

RATING ACTION COMMENTARY

# Fitch Affirms Volcan at 'BB'; Revises Outlook to Positive

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Fitch Ratings - Chicago - 01 Feb 2021: Fitch Ratings has affirmed Volcan Compania Minera S.A.A.'s Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BB', as well as its unsecured notes due in 2022 at 'BB'. The Rating Outlook is revised to Positive from Negative.

In conjunction with these rating actions, Fitch has assigned a 'BB' rating to the company's proposed issuance of USD450 million notes due 2026. Proceeds from this issuance will be used to repay a portion of the company's 2022 notes as well as part of its syndicated bank loan. A full list of rating actions follows at the end of this release.

The rating affirmations reflect Fitch's expectation that Volcan will be able to successfully refinance its USD535 million notes due in 2022 due to the decision by the company to issue equity. They also reflect Fitch's expectation of a strong operating performance for Volcan during 2021 due to increased output and favorable commodity prices.

The Positive Outlook reflects Volcan's decision to raise USD400 million in equity, which is significantly higher than the USD200 million expectation Fitch previously factored into its 'BB' rating through a combination of asset sales or equity raises. An upgrade to 'BB+' of the aforementioned ratings is likely if the company successfully executes an issuance of this size.

## KEY RATING DRIVERS

**Favorable Pricing Environment:** A shortage of zinc concentrate developed during 2020 as zinc smelters continued to operate throughout the crisis, while mine supply declined by about 3.5% due to pandemic-related restrictions. The shortage of zinc concentrates in combination with strong demand for products produced by Volcan should lead to a favorable pricing environment during 2021. Key factors supporting demand for zinc, lead and silver are increasing auto production, the building of inventory levels by the State Reserve Bureau in China, massive amounts of fiscal and monetary stimulus globally, and optimism surrounding the vaccine rollouts.

**Improving Cash Flow:** Fitch expects Volcan's EBITDA to increase to USD294 million in 2021 from our forecast of USD150 million in 2020. Fitch's 2021 projection is based upon a conservative forecast price of USD2,350 per tonne for zinc in 2021, which is 10% below the 2021 forward price of USD2,607 per tonne, and 250,000 tonnes of zinc production. Volcan's mines were closed for more than two months during 2020 due to restrictions imposed by the Peruvian government to control the coronavirus pandemic, which resulted in the company producing less than 170,000 tonnes of zinc.

**Diminished Refinancing Risk:** Volcan is seeking to issue USD450 million in callable bonds and raise USD400 million in equity during 2021. The presence of Glencore in the company's capital structure, as well as the favorable outlook for zinc, make it highly likely that the company will be successful with these ventures. Proceeds from these capital market activities will be used to refinance the company's USD535 million bond that falls due in 2022, reduce the company bank debt, and to fund capex related to the Romina expansion in its Alpacamarca mining unit.

**Glencore Ownership:** Volcan's ratings have not been uplifted from its standalone credit profile due to Glencore's majority voting rights. Glencore's 55% voting and 22% economic stakes in the company is a positive consideration, however, as it enhances Volcan's ability to receive financing from various sources. Glencore is a leading producer of zinc and has curtailed

the operations of its higher cost mines, which has supported prices, during times of suppressed prices. Volcan is considered a key asset by Glencore due to its low-cost zinc operations, as well as its extensive mining rights within Peru.

**Competitive Cost Position:** Due to operational disruptions the company's cash cost of production was distorted during 2020 due to lower production volumes and lower dilution of fixed costs, together with lower prices for Volcan's main by-products. The company's consolidated operations exhibited a reasonable cost position with a C1 cash cost net of by-products of USD1,400/metric tonne for zinc during 2019, which fell within the third quartile of the global zinc cost curve.

**Asset Sales Headwinds:** Pursuing measures such as selling noncore assets remains challenging. Key assets that could be sold are 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. Assets disposals may be used as a contingent source of cash should the company not succeed with its bond issuance and/or equity offering.

## **DERIVATION SUMMARY**

Volcan benefits from a fairly diversified production of base and precious metals, similar to peers Compania de Minas Buenaventura S.A.A. (BB+/Stable) and Nexa Resources Peru S.A.A. (BBB-/Negative), and is more diversified than Minsur S.A. (BBB-/Negative). The company's scale of operations is larger than Nexa Resources Peru and Minsur, yet considerably smaller than higher-rated miners such as Industrias Penoles S.A.B. de CV (BBB/Stable) and Southern Copper Corporation (SCC; 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 Positive Outlook focused on the company's decision to raise USD400 million in equity, which is significantly higher than previously anticipated amid an improved operational environment. 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 four years of reserves is also on the lower end, when compared with Peruvian and other global mining peers.

## KEY ASSUMPTIONS

Average zinc price of USD2,350/tonne in 2021, USD2,000/tonne in 2022 and USD2,100/tonne thereafter;

Average silver price of USD20.00/oz in 2021, and USD17/oz in 2022 and thereafter;

Average lead prices of USD2,100/tonne in 2021, and thereafter;

Capex of USD210 million, USD260 million, USD300 million in 2021, 2022, and 2023;

Zinc output of 250,000 MT, 280,000 MT and 300,000 MT in 2021, 2022 and 2023. Silver output of 18 million oz, 13 million oz, and 16 million oz in 2021, 2022, and 2023;

Yauli's zinc and silver production rise more than 50% and 80% while mineral treated rises 40% in 2021 due to better grades. Programmed Silver Oxides plant stoppage expected in 2022;

Equity issuance of USD 400 million in 2021; no asset sales;

Debt issuance of USD 450 million five-year senior unsecured debt in 2021, loan agreement of USD125 million in 2022; USD535 million in 2022 bonds and short-term debt with banks will be repaid.

## RATING SENSITIVITIES

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

--Fitch would upgrade Volcan's rating if the proposed equity raise successfully reaches USD400 million and uses proceeds to lower gross debt to below USD700 million.

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

--The failure to raise at least USD200 million in equity;

--An inability to issue a new bond during 2021 that would allow the company to prepay at least USD300 million of its bond due in 2022 during the first half of 2021.

### **BEST/WORST CASE RATING SCENARIO**

International scale credit 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, visit <https://www.fitchratings.com/site/re/10111579>.

### **LIQUIDITY AND DEBT STRUCTURE**

Skewed Maturity Profile: Volcan has a sizable portion of its total debt maturing in the next 18 months. The company had USD98 million of cash and marketable securities as of Sept 30, 2020. This compares with USD893 million of total debt. Refinancing risk is high due to the maturity of a USD300 million syndicated loan in January 2022 and a USD535 million bond in February 2022.

Refinancing Plan Lowers Risk: Volcan plans to issue USD450 million of five-year callable bonds in 2021 and to raise USD400 million of equity. Proceeds from these activities will be used to repay the bond due in 2022, lower bank debt, and fund capex.

Key investments for the company are related to improved mining plans at Yauli, its largest mining unit, and improving production at Alpamarca through the Romina expansion.

## SUMMARY OF FINANCIAL ADJUSTMENTS

Excluded debt related to operating leases.

## SOURCES OF INFORMATION

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

## 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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg)

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## RATING ACTIONS

ENTITY/DEBT

RATING

PRIOR



ENTITY/DEBT	RATING			PRIOR
Volcan Compania Minera S.A.A.	LT IDR	BB Rating Outlook Positive	Affirmed	BB Rating Outlook Negative
	LC LT IDR	BB Rating Outlook Positive	Affirmed	BB Rating Outlook Negative
● senior unsecured	LT	BB	Affirmed	BB
● senior unsecured	LT	BB	New Rating	

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## **APPLICABLE CRITERIA**

[Corporate Rating Criteria \(pub. 21 Dec 2020\) \(including rating assumption sensitivity\)](#)

## **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)

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