FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades Volcan to 'BB'; Outlook Negative

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Fitch Ratings - Chicago - 08 Apr 2020: Fitch Ratings has downgraded Volcan Compania Minera S.A.A.'s Long-Term Foreign and Local-Currency Issuer Default Ratings (IDRs) to 'BB' from 'BBB-'; Volcan's IDRs are maintained on Outlook Negative. A full list of rating actions follows at the end of this release.

The downgrade is due the unfavorable environment for selling assets and raising cash through equity, created by the coronavirus pandemic, as well as the pressure placed upon the company's cash flow and liquidity from falling zinc prices and operational stoppages related to government measures to slow the spread of the virus. Prior to the crisis Volcan had intended to reduce its net debt through extraordinary measures such as selling non-core assets or pursuing equity sources in order to meaningfully improve its capital structure.

The Negative Outlook reflects heightened refinancing risks in the current environment. At the end of 2019, Volcan had USD34 million of cash and USD194 million of short-term debt as of Dec. 31, 2020. Fitch expects the company to roll over the majority of the debt with the aforementioned banks and some additional relationship banks. If this does not occur within the next four or five months, additional downgrades could occur.

KEY RATING DRIVERS

Deteriorating Cash Flow: The coronavirus pandemic is expected to create a rapid decline in Volcan's operating cash flow due to a collapse in zinc demand globally from weak industrial activity and auto sales, as well as new mining capacity. Volcan's position has been exacerbated by measures taken by the Peruvian government, which has led to the closure of its mines on March 16. There continues to be uncertainty whether the measures will be lifted on April 12 as scheduled, as well as the timing for which the company ramps up operations. Fitch used a price of USD1,900 per ton of zinc in 2020 and an expectation of 205,000 tons of zinc output for financial modeling purposes, which compare with USD2,539 per ton of zinc and 239,000 tons of output in 2019. Fitch expects Volcan's EBITDA to decline to approximately USD100 million in 2020 from USD189 million based upon these assumptions.

Elevated Refinancing Risk: Volcan had USD35 million of cash at the end of 2019 and USD194 million of USD782 million of total debt fall during 2020. Short term debt is concentrated in a USD17.5 million loan with Citibank, a USD60 million loan with Banco de Credito, and a USD110 million loan syndicated by Scotiabank. Fitch expects these relationship banks to roll over most of this debt. They may also be required to extend working capital to the company. If this does not occur in next four or five months, additional downgrades could occur.

Glencore Ownership: Fitch views Glencore's majority voting right ownership as a positive to Volcan, but the overall rating implication is a soft consideration for the company. Glencore has a very large scale of operations in the zinc market and has the ability to influence prices by curtailing other high-cost operations during times of suppressed prices. This was evident when Glencore mothballed around a third of its zinc output during the previous low zinc-price environment. Given the widespread impact upon the metals and mining industry and the impact upon Glencore's operations globally, support in the form of an equity contribution is not factored in the rating.

Asset Sales Headwinds: The coronavirus has increased elevated global uncertainty and skewed risks to the downside. Pursuing measures such as selling noncore assets remains challenging. Key assets that could be sold are the company's Volcan's approximate 20% stake in Polpaico, a Chilean cement producer, and its hydro assets. The company also owns a port project, which is not expected to be sold.

Cost Position Expected to Increase: The company's consolidated operations exhibited a reasonable cost position with a C1 cash cost net of by-products of USD1,400/metric ton (MT) for zinc during 2019, which falls in the third quartile of the global zinc cost curve. However cash cost is expected to increase due to lower production volumes and lower dilution of fixed costs, together with lower prices for Volcan's main byproducts. Volcan's cash cost position for 2019 was well below CRU's 90th percentile cash cost of around USD2,220/MT.

Weaker Zinc Fundamentals: Prior to the crisis, Fitch had forecast a downward trend for zinc prices for 2020 due to weak auto demand in China and Europe, and a projected increase in mine output of more than 5%. While disruptions will curtain the latter figure, auto demand is expected to contract by more than 10% globally.

DERIVATION SUMMARY

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 Resources Peru S.A. (NexaPeru: BBB-/Stable) and Minsur (BBB-/Negative), yet considerably smaller than higher rated miners Industrias Penoles S.A.B de C.V. (BBB/Stable) and Southern Copper Corporation (BBB+/Stable). Volcan has a weaker capital structure than these peers, as it did not use elevated prices in 2017 and 2018 to reduce debt or build cash. The company also has a much poorer liquidity position than its peers.

The company's ratings continue to reflect a competitive cost position and moderate scale, with its Negative Outlook focused on its weakened capital structure and lower liquidity. 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 also on the lower end, when compared with Peruvian and other global mining peers.

KEY ASSUMPTIONS

Average zinc price of USD1,900/tonne in 2020, and USD2,000/tonne in 2021 and USD2,000/tonne in 2022;

Average silver price of USD15.50/ounce (oz) for the whole projected period;

Lead prices at USD1,835/tonne in 2020, USD1,790/tonne in 2021, USD1,895/tonne in 2022,

Average copper price of USD5,300/tonne in 2020, USD5,800/tonne in 2021 and USD6,200/tonne in 2022;

Average gold price of USD1,400/oz in 2020; USD1,300/oz in 2021 and USD1,300/oz in 2022 thereafter;

Capex of USD150 million in 2020, USD190 million in both 2021 and 2022;

No assets sales or equity issuance;

Production is closed for six weeks;

Short-term debt with banks will be rolled over.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Refinancing the bank debt would lead to a stabilization of the rating;

Maintaining leverage at or below 3.0x through the cycle would also lead to rating stabilization.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

The inability to refinance its current maturities;

An inability to replenish reserves and resources, leading to significantly lower mine life at key operations;

An adverse change in the overall framework for mining projects in Peru, and if taxes and royalties turn punitive.

BEST/WORST CASE RATING SCENARIO

Best/Worst Case Rating Scenarios Non-Financial Corporate:

Ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Elevated Refinancing Risk: Volcan has a sizable large maturity profile due within the next 12 months. The collapse in zinc prices has further deteriorated this situation. As of year-end 2019, the company had availability of USD33 million while faces short term debt maturities of USD216 million.

As of Dec. 31, 2019, the company's total debt amounted to USD786 million (excluded operating leasing) from this amount USD570 million are in the long term and USD535 million corresponded to senior unsecured notes maturing in February 2022.

SUMMARY OF FINANCIAL ADJUSTMENTS

Excluded debt related to operating Leases

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
Volcan Compania Minera S.A.A.	LT IDR	BB	Downgrade
	LC LT IDR	BB	Downgrade
• senior unsecured	LT	BB	Downgrade

VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

Corporate Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Volcan Compania Minera S.A.A.	EU Endorsed

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