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## Fitch Downgrades Volcan to 'B-'; Places on Rating Watch Negative

Fitch Ratings - New York - 04 Oct 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 'B+', as well as its senior unsecured notes due in 2026 to 'B-' from 'B+' and an 'RR4' Recovery Rating has been assigned. The ratings have been placed on Rating Watch Negative.

The ratings downgrade is driven by increased liquidity pressure amid recent governance concerns that could thwart Volcan's ability to refinance in a timely manner while pressure mounts on FCF generation from low zinc prices, high costs and capital expenditure needs to sustain volumes.

The Negative Watch reflects the challenges Volcan faces completing its refinancing strategy and pursuing additional alternatives to raise cash in the next two quarters in order to avoid further negative rating actions.

### Key Rating Drivers

**Governance Concerns:** The misalignment of priorities between Volcan's majority shareholder, Glencore, and minorities, such as Peruvian Pension Funds and the Picasso and Letts families, became apparent after the general shareholder agreement to spinoff the Chancay port development, which prompted high profile board and management changes. Although initial concerns about short-term control have seemingly subsided, the impact of these and further discrepancies on asset sales, liquidity facilities or liability management might affect the company's financial flexibility. Volcan called for a new general shareholder meeting for October 23rd to vote for board changes.

**Heightened Refinancing Risk:** Given scant cash availability and negative FCF, Volcan is hard pressed to meet upcoming debt maturities in 2024. These consist of three USD35 million quarterly amortizations starting in 2Q24 totaling USD105 million of a bank syndicate. The company signed preliminary offtake agreements for concentrates sales prepayments for up to USD25 million and continues to evaluate other options, including asset sales. As of June 30 2023, Volcan had USD50 million of cash. In addition, its revolving credit facility of USD50 million ends in November 2023.

**Asset Sales:** Divestitures from non-core assets may be used as a contingent source of cash for capex financing and 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 has not considered the disposal of the now spun-off Chancay port project. The final outcome and timing of these transactions remains uncertain.

**Negative FCF:** Fitch forecasts Volcan's EBITDA at USD235 million in 2023 from almost USD300 million in 2022. Capital expenditures are expected to be USD190 million in 2023, down from USD222 million in 2022, but below previous expectations of USD240 million as investments are decreased and most of the Romina expansion in Alpamarca is postponed into 2024. Volcan's FCF is expected to be marginally positive in 2023 and turn negative by USD55 million in 2024 after these changes.

**Challenging Operations:** Zinc prices plummeted as the market balance swung into a surplus, while Volcan slowly improves cost metrics and weighs an expansion project to tackle short mine lives of about five years. 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. While the unit cost in 1H23 is 5% lower than in 2022, it remains 12% higher than in 2019.

**Moderate Leverage:** Fitch expects gross and net leverage EBITDA ratios to average 3.8x and 3.3x, respectively, between 2023 and 2025. EBITDA to interest expense is expected to weaken to an average of 4.7x between 2023-2025 and fall to below 2.0x in 2026. Gross leverage is forecast to average about USD900 million between 2023 and 2025, up from USD790 million in YE 2022. This includes debt financing of the Romina related capital expenditures of USD12 million in 2023, USD65 million in 2024 and USD63 million in 2025, partial refinancing of the syndicate loan installment payments and an additional buffer stemming from reduced flexibility due to higher costs.

**Glencore's Exit:** Glencore's publicly stated intention to sell its 55% voting and 22% economic stakes in the company does not affect Volcan's rating. Fitch has not considered further financing, or operational support from Glencore. However, this could have implications for Change of Control Clauses in lending documents that might result in additional refinancing risk for Volcan. Furthermore, this process casts doubt on Volcan's ability to promptly develop its extensive mining rights.

ESG - Governance Structure: Volcan Compania Minera S.A.A.'s dynamics between its shareholders, Glencore and minority shareholders, such as Picasso and Letts family, impact their ability to address the company's capitalization needs.

## 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 3.8x

and 3.3x 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 USD2,600/tonne in 2023, USD2,500/tonne in 2024 and USD2,300/tonne in 2025;

--Average silver price of USD23.75/oz in 2023, USD22.5/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 USD192 million, USD250 million and USD250 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 2025. Fitch expects the resulting Alpamarca, with the Romina expansion, to contribute 10% of revenues in 2026.

## **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;

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

--Failure to improve liquidity through asset sales or alternative options.

--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.

## Liquidity and Debt Structure

**Pressured Liquidity:** Volcan had USD50 million of readily available cash and equivalents in June 30th, 2023 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 USD105 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 '5' for Governance Structure due to the dynamics between its shareholders, Glencore and minority shareholders, such as Picasso and Letts family, that impact their ability to address the company's capitalization needs.

Volcan Compania Minera S.A.A. has an ESG Relevance Score of '4' for Management Strategy due to ongoing governance concerns, which have impaired management's ability to execute on its strategy, which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

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 Chillón river. This has a negative impact on the credit profile, and is relevant to the rating[s] in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG

Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit <https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

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## Rating Actions

ENTITY/DEBT	RATING		RECOVERY	PRIOR
Volcan Compania Minera S.A.A.	LT IDR	B- 	Downgrade	B+ 
	LC LT IDR	B- 	Downgrade	B+ 
• senior unsecured	LT	B- 	Downgrade	RR4 B+

## RATINGS KEY OUTLOOK WATCH

POSITIVE	⊕	◊
NEGATIVE	⊖	◊
EVOLVING	◊	◆
STABLE	○	

### Applicable Criteria

[Climate Vulnerability in Corporate Ratings Criteria \(pub.21 Jul 2023\) \(including rating assumption sensitivity\)](#)

[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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