

RatingsDirect®

Research Update:

CAP S.A. Downgraded To 'BB+' From 'BBB-' On Weaker Financial Performance Due To Lower Iron Ore Prices

Primary Credit Analyst:

Marcus Fernandes, Sao Paulo (55) 11-3039-9734; marcus.fernandes@standardandpoors.com

Secondary Contact:

Diego H Ocampo, Sao Paulo (54) 114-891-2124; diego.ocampo@standardandpoors.com

Table Of Contents

Overview

Rating Action

Rationale

Outlook

Ratings Score Snapshot

Related Criteria And Research

Ratings List

Research Update:

CAP S.A. Downgraded To 'BB+' From 'BBB-' On Weaker Financial Performance Due To Lower Iron Ore Prices

Overview

- Standard & Poor's has revised its price assumptions for iron ore because global demand remains soft, resulting in the likely lower cash generation and tighter credit metrics for Chile-based mining company, CAP, in the next two years.
- We have downgraded CAP to 'BB+' from 'BBB-'.
- We expect the ongoing weak market conditions to keep driving iron ore prices down, resulting in pressured financial metrics for the next two years.

Rating Action

On Jan. 30, 2015, Standard & Poor's Ratings Services lowered its corporate credit and issue ratings on CAP S.A. to 'BB+' from 'BBB-'. The outlook is negative.

Rationale

The downgrade reflects our expectation that CAP's financial risk profile will weaken in the next two years due to the eroding iron prices, which we now expect to remain at \$65 per ton in 2015 and 2016 and at \$70 per ton in 2017 (Platts 62% iron content, delivered in China).

Even though the new price assumptions for 2015 and 2016 are \$20 per ton lower than our previous ones, the hit on CAP's financial performance wouldn't be as hard given the company's cost-cutting efforts and lower capital expenditures (capex). Moreover, freight costs have significantly dropped and the Chilean peso depreciated 10% in the past six months, all of which we expect to mitigate the impact of lower iron ore prices.

We continue to consider CAP's financial risk profile as "intermediate" despite our expectations of slightly weaker main credit metrics—debt to EBITDA of slightly above 3x and funds from operations (FFO) to debt close to 20%—in 2015 and 2016 than the typical range for that category. The company's ability to improve credit ratios is limited due to lower commodity prices, in our opinion. For that to happen, CAP would need to cut capex and/or explorations costs, but which could hinder future performance. The reduced flexibility prompted us to remove the "positive" comparison score, which we had assigned

while iron ore prices were higher and CAP's capital expansion cycle was coming to an end, while it benefited from the incremental volumes.

Our revised base case incorporates the following additional assumptions:

- Iron ore prices of \$65 per ton in 2015 and 2016 and at \$70 in 2017 (62% Fe content);
- Premiums for magnetite content of \$2.5 per ton, on top of regular industry premiums for concentrate quality (about \$7 per ton for sinter feed 67% Fe content compared to 62%);
- Discounts for moisture content of 8% in volumes,
- Average freight costs of \$16 per ton;
- Cash costs for iron ore of about \$47/ton (FOB);
- Iron ore volumes of 16 metric tons per annum (mtpa) in 2015, 17 mtpa in 2016, and 18 mtpa in 2017, most of which is pellet feed with a 67% Fe content;
- Pellets would account for 25% of the output with a premium of \$30 per ton;
- Annual crude steel output of 740,000 tons and steel products of 350,000 tons;
- Average cash costs for steel and steel products of slightly below \$500 per ton; and
- Annual capex declining to maintenance levels of \$150 million in 2015 and afterwards.

Those assumptions lead to the following:

- EBITDA margins of about 17% through 2017;
- FFO to debt of about 21% in 2015, 23% in 2016, and 33% in 2017; and
- Debt to EBITDA of 3.6x in 2015, 3.2x in 2016, and 2.3x in 2017.

Liquidity

We assess CAP's liquidity as "adequate" because we expect cash sources to exceed uses by at least 20% in the next 12 months. We also expect the company to keep generating cash surpluses even if EBITDA were to be 15% lower than our estimates.

Main Liquidity Sources:

- Cash and short-term investments of \$385 million, as of Sept. 30, 2014
- Cash flow from operations of \$260 million
- Committed bank lines for \$350 million

Main Liquidity Uses:

- Capital investments of \$150 million
- Dividend payments of about \$30 million
- Short-term debt payments of \$290 million

In addition, CAP's financial flexibility benefits from ample room under the current covenant for its domestic bonds, and the company enjoys a high standing in the domestic credit market.

Outlook

The negative outlook reflects our expectation that market conditions will remain soft in the short term, which will pressure CAP's credit metrics. We believe the company will focus on improving its operating efficiency in the steel division while its mining division remains profitable thanks to its focus on high-grade products. We expect also that the company will remain generating positive free cash flow, which will allow it to reduce its debt gradually, but metrics should remain pressured for the "intermediate" financial risk profile, with FFO to debt of about 20%.

Upside scenario

Although unlikely at this moment, an upgrade could result from stronger-than-expected performance either due to more positive market conditions or deeper cost cuts that may result in stronger credit metrics, such as FFO to debt persistently above 45%.

Ratings Score Snapshot

Corporate credit rating: BB+/Negative/--

Business Risk Profile: Fair

- CICRA: Moderately High
- Competitive Position: Fair

Financial Risk Profile: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bb+

Modifiers

- Diversification/Portfolio Effect: Neutral
- Capital Structure: Neutral
- Financial Policy: Neutral
- Liquidity: Adequate
- Management and Governance: Satisfactory
- Comparable Rating Analysis: Neutral

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors Published For The Metals And Mining Upstream Industry, Dec. 20, 2013
- Corporate Methodology, Nov. 19, 2013

- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

Related Research

- Standard & Poor's Makes Significant Downward Revisions To Its 2015-2017 Metals Price Assumptions, Jan. 20, 2015

Ratings List

Downgraded

	To	From
CAP S.A. Corporate Credit Rating Senior Unsecured	BB+/Negative/-- BB+	BBB-/Negative/-- BBB-

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

Copyright © 2015 Standard & Poor's Financial Services LLC, a part of McGraw Hill Financial. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgement as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription) and www.spcapitaliq.com (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.