FitchRatings

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Fitch Downgrades Volcan to 'B+'; Outlook Stable

Fitch Ratings - New York - 11 Apr 2023: Fitch Ratings has downgraded Volcan Compania Minera S.A.A.'s Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to 'B+' from 'BB', as well as its senior unsecured notes due in 2026 to 'B+' from 'BB'. The Rating Outlook is Stable.

The ratings downgrade reflects Fitch's expectation that the company's gross and net leverage ratios will rise to an average of 4.0x and 3.2x, respectively, over the rated horizon. The higher leverage is due to higher costs and production volumes below previously projected levels amidst a backdrop of falling prices and capital expenditures that will be needed to sustain volumes. Resulting negative free cash flow will need additional borrowing at less favorable terms than historically obtained.

Volcan's rating was not supported by Glencore's ownership stake in the company. Glencore's decision to sell its stake in the company could have implications for Change of Control Clauses in lending documents that could result in additional refinancing risk for Volcan.

Key Rating Drivers

Lower Production: Volcan's output has been below Fitch's expectations over the last two years, as the 2020 coronavirus pandemic resulted in investment cuts and operational hardships that affected mine plans. The Yauli operation (58% of sales in 2022) has faced difficulties to access newly discovered higher-grade areas while the Chungar operation (20% of sales in 2022) has been grappling with narrower veins. Fitch has adjusted downward Volcan's forecast production to an average of 410,000 MT zinc equivalent between 2023 and 2025 from 460,000 MT zinc equivalent, previously.

Weakening Zinc Prices: Decreasing energy costs have started to ease their sway in the zinc smelting and refining market. The zinc refined market will be in a 39,000 MT deficit during 2023, according to metals and mining consultancy CRU. This figure represents less than 0.5% of zinc production, while global concentrate surplus will reach 112,000 MT. Fitch expects this downward pressure to lower zinc prices to an average of USD3,000/MT in 2023 from USD3,527/MT in 2022 and toward USD2,100/MT in the long term.

High Cost: Volcan's cost structure reached the fourth quartile of the global zinc all-in sustaining cost curve in 2022, with a weighted average of USD2,540/MT Zinc, including byproducts according to metals consultancy CRU. CRU finds the largest unit cost increase between 2019 and 2022 in the Chungar mine (70%) followed by that in the Yauli operation (30%) driven mostly by energy and consumables expenses.

Low Mine Life: Volcan is working to improve mine life in reserves from approximately five years, which is consistent with the 'B' rating category. The company's Romina expansion has the potential to improve its reserve profile. Without it and other brownfield or greenfield developments, Volcan's reserves would be consistent with the 'CCC' rating category given its declining grades with little prospects of a turnaround.

Cash Flow Generation: Fitch forecasts Volcan's EBITDA at USD285 million in 2023 from almost USD300 million in 2022. Capital expenditures are expected to be USD240 million in 2023, up from USD222 million in 2022, but below the USD300 million previously expected as delays in the Romina expansion in Alpamarca will postpone investment into 2024. Volcan's FCF is expected to remain negative under Fitch's conservative price deck projections.

Weak Credit Ratios: Fitch projects gross leverage to average over USD1 billion between 2023 and 2025, up from USD790 million in YE 2022. This includes debt financing of the Romina related capital expenditures of USD50 million in 2023 and USD80 million in 2024, partial refinancing of the syndicate loan installment payments and an additional buffer stemming from reduced flexibility due to higher costs. Fitch expects gross and net leverage EBITDA ratios to average 4.0x and 3.2x, respectively, between 2023 and 2025. EBITDA to interest expense is expected to weaken to an average of 3.7x between 2023-2025 and fall to below 2.0x in 2026.

Glencore's Exit: Glencore's publicly stated intention to sell its 55% voting and 22% economic stakes in the company does not affect Fitch's rating of Volcan. Fitch was not considering further financing, or operational support from Glencore. However, this process casts doubt on Volcan's ability to promptly develop its extensive mining rights. More generally, it also underscores a perceived higher risk toward mining development in Peru amid recent escalations of violence against mining operations in the country. Fitch will assess the implications of the change of control when more information about the new controller becomes available.

Asset Sales: Divestitures from non-core assets may be used as a contingent source of cash for debt repayment. Assets more likely to be sold include Volcan's approximately 16% stake in Polpaico, a Chilean cement producer, and its hydro power plants. Fitch does not expect the 40% stake in the Chancay port project, located 50 miles north of Lima, to be considered for a near-term disposal before the construction finishes in late 2024.

Derivation Summary

Volcan's production of base and precious metals diversification is higher than that of peers Ero Copper Corp (B/Stable), Aris Mining Corp (B+/Stable), Nexa Resources SA (BBB-/Stable), and Minsur SA (BBB-/Positive), similar to that of Compania de Minas Buenaventura SAA (BB-/Stable), but lower than that of Industrias Penoles SAB de CV (BBB/Stable). Volcan operates in one country (Peru), like Buenaventura, or Penoles (Mexico), Ero (Brazil) and Aris (Colombia) whereas Nexa and Minsur have diversified into Peru and Brazil.

Volcan's scale of operations is higher than that of Ero and Aris, similar to that of Buenaventura, but lower than that of Nexa Resources and Minsur, and considerably smaller than that of higher-rated miner Penoles.

Fitch projects that Volcan will have a weaker capital structure and liquidity than these peers. Its 4.0x and 3.2x gross and net EBITDA leverage compares with Buenaventura's 3.9x and 2.6x. Both trail behind Aris' 2.5x and 1.7x or Ero's 2.0x and 1.5x.

Volcan's cost position in the fourth quartile of the zinc all-in sustaining costs is similar to that of Buenaventura's fourth quartile in the gold curve, but worse than Aris Mining's third in gold or Ero Copper's second in copper.

Volcan's consolidated life of mine of five years of reserves is also on the lower end, and is comparable with that of Buenaventura or Aris Mining's four years but lower than Ero's 17 years.

Key Assumptions

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

--Average zinc price of USD3,000/tonne in 2023, USD2,500/tonne in 2024 and USD2,200/tonne in 2025;

--Average silver price of USD21.25/oz in 2023, USD20/oz in 2024, and USD20/oz in 2025;

--Average lead prices of USD2,100/tonne in 2023, USD1,900/tonne in 2024, and USD1,800/tonne in 2025;

--Capex of USD240 million, USD272 million and USD192 million in 2023, 2024, and 2025;

--Zinc output of 243,000 MT, 260,000 MT and 264,000 MT in 2023, 2024 and 2025;

--Silver output of 13.4 million oz, 12.0 million oz, and 11.6 million oz in 2023, 2024, and 2025;

--Yauli's zinc and silver production rise 9% and 4%, respectively in 2023. Fitch expects Yauli to contribute 60% of revenues in 2023;

--Romina is expected to achieve full production in late 2024. Fitch expects the resulting Alpamarca, with the Romina expansion, to contribute 10% of revenues in 2025.

RATING SENSITIVITIES

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

--A sustained gross debt/EBITDA ratio of less than 3.5x in a sustained basis;

--A sustained net debt/EBITDA ratio of less than 3.0x 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 gross debt/EBITDA ratio of more than 4.5x with an unwillingness or inability to deleverage;

--A sustained net debt/EBITDA ratio of more than 4.0x with an unwillingness or inability to deleverage;

--Negative FCF over the rating horizon;

--EBITDA to interest expense coverage ratio consistently below 2.0x.

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

Pressured Liquidity: Volcan ended 2022 with USD74 million of readily available cash and equivalents and about USD785 million in total debt. Volcan's outstanding USD365 million of bonds mature in 2026. Its USD400 million syndicate loan matures in 2026 with payments starting in 2024.

Volcan's liquidity position is pressed to finance capex for Romina and to refinance the approximately USD103 million and USD137 million 2024 and 2025 installments of its syndicate loan. Fitch expects that all maturing debt will be refinanced.

Issuer Profile

Volcan is a polymetallic mining company with a fourth quartile cost position on the global zinc cost curve per CRU. It has a track record over 75 years of operating in Peru. Volcan is diversified into the base metals zinc and lead and the precious metal silver.

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

Volcan Compania Minera S.A.A. 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 tonnes of zinc concentrates in the Chillon river. This has a negative impact on the credit profile, and is relevant to the rating[s] in conjunction with other factors.

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.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Volcan Compania Minera S.A.A.	LT IDR	B+	Downgrade		BB
	LC LT IDR	B+	Downgrade		BB
• senior	LT	B+	Downgrade		BB

ENTITY/DEBT	RATING	RECOVERY	PRIOR
unsecured			

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	◎	◆
STABLE	◎	

Applicable Criteria

Corporate Rating Criteria (pub.28 Oct 2022) (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), v8.1.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

Volcan Compania Minera S.A.A.	EU Endorsed, UK Endorsed

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