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Fitch Upgrades Volcan IDRs to 'B-'; Outlook Stable

Fitch Ratings - New York - 11 Sep 2024: Fitch Ratings has upgraded Volcan Compania Minera S.A.A.'s Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to 'B-' from 'CCC+'. Fitch has also assigned final 'B-/RR4' ratings to Volcan's new senior secured notes due 2030. Additionally, Fitch has upgraded Volcan's remaining senior unsecured notes due in 2026 to 'CCC-/RR6' from 'CCC-/RR6'. The Rating Outlook is Stable.

The upgrades reflect significant reduction in Volcan's refinancing risks, with no major debt due until 2029 following the successful conclusion of its bond exchange offer with an acceptance rate of more than 80%. Furthermore, Volcan has recently improved its debt profile with its term loan refinancing, which postponed amortizations to start in 2025 and final maturity to 2029. The company's execution risk on its critical investment plan to expand its Romina operations and its moderate financial flexibility following these recent refinancing efforts remain rating constraints.

Key Rating Drivers

Exchange Offer Completion: Volcan has accomplished the refinancing of most of the 2026 notes and of all of its syndicate loan. Approximately 81.37% of the existing USD365 million 4.375% senior notes due 2026 noteholders have accepted the exchange offer for 8.75% senior secured notes due 2030. Volcan waived the minimum participation condition of 90% to conclude and settle the transaction. The new senior secured notes and senior secured syndicate loan are secured by a collateral package, including trusts over receivables, over shares of subsidiaries and mortgages over material assets.

Lowered Refinancing Risk: Fitch assesses that Volcan's current cash flow generation, including improving operations, recovering market conditions, asset sale proceeds and postponed maturities, allows the company to support its financial obligations. Most of Volcan's 2026 bonds were exchanged for 2030 notes. The company refinanced its loan syndicate, reducing annual instalments and postponing maturities. One quarterly installment of about USD35 million from the old syndicate was paid in 2024 and deducted from the new secured loan. The new secured syndicate loan is due on 2029 and the new secured bonds are due on 2030.

Asset Sales and Other Financing Advance: Volcan bolstered its cash position with sales of a hydro power plant for USD78.5 million, of which USD31.70 million has already been received, and metals concentrate prepaid sales for USD25 million. Along with USD68 million cash available as of June 30, 2024, these proceeds strengthen the company's financial standing. Fitch's rating case does not consider additional asset sales due to the uncertain timeframe and final value of expected transactions. However, Fitch's rating case contemplates potential disposals from Volcan's 16% stake in Cementos Polpaico in Chile and its land package near the developing Chancay port.

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 the region is familiar with mining activities. Fitch expects Romina to contribute 9% of revenue in 2026 and 15% on 2027.

FCF Pressured by Investments: Fitch expects EBITDA to reach about USD270 million as recent price increases help offset operational mishaps, despite slow streamlining efforts. Capex is expected to increase to more than USD200 million in 2024 and over USD260 million in 2025 during Romina's construction. Fitch anticipates capex averaging about 29% of revenue over the next three years, compared to 20% in the three previous years. Despite no expected dividend payments, FCF should 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 have risen from depressed levels as the focus shifts to mine supply due to global mine cutbacks and smelter limitations. However, demand is still low and business intelligence consultancy CRU, 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.

Before the stoppage, cost containment strategies were gradually delivering results, as shown by unit cost improvements, although costs remain higher than in 2019. Volcan postponed the Romina expansion by one year. This project, which addresses the short mine lives of about five years, 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 Compania de Minas Buenaventura SAA (BB-/Stable) or Minsur SA (BBB-/Stable). However, it is lower than 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 3.4x and 3.2x gross and net EBITDA leverage average of 2024-2026 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.

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 81% 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 rated at 'B-1/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

- Completion of Romina in a timely manner, resulting in an improvement in the cost profile, production and reserve life;
- 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

- Inability to obtain financing;
- Further delays in Romina construction and ramp-up;
- Negative FCF over the rating horizon impacting liquidity;
- EBITDA to interest expense coverage ratio consistently below 2.5x;
- 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: The conclusion of refinancing exercises resulted in the postponement of payments and in an improved maturity profile. The next relevant maturity for Volcan is due in 2026 (USD90 million) with the largest maturities in 2029 (USD275 million) and 2030 (USD300 million).

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 has been 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 is due in 2030 and the bond offer exchanged 81% of 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 capex for Romina in 2024 (USD25 million) and in 2025 (USD100 million). 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.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

[Click here](#) to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

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

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

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, which 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- ● Upgrade	CCC+ ●

ENTITY/DEBT	RATING		RECOVERY	PRIOR	
	LC LT IDR	B- 	Upgrade	CCC+ 	
• senior unsecured	LT	CCC	Upgrade	RR6	CCC-
• senior secured	LT	B-	New Rating	RR4	B-(EXP)

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 [\(1\)](#)

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Endorsement Status

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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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