FitchRatings

04 APR 2024

# Fitch Downgrades Volcan to 'CC'

Fitch Ratings - New York - 04 Apr 2024: Fitch Ratings has downgraded Volcan Compania Minera S.A.A.'s Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to 'CC' from 'CCC-', as well as its senior unsecured notes due in 2026 to 'CC'/'RR4' from 'CCC-'/'RR4'.

The downgrade to 'CC' reflects heightened refinancing risk and weak financial flexibility to service debt maturities in April 2024, while debt restructuring plans are under way. Volcan's FCF generation suffers undue pressure given the uncertain restart of its partially halted largest mining unit. Additionally, its refinancing and liquidity needs remain unresolved despite ongoing negotiations, ahead of Volcan's syndicate loan first installment in April 30th 2024 (USD35 million).

Moreover, low zinc prices threaten to thwart cost control and capital expenditures rationalization efforts. Asset sales or concentrate prepayments appear delayed and proceeds are likely to be used for Romina's capex.

## Key Rating Drivers

**Temporary Partial Stoppage:** Permitting revocations to continue operating the expansion of the Rumichaca tailings dam prompted a suspension of nearly 60% of the Yauli mining unit. This affects about 40% of Volcan's consolidated revenue. The interruption is expected to last for one month, and the company has built stockpiles to expedite the resumption towards the last fortnight of April. Notwithstanding, final restart dates are contingent on additional authorities' reviews. Tailing dams do not appear to show any structural damage.

**Liquidity Crisis Intensifies:** The mine halting further complicates Volcan's financial flexibility, delays negotiations with bank lenders and increases uncertainty ahead of the first USD35 million installment due in April 30th. Quarterly amortizations, which total USD105 million in 2024, increase to USD135 million in 2025 and USD160 million in 2026 when the USD400 million bank syndicate loan matures. The USD365 million of bonds mature in 2026. As of Dec. 31 2023, Volcan had USD62 million of cash. Fitch expects FCF to turn negative in 2024 and remain that way through 2025.

**Asset Sales Slowdown:** Fitch is not assuming asset sales in its rating case. Assets considered to be sold include Volcan's hydro power plants and its stake in a Chilean cement producer. Even if disposals are attained, Fitch assumes that Volcan will prioritize the capex investment needs of its Romina project rather than debt repayments because negotiations with creditors may limit use of proceeds.

**Refinancing Talks Underway:** Volcan, its bank lenders and bondholders hired financial advisors to engage in debt restructuring discussions. These efforts aim to postpone maturities under different terms. Fitch believes that a concomitant solution for both bank lenders and bondholders is needed to enhance financial flexibility. With conversations still in progress, it is unclear whether a distressed debt exchange (DDE), under Fitch criteria, will be launched.

**Operating Challenges Remain:** Zinc prices are still depressed at about USD2,500/MT because market surpluses continue despite global mine cutbacks. The Yauli curtailment will likely affect Volcan's streamlining efforts. Cost containment strategies were slowly delivering, prior to the stoppage. The unit cost in 2023 was 12% higher than in 2019. Volcan is postponing the Romina expansion one year. It would tackle short mine lives of about five years.

**ESG -Complex Governance Structure:** Fitch believes the shareholder dispute accelerated Volcan's liquidity difficulties and impaired its ability to address its refinancing needs. Additional disagreements can further complicate the company's options and decisions going forward. Volcan's majority shareholder, Glencore, controls 55% of voting shares (22% economic stake) and its minorities are Peruvian Pension Funds (51% of economic stake), and the De Romana and Letts families (20% of voting shares).

## Derivation Summary

Volcan's production of base and precious metals diversification is higher than peers Ero Copper Corp (B/Stable), Aris Mining Corp (B+/Stable), Nexa Resources SA (BBB-/Stable), and Minsur SA (BBB-/Stable). It is similar to that of Compania de Minas Buenaventura SAA (BB-/Stable), but lower than that of Industrias Penoles SAB de CV (BBB/Stable) or Teck Resources Ltd (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 and Teck's main operations are located in Canada, Chile and Peru.

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 or Teck.

Fitch projects that Volcan will have a weaker capital structure and liquidity than these peers. Liquidity needs are much more pressing than those of Buenaventura, Aris or Ero.

Volcan's cost position in the third quartile of the zinc all-in sustaining costs, according to CRU, is better than that of Buenaventura's fourth quartile in the gold curve, similar to that of Aris Mining's third in gold and worse than 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 (without Cerro Verde) but lower than Penoles' 10 years in precious metals, Minsur's eight years in tin, Aris Mining's 18 years in gold, Ero's 17 years in copper and Teck's 31 years in copper.

## Key Assumptions

--Average zinc price of USD2,500/tonne in 2024, USD2,400/tonne in 2025 and USD2,300/tonne in 2026;

--Average silver price of USD23.75/oz in 2024, USD22.5/oz in 2025, and USD20/oz in 2026;

--Capex of USD215 million, USD290 million and USD190 million in 2024, 2025, and 2026;

--Zinc output of 240,000 MT, 244,000 MT and 232,000 MT in 2024, 2025 and 2026;

--Silver output of 12.5 million oz, 13.4 million oz, and 13.3 million oz in 2024, 2025, and 2026;

--Yauli's zinc and silver production falls 4% and 6%, respectively in 2024. Fitch expects Yauli to contribute 61% of revenues in 2024;

--Romina is expected to achieve full production in late 2026. Fitch expects the resulting Alpamarca, with the Romina expansion, to contribute 10% of revenues in 2027.

## Recovery Analysis

The recovery analysis assumes Volcan would be reorganized as a going concern in bankruptcy rather than liquidated. Fitch assumed a 10% administrative claim. Volcan's going concern EBITDA assumption is based on zinc at USD2,500/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.

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 total debt. These assumptions result in a recovery rate for the unsecured bond within the 'RR2' range, but due to Brazil's soft cap, at 'RR4'. Volcan's senior unsecured debt is rated 'CC'/'RR4'.

## RATING SENSITIVITIES

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

--An upgrade is unlikely until the company addresses the refinancing of its credit syndicate and 2026 bond.

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

--Failure to address its refinancing needs and/or launching of a coercive debt exchange or announcing a debt restructuring;

--Prolonged production stoppage in Yauli mine

## Liquidity and Debt Structure

**Pressured Liquidity:** Volcan had USD62 million of readily available cash and equivalents in Dec. 31, 2023 and about USD790 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. Maturities consist of three USD35 million quarterly amortizations starting in 2Q24 totaling USD105 million of a bank syndicate.

Volcan's liquidity position is hard pressed to finance the USD140 million in capex for Romina and to refinance the approximately USD105 million and USD135 million 2024 and 2025 installments of its syndicate loan.

Volcan signed concentrates sale prepayment agreements for up to USD25 million. Additional offtake agreements could be negotiated. However, this process along with asset sales has failed to meet previous amounts and timeframe expectations.

## 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 '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 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.

## Fitch Ratings Analysts


**Hector Collantes**
Director
Primary Rating Analyst
+1 212 908 0369
Fitch Ratings, Inc. Hearst Tower 300 W. 57th Street New York, NY 10019

**Alejandra Fernandez**
Director
Secondary Rating Analyst
+56 2 3321 2903

**Martha Rocha**
Managing Director
Committee Chairperson
+1 212 908 0591


## Media Contacts


**Elizabeth Fogerty**
New York
+1 212 908 0526
elizabeth.fogerty@thefitchgroup.com


## Rating Actions

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

**RATINGS KEY** **OUTLOOK** **WATCH**

**POSITIVE** ⊕ ⬘

**RATINGS KEY OUTLOOK WATCH**

| RATINGS KEY | OUTLOOK | WATCH |
| --- | --- | --- |
| 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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