Research Update:

Copper Producer First Quantum Minerals 'B+' Ratings Affirmed Despite Cost Pressure; Outlook Stable

September 27, 2022

PRIMARY CREDIT ANALYST

Ivan Tiutiunnikov
London
+ 44 20 7176 3922
ivan.tiutiunnikov
@spglobal.com

SECONDARY CONTACT

Pierre Gautier
Paris
+ 0033144206711
pierre.gautier
@spglobal.com

Rating Action Overview

- Lower copper prices and higher-than-expected costs will translate into weaker EBITDA and credit metrics for Canada-headquartered miner First Quantum Minerals (FQM), compared with our previous expectations.
- While we assume copper prices of $8,700/tonne (/t) in 2023, we also consider the sensitivity of FQM's credit metrics to weaker macroeconomic conditions.
- In our view, the company would be able to mitigate lower profitability as long as it maintains its financial policy, namely net debt reduction to about $4.7 billion in the short to medium term, and net debt to EBITDA below 2x.
- As a result, we affirmed our 'B+' long-term issuer credit rating on FQM and our 'B+' issue rating on its unsecured debt.
- The stable outlook reflects our view that FQM will be able to absorb potentially lower profitability in the coming 12 months.

Rating Action Rationale

We affirmed the 'B+' issuer credit rating as we continue to factor in supportive copper prices in 2023, and expect FQM will take actions to protect its credit metrics should copper prices reduce. Cost pressures have been pronounced during 2022, amid higher fuel, steel, freight, and other production costs. We now anticipate adjusted EBITDA of $3.3 billion-$3.5 billion in 2022, compared with our previous expectation of $4.2 billion-$4.4 billion in 2022. Under our working assumption of a copper price of $8,700/t in 2023, we expect the company to deliver EBITDA of $3.4 billion-$3.7 billion, translating into adjusted debt to EBITDA of 2.0x-2.3x, in line with our 2.5x threshold during healthy market conditions. If we assume a lower copper price of $6,500/t-$7,000/t, we estimate adjusted EBITDA of at least $2.1 billion, translating into adjusted debt to EBITDA of about 4x. This is still in line with our expectation during weaker market

conditions, namely adjusted debt to EBITDA of 4x-5x.

The company's financial policy means that it will act during weaker market conditions. This is because FQM has a public leverage limit of net debt to EBITDA of 2x (compared with 1.3x on June 30, 2022). We understand that the company does not intend to go above this level, so we anticipate that in a hypothetical scenario of lower copper prices, the company will cut its operating costs, capital expenditure (capex), and dividends to contain the effect on credit metrics. FQM also has a public commitment of debt reduction, targeting $1 billion in the short to medium term. We understand this as net debt of $4.7 billion, compared with $5.3 billion as of June 30, 2022, which leaves room for further debt reduction.

Ongoing investments should help the company grow its business while leaving room for debt reduction. At this stage, the company remains committed to growing its copper production to 850,000/t-910,000/t in 2024 from 816,435/t in 2021 (mostly linked to higher production in the Cobre Panama mine and the Zambian Kansanshi mine expansion). Our capex expectation in 2023 and 2024 is $1.2 billion-$1.4 billion per year, most of which is committed. We understand that the company's flexibility to mitigate a reduction in EBITDA and cash flows is supported by its focus on deleveraging ahead of a more substantial capex program, which we expect after 2025. This is when FQM plans to start working on its greenfield projects such as Taca Taca in Argentina (no decision before 2024) and/or Haquira in Peru (potentially closer to 2030).

Outlook

The stable outlook reflects our view that FQM will be able to absorb potentially lower profitability in the coming 12 months. The company's commitment to its financial policy is a key mitigation factor as the global economy's outlook becomes more uncertain.

We expect FQM will post S&P Global Ratings-adjusted EBITDA of $3.3 billion-$3.5 billion in 2022, translating into free operating cash flow (FOCF) of $1.0 billion-$1.2 billion and adjusted debt to EBITDA of 2.5x (excluding a sustainable cash position of about $0.8 billion). We view adjusted debt to EBITDA of 3x-4x under normal copper prices as commensurate with the rating (4x-5x in the low part of the cycle). These thresholds might become more demanding if capex increased leading to much lower free cash flow.

We do not assume any changes to the current fiscal regimes in its countries of operation. Any significant changes to licenses, royalties, or taxes in Zambia or Panama may lead us to reassess the rating.

Downside scenario

Rating downside is likely to stem from a combination of lower copper prices, higher costs, and limited willingness to pull some financial policy levers. Some triggers for a negative rating action include:

- Adjusted debt to EBITDA meaningfully exceeding 4x without clear prospects of recovery (under the assumption of copper prices of $7,000/t or below). According to our calculations, a combination of the price of copper at $6,500/t and below, coupled with persistently high costs, might to lead to a downgrade.
- Deviation from the company's financial policy. For example, slowing down its gross debt reduction or committing to multi-billion-dollar projects before building sufficient financial

headroom.

Upside scenario

Given risks of persistently high costs and lower prices in the coming quarters, we do not expect to raise the rating in the next 12 months or so. Over time, a higher rating could be supported by the following:

- Improvement of the company's cost position to be more immune to copper prices (for example, demonstrating clearly positive FOCF (before growth capex) at the lower part of the cycle.
- Adjusted debt to EBITDA clearly below 3x (under mid-cycle copper prices) and total capex of about $1.2 billion.
- Reduction in the company's net debt to $4.7 billion and below, in line with the company's financial policy.
- Longer term, investing in greenfield projects that will support diversity of operations (geographies and metals).

Company Description

FQM is a midsize copper miner producing 816,435 tonnes in 2021, translating into S&P Global Ratings-adjusted EBITDA of about $3.6 billion.

Its portfolio has high asset concentration between two mines in Zambia (Kansanshi and Trident), and one in Panama. In 2021, Zambia contributed about 50% of the group's comparative EBITDA, and Panama contributed about 45%. The remainder was split between smaller mining operations: Las Cruces in Spain, Guelb Moghrein in Mauritania, Cayeli in Turkey, Pyhasalmi in Finland, and the Ravensthorpe nickel mine in Australia.

FQM's group copper cash cost of $1.30/lb in 2021 places it the third quartile of the global unit cash-cost curve, despite differences between its mines.

Peers include diversified miners such as BHP (1.6 million metric tonnes of copper production) and Rio Tinto (494,000 tonnes), as well as pure copper miners such as Kaz Minerals (298,700 tonnes) and Antofagasta (721,500 tonnes).

Our Base-Case Scenario

Assumptions

- No effect on the company's performance (operational and financial) from Zambia's sovereign default/debt restructuring.
- Stable fiscal environment in its countries of operations. Panama's latest decision to impose a $375 million annual contribution will affect EBITDA somewhat in 2022, and with full effect in 2023.
- We assume the company will reduce net debt to its target of about $4.7 billion by end-2023.
- In our 2022-2023 capex forecast, approximately $600 million is sustaining and capitalized

stripping. The remainder is growth capex.

First Quantum Minerals Ltd.--Key Metrics*

	--Fiscal year ended Dec. 31--			
Mil. $	2020a	2021a	2022e	2023f
World GDP growth (%)	-3	6.1	3.3	3.5
Copper price ($/t)	6,174	9,318	8,700	8,700
Copper price ($/lb)	22.09	3.64	3.96	3.95
Copper production (kt)	779	816	790-855	840-910
C1 cash cost for copper (net of by-products) ($/lb)	1.21	1.3	1.6-1.8	1.5-1.8
Adjusted EBITDA	2,210	3,602	3,300-3,500	3,400-3,700
FFO	1,254	2,602	2,300-2,500	2,600-2,900
Capex	610	995	1,250	1,250-1,400
FOCF	367	1,365	1,000-1,300	1,000-1,300
Dividends	7	42	200-250	250-300
Reported net debt	7,409	6,053	5,200-5,400	4,500-4,700
Adjusted debt †	10,512	10,137	9,200-9,300	7,700-7,800
Adjusted debt to EBITDA (x)	4.8	2.8	2.6-2.8	2.0-2.3
FFO to Debt (%)	11.9	25.7	25-30	33-38

*All figures adjusted by S&P Global Ratings. † Our adjusted debt is on gross basis, and includes about $1.5 billion Franco-Nevada streaming, and $0.5 billion for asset retirement obligations, among other smaller adjustments. We incorporate in our forecast small amounts of amortization of the deferred revenue balance on the Franco-Nevada streaming transaction. We do not deduct any of the sizable cash that FQM has on balance sheet, because no amount has been earmarked specifically for debt repayment. If we were to assume a lower cash balace at the end of 2022 (more in line with historical average), adjusted debt/EBITDA would be around 2.5x, and FFO/Debt would be around 30%. a--Actual. e--Estimate. f--Forecast.

Liquidity

We assess FQM's liquidity as adequate and expect that liquidity sources will cover liquidity uses by about 3.2x over the 12 months starting July 1, 2022. Our assessment is supported by our expectation of strong FFO generation and FQM's cash balance and availability under its revolving credit facility (RCF).

We also factor in the company's successful track record in accessing bank and capital markets financing, and refinancing its debt in time in the past few years. The amendment of financial covenants in April 2020, at the height of the pandemic, also highlights the support from the company's banking syndicate.

On the flipside, we also note the company's exposure to countries with high risk of operations and unstable fiscal environments.

We estimate that FQM's main liquidity sources over the 12 months from July 1, 2022, include:

- Cash and cash equivalents of about $1.8 billion. A significant portion of cash is held outside Zambia with international banks or in money market funds;

- $0.6 billion undrawn of the $1.3 billion RCF, which matures in September 2025; and
- FFO of $2.3 billion-$2.5 billion, after lease payments and amortization of deferred revenue.

We estimate FQM's main liquidity uses over the same period include:

- Short-term debt of $0.6 billion;
- Sustained and capitalized stripping capex of about $0.6 billion;
- Potential working capital swings during the year of up to $0.1 billion; and
- Dividends of $0.2 billion-$0.3 billion.

Covenants

The company's bank facility contains a covenant of net debt-to-EBITDA below 3.5x. On June 30, 2022, the company met this requirement, and net debt-to-EBITDA was 1.3x. We expect comfortable headroom under this covenant will remain amid the company's focus on debt reduction. Assuming weaker copper prices, of $6,500/t-$7,000/t, the company should have some headroom under the financial covenant.

Rating Above The Sovereign

Our ratings on FQM are currently not capped by either the foreign currency sovereign rating on Zambia (SD/SD) or Zambia's transfer & convertibility assessment ('CCC+'). We expect the proportion of EBITDA and free operating cash flow in Zambia and Panama (foreign currency: BBB/Negative/A-2) to be roughly equal over the coming years. In October 2020, Zambia defaulted after it decided not to meet its financial obligations. The Zambian government and the IMF continue to negotiate a financing package. There was no impact on FQM's operations or its ability to repatriate cash. In February 2022, we raised our local currency rating on Zambia to 'CCC+' from 'CCC-', reflecting that risks to domestic debt repayment have fallen as the new government is undertaking reforms to strengthen fiscal performance and economic conditions in the country.

However, country-related risks cannot be ignored; over the past few years FQM has been subjected to:

- Frequent changes in the fiscal regime--including in the mineral royalty rates, corporate tax rate, variable tax rate, and VAT regime. The tax regime has changed over 10 times since the early 2000s;
- Delays in the recovery of non-negligible VAT receivables;
- The now-concluded assessment by the Zambia Revenue Authority, which was claiming a payment of about $8 billion for underpaid customs duties; and
- An international arbitration related to ZCCM Investments, the minority partner in Kansanshi, in late 2016--now resolved.

We will continue monitoring developments in the country, specifically any material disruptions to operations or foreign-exchange controls hindering non-financial entities' ability to repatriate cash.

Issue Ratings - Subordination Risk Analysis

Capital structure

FQM's capital structure as of June 30, 2022, comprises:

- Four senior unsecured bonds, totaling $4.7 billion, with maturities between 2024 and 2027. All the bonds are issued by holding company First Quantum Minerals Ltd. and guaranteed jointly and severally by subsidiaries. All the mines are included as guarantors except Kansanshi, Ravensthorpe, and Cobre Panama;
- A senior secured bank facility--consisting of a term loan ($1.6 billion outstanding) and RCF ($0.7 billion drawn)--is issued by the same holding company and maturing in September 2025;
- $28 million outstanding under the senior unsecured facility at the Sentinel (Kalumbila) level, maturing in December 2022;
- $147 million trading facilities; and
- A $1.5 billion precious metal stream agreement with Franco-Nevada, for the financing of Cobre Panama capex. We consider this instrument to have priority in the Cobre Panama cash flows, without recourse to the rest of the group's operations.

Analytical conclusions

The senior unsecured bonds are rated in line with the 'B+' rating on FQM, as the priority liabilities (senior secured bank facilities, streaming agreement, trading facilities, and the Kalumbila term loan) ahead of the bonds are below 50%.

We understand that the bonds and the bank debt share a similar security package, including upstream guarantees from some of FQM's key operating and financial companies. That said, the bank debt enjoys additional security in the form of an assignment of intercompany loans and share pledges. As a result, we see the bonds and the bank debt as ranking at the same seniority (pari passu) although under certain default scenarios this could bring more value to the banks.

Ratings Score Snapshot

Issuer Credit Rating: B+/Stable

Business risk: Weak

- Country risk: High
- Industry risk: Moderately High
- Competitive position: Fair

Financial risk: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: b+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: b+

ESG credit indicators: E-3, S-3, G-3

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities, April 29, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- S&P Global Ratings' Metal Price Assumptions: Prices Settle Lower As Slowdown Fears Grow, Aug. 8, 2022

Ratings List

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914