FitchRatings

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Fitch Upgrades Volcan to 'CCC+'; Assigns Expected 'B-(EXP)' Rating to New Proposed Secured Issuance

Fitch Ratings - New York - 05 Aug 2024: Fitch Ratings has upgraded Volcan Compania Minera S.A.A.'s (Volcan) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to 'CCC+' from 'CC'. Fitch has also upgraded Volcan's senior unsecured notes due in 2026 to 'CCC-'/'RR6' from 'CC'/'RR4' and assigned a rating of 'B-(EXP)'/RR4' to the new senior secured notes due 2030.

The upgrades reflect Volcan's improved debt profile following the conclusion of its 2026 term loan refinancing, which pushed amortizations to start in 2025 and final maturity to 2029.

The expected 'B-' rating to the proposed exchange offer reflects significant reduction in Volcan's refinancing risks, with no major debt due until 2029. The company's moderate financial flexibility following these recent refinancing efforts and execution risk on its crucial investment plan to expand its Romina operations remain rating constraints.

If the proposed tender offer is successfully completed, the IDR will be upgraded to 'B-', and any remaining existing unsecured bonds will be upgraded to 'CCC'/'RR6'.

Key Rating Drivers

Exchange Offer Overview: Volcan has entered into a transaction support agreement with an ad hoc group of note holders, representing approximately 36.3% of the existing 2026 USD365 million notes and has accomplished refinancing with all of its syndicate lenders. The exchange offers consist of the 4.375% senior notes due 2026 for the expected 8.75% senior secured second out notes due 2030. The new senior secured notes and senior secured syndicate loan will be secured by a collateral package, including trusts over receivables, over shares of subsidiaries and mortgages over material assets.

Not Considered a DDE: Fitch does not consider the exchange as a distressed debt exchange (DDE) since, at this time, it is not deemed to have been done to avoid a default. No immediate debt haircut will occur but a maturity extension and structural subordination for bondholders that do not accept the deal due to the larger secured debt profile as well as the elimination of some restrictive covenants deteriorate the debt agreement terms. Fitch assesses that Volcan's current cash flow generation, including improving operations, recovering market conditions, asset sale proceeds and postponed maturities allow the company to support its financial obligations.

Improvement on Refinancing Risk: Volcan's loan syndicate was refinanced diminishing annual installments and postponing maturities; one quarterly installment of the old syndicate, of about USD35 million, was paid in 2024 and deducted from the new secured loan. The 2026 bonds refinancing would provide further relief on Volcan's debt schedule amortization. The new secured syndicate loan is due on 2029 and the new secured bonds are due on 2030.

Asset Sales and Other Financing Advance: Signed hydro power plant's sales for USD78.5 million, of which USD31.70 million already became cash proceeds, and metals concentrate prepaid sales for USD25 million, add to the USD68 million cash available on June 30, 2024 to bolster Volcan's cash position. No additional asset sales are considered in Fitch's rating case given the uncertain timeframe and final value of expected transactions. According to Fitch, contemplated disposals would total about USD70 million from Volcan's 16% stake in Cementos Polpaico in Chile and from its land package near the Chancay port under development.

Additional Financing Needed to Build Romina: Romina requires USD125 million in remaining capex and could add 75,000 of zinc equivalent MT/year. Romina is a zinc, lead, silver deposit located in the Lima province, 15 km from the Alpamarca operation, which is depleting in 2024. Romina could use Alpamarca's camp sites, tailings dam and concentrator plant to speed up ramp up through 2H26. An environmental study modification is pending but it operates in a region familiar with mining activities. Fitch expects Romina to contribute with 9% of revenue in 2026 and 15% on 2027.

FCF Pressured by Investments: EBITDA is expected to reach about USD270 million as recent price increases help offset operational mishaps amid continued albeit slow streamlining efforts. Capex is expected to increase to more than USD200 million in 2024 and more than USD260 million in 2025 as the construction of Romina takes place. Capex is expected to average about 29% of revenue over the next three years, compared to 20% in the three previous years. Given no dividend payments expected, FCF is expected to turn marginally negative in 2024 and remain so in 2025 due to higher capex needs and weaker expected zinc prices.

Operating Challenges Continue: Zinc prices start to increase from depressed levels as focus shifts to mine supply from smelter limitations because of global mine cutbacks. However, demand remains feeble and CRU, the business intelligence consultancy, expects new supply to reach the market in 2025 and 2026. The Yauli unit's approximately one-month partial stoppage will likely affect Volcan's streamlining efforts. Cost containment strategies were slowly delivering, prior to the stoppage, as evidenced by unit cost improvements although it remains higher than in 2019. Volcan postponed the Romina expansion one year, this project helps address short mine lives of about five years, and will contribute to cash flows in 2026.

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 similar to that of Compania de Minas Buenaventura SAA (BB-/Stable) or Minsur SA (BBB-/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 3.5x and 3.2x gross and net EBITDA leverage compares poorly with Minsur's 1.2x and 0.8x, Buenaventura's 2.2x and 1.7x, Nexa's 2.9x and 2.1x. Volcan also trails behind similarly rated Aris' 2.0x and 1.3x or Ero's 1.6x and 1.2x.

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

Volcan's consolidated life of mine of five years of reserves is also on the lower end, and is comparable with that of another underground miners, such as Buenaventura without considering its stake in large and long-lived Cerro Verde copper mine. Volcan's mine life is lower than Aris Mining's 18 years and Ero's 17 years.

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Key Assumptions

--Average zinc price of USD2,700/tonne in 2024, USD2,500/tonne in 2025 and USD2,300/tonne in 2026;

--Average silver price of USD25/oz in 2024, USD23.75/oz in 2025, and USD21.25/oz in 2026;

--Zinc output of 233,000 MT, 241,000 MT and 251,000 MT in 2024, 2025 and 2026;

--Silver output of 13.1 million oz, 11.8 million oz, and 13.8 million oz in 2024, 2025, and 2026;

--Yauli's zinc and silver production falls 6% and 21%, respectively in 2024, and rises 7% and 6% in 2025. Fitch expects Yauli to contribute 60% of revenues in 2024;

--Romina is expected to start operations in mid-2026 and achieve full production in 2027. Fitch expects Romina expansion, to contribute 9% of revenues in 2026 and 15% in 2027;

--Capex of USD205 million, USD265 million and USD240 million in 2024, 2025, and 2026;

--No dividends;

--No additional asset sales;

--Loan syndicate is refinanced and bond exchange offer has 90% acceptance, Romina requires external financing for USD125 million.

Recovery Analysis

Going-Concern Approach

The recovery analysis assumes that Volcan would be considered a going concern in an event of bankruptcy and that the company would be reorganized rather than liquidated. Fitch has assumed a 10% administrative claim. Volcan's going concern EBITDA assumption is based on zinc at USD2,400/ton and USD2,400/ton in 2024 and 2025, respectively. The going concern EBITDA estimate reflects Fitch's view of a sustainable, post-reorganization EBITDA level upon which it bases the enterprise valuation in a low zinc price environment.

An enterprise valuation multiple of 5x EBITDA is applied to the going concern EBITDA to calculate a post-reorganization enterprise value. The choice of this multiple considered the following factors: the historical bankruptcy case study exit multiples for peer companies were 4.0x-6.0x, improving financial subfactors, mid quality assets, and high-quality counterparties despite challenging dynamics in a volatile and commoditized industry.

Fitch applies a waterfall analysis to the post-default enterprise valuation based on the relative claims of debt in the capital structure. The debt waterfall assumptions consider the company's proforma debt following refinancing and debt exchange as well as the debt funded capex for Romina.

These assumptions result in a recovery rate for the first-lien secured bonds within the 'RR1' range, but due to the soft cap of Peru at 'RR4', Volcan's senior secured notes are expected to be rated at 'B-'/'RR4'. For the unsecured notes, the recovery is within the RR6 range, therefore results in a rating downgrade from the IDR, being rated at 'CCC-'/'RR6'.

RATING SENSITIVITIES

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

--If the proposed tender offer is successfully completed, the IDR will be upgraded to 'B-'.

Further rating upgrades would depend on:

--Positive to neutral FCF over the rating horizon;

--EBITDA to interest expense coverage ratio consistently above 5.0x;

--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.

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

--Failure to refinance notes at least 12 months in advance.

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

--Negative FCF over the rating horizon;

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

--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.

Liquidity and Debt Structure

Refinancing Efforts Improve Debt Profile: Volcan had USD68 million of readily available cash and equivalents and about USD790 million in total debt in June 30, 2024. Debt was mostly comprised of USD365 million syndicate loan maturing in 2026 with payments starting in 2024 and a USD365 million bonds maturing in 2026.

The recently refinanced USD400 million secured syndicate loan replaces the previous unsecured one. One of the quarterly amortizations, of about USD35 million, from the previous loan was paid and will be deducted from the new syndicate loan. Installments of USD10 million, USD20 million, USD25 million and USD35 million are due on 2025, 2026, 2027 and 2028, with the rest maturing in 2029.

The new secured bond would be due in 2030 and the bond offer targets to exchange the USD365 million unsecured bond due in 2026. The collateral package for the loan and the bond ranks both pari passu with the same claims over trusts over receivables, over shares of subsidiaries and mortgages over material assets.

Volcan's liquidity position is hard pressed to finance the USD125 million in capex for Romina in 2024 and in 2025. Hydro power plant's sales for USD78.5 million and metals concentrate prepaid sales for USD25 million add to the USD68 million cash available on June 30, 2024. Additional asset sales or offtake agreements could be negotiated. However, these processes entail uncertain timing and final proceeds. Thus, they are not considered in Fitch's rating case.

Issuer Profile

Volcan is a polymetallic mining company with a third quartile cost position on the global zinc cost curve per CRU. It has operated in Peru for over 75 years. Volcan is diversified into the base metals zinc and lead, and 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 Governance Structure due to the dynamics between its shareholders, particularly with 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 Chillon 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	LT IDR	CCC+	Upgrade		CC

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Minera S.A.A.					
	LC LT IDR	CCC+	Upgrade		CC
• senior unsecured	LT	CCC-	Upgrade	RR6	CC
• senior secured	LT	B-(EXP)	Expected Rating	RR4	

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Corporate Rating Criteria (pub.03 Nov 2023) (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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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch’s website.

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