

Fitch Affirms Volcan at 'BB'; Outlook Revised to Stable

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 senior unsecured notes due in 2026 at 'BB'. The Rating Outlook was revised to Stable from Positive.

The ratings affirmation and revised outlook reflects Fitch's expectation that the company's leverage profile and liquidity will remain flat. The rating case no longer considers an equity raise of USD400 million from its shareholders and/or divestment of assets over the rated horizon. The company's cash flow profile is expected to remain strong with FFO estimated to average about 30% over the rated horizon, which will cover its capex requirements and upcoming maturities, but it will not boost its liquidity position and net leverage profile in line with a higher rating.

KEY RATING DRIVERS

Supportive Zinc Prices: High energy costs continue to exert pressure on zinc smelters sustaining a bottleneck in the refined market. According to metals and mining consultancy CRU, the refined market will continue to be in a 183,000 MT deficit during 2022 and be tight during 2023. Along with depleting inventories, zinc prices have reached levels of USD4,460/MT in 1Q22. Global slowdown concerns and growing concentrates linger over the zinc price but Fitch still considers a historically high average of USD3,500/MT in 2022 before a multiyear downtrend resumes towards USD2,100/MT in the rated horizon.

Cash Flow Generation: Fitch forecasts Volcan's EBITDA to be USD375 million in 2022, supported by high prices in 1H22 and stable operations. FFO is expected to be more than USD320 million, from USD260 million in 2021, enough to cover capex needs of USD260 million from USD175 million in 2021 while dividends remain suspended. Strong cash flow will allow Volcan to self-finance low capital-intensive expansion programs. This includes improving operations at Yauli, its largest mining unit, and building the Romina expansion in Alparmarca, which together are expected to cost USD50 million in 2022.

Improving leverage profile: Volcan issued USD475 million of 2026 bonds, of which it later repaid USD110 million seizing high zinc prices. It also obtained a USD400 million syndicate loan to pay its USD410 million bond outstanding due in early 2022. As a result, Fitch projects gross leverage to be higher than USD760 million in 2022, down from USD913 million in 2021 year-end, and remain relatively flat. Gross and net leverage EBITDA ratios are expected to average 2.5x and 2.1x, respectively, between 2022 and 2024.

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 zinc operations footprint, cost position, and its extensive mining rights within Peru.

Pressured Cost Position: Recent inflationary pressures on steel, oil, freights, explosives, chemical reagents and wages have prevented Volcan to improve its cost position. It started to deteriorate during the 2020 government mandated closures amid the coronavirus crisis in Peru. Volcan's cost structure remains in the third quartile of the global zinc all-in sustaining cost curve, according to metals consultancy CRU. The company is working on streamlining its operations while it also fosters exploration efforts at approximately USD40 million to improve its approximately four years of life of mine.

Potential Asset Sales: Noncore assets sales could be considered to repay debt. Key assets that could be sold are Volcan's approximate 16% stake in Polpaico, a Chilean cement producer, and its hydro power plants. The company also owns a port project 50 miles north of Lima, which has recently waived constraints for a potential disposal. Assets divestitures may be used as a contingent source of cash should the company not succeed with its 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 S.A. (BBB-/Stable), and is more diversified than Minsur S.A. (BBB-/Stable).

The company's scale of operations is comparable albeit lower than that of Nexa Resources and Minsur, and considerably smaller than that of 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 weaker liquidity position than its peers.

Volcan's cost position has been under pressure by cost inflation along with those of moderate scale peers. 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 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

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

- Average zinc price of USD3,500/tonne in 2022, USD3,000/tonne in 2023 and USD2,500/tonne in 2024.
- Average silver price of USD22.50/oz in 2022, USD20/oz in 2023, and USD17.5/oz in 2024.
- Average lead prices of USD2,700/tonne in 2022, USD2,300/tonne in 2023, and USD1,900/tonne in 2024.
- Average copper price of USD9,500/tonne in 2022, USD8,500/tonne in 2023, and USD7,500/tonne in 2024.
- Capex of USD260 million, USD300 million and USD215 million in 2022, 2023, and 2024.
- Zinc output of 247,000 MT, 266,000 MT and 283,000 MT in 2022, 2023 and 2024.
- Silver output of 10.3 million oz, 11.4 million oz, and 11.6 million oz in 2022, 2023, and 2024.
- Yauli's zinc and silver production rise 18% and falls 11%, respectively in 2022. Yauli is expected to contribute with 62% of revenues in 2022

RATING SENSITIVITIES

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

- A sustained net debt/EBITDA ratio of less than 2.0x in a sustained basis;
- Positive to neutral FCF over the rating horizon;
- Improved liquidity through asset sales or equity injection.

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

- A sustained net debt/EBITDA ratio of more than 3.0x with an unwillingness or inability to deleverage;
- Negative FCF over the rating horizon

LIQUIDITY

Volcan ended March 31st, 2022 with USD226 million of readily available cash and equivalents and about USD19 million of short-term debt. Volcan extended its maturities to 2026 with a USD475 million issuance in February 2021, used to pay down syndicate and fund capex, and obtained a USD400 million syndicated loan to fund the USD410 million outstanding pay of its 2022 bonds. After its liability management exercises, Volcan ended March 31st 2022 with total debt of USD887 million. During the 2Q22 it paid down an additional USD110 million of the 2026 bonds, which have an outstanding of USD365 million.

FULL LIST OF RATING ACTIONS

Fitch has taken the following rating actions:

Volcan S.A.

- Affirm LT LC and FC IDR at 'BB'
- Affirm senior unsecured debt Rating at 'BB'
- Change Outlook to Stable

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Summary of Financial Statement Adjustments –Described in the applicable criteria.

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.

ESG Considerations

Volcan has an ESG Relevance Score of '4' for Waste & Hazardous Materials Management; Ecological Impacts due to its zinc concentrate leak. In June 2022, a truck careened off the road spilling 30 million tonnes of zinc concentrates in the Chillan river. Although cleaning works have concluded, reparations and potential fines are pending to be defined. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3' — 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 our ESG Relevance Scores, visit www.fitchratings.com/esg.