corporate Rating Criteria (pub. 23 Mar 2018)
https://www.fitchratings.com/site/re/10023785