FitchRatings

Tagging Info

Fitch Affirms CAP S.A.'s IDRs at 'BBB' & National Rating at 'AA-(cl)'; Outlook to Negative

Ratings Endorsement Policy
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Fitch Ratings-Chicago/Santiago-12 March 2015: Fitch Ratings has affirmed CAP S.A.'s (CAP) foreign and local currency Issuer Default Ratings (IDRs) at 'BBB' and national scale rating at 'AA-(cl)'. The National Equity Rating has also been affirmed at First Class Level '1(cl)'. The Rating Outlook is revised to Negative from Stable. A full list of rating actions is shown at the end of this release.

KEY RATING DRIVERS:

Weakening Long-Term Credit Metrics Drive Negative Outlook:

CAP's Negative Outlook reflects weaker than expected financial performance and corresponding deterioration in credit metrics. The company's large investment plan to increase its iron ore production has been finalized during a period of oversupply and lower pricing. Higher debt of USD1.3 billion as of 2014 compared to USD932 million in 2013 relates to the additional debt taken on board by the company to finalize its expansionary capex plans. Leverage ratios have been exacerbated by a period of lower than anticipated iron ore pricing and unfavorable product mix in its sales that has diluted the benefit received from its higher premium products and additional sales volumes. CAP's net debt-to-EBITDA ratio was 2.5x in 2014 compared to 1x in 2013 and a neutral net debt position in 2012.

Fitch's Base Case assumptions for CAP indicate a peak net debt to EBITDA ratio of around 2.7x during 2015, 1.8x in 2016 and around 1x in 2017 based on sales volumes of 16 million tonnes of iron ore during 2015, 17 million tonnes in 2016 and 18 million tonnes thereafter. Fitch revised down its iron ore price assumptions on Feb. 4, 2015 to assume average prices of USD65 per tonne in 2015 (China import iron ore fines 62% CFR), USD75 per tonne in 2016 and USD80 per tonne in the long term. Previously, Fitch had assumed a constant USD90 per tonne price over all three periods. The company's debt coverage ratios in 2014 weakened, as demonstrated by its funds from operations (FFO) interest coverage ratio of 2.9x compared to 18x in 2013 and EBITDA-to-gross Interest expense ratio of 5.5x compared to 16.4x during the prior year. The company has financial covenants with a net debt to EBITDA threshold of below 4x relating to its USD200 million revolving credit facility and USD150 million of bank debt that will be repaid by April 2016 in three equal installments. CAP does not exceed this threshold under Fitch's base case.

Refinancing of Short-Term Debt Expected:

CAP is expected to successfully refinance its short-term debt. For 2014, the company held cash and marketable securities of USD302 million, excluding restricted cash of USD36 million relating to its project finance debt, compared to short-term debt of USD368 million corresponding to tight cash-to-short-term debt coverage of 0.8x. This compares to 1.8x in 2013 and 4.5x in 2012 for this coverage ratio. During the next three years, CAP has USD541 million of debt maturities due with USD368 million due in 2015, USD112 million due in 2016, and USD62 million due in 2017.

CAP's long-term debt in 2014 was composed of bank loans (37%), local bonds (18%), project finance (22%) and international bonds (6%). CAP has access to additional liquidity in the form of uncommitted credit lines with local banks should it be required, and benefits from its relationship with its major long-term strategic shareholder, Mitsubishi Corporation of Japan. The company also has a number of high-quality assets at its disposal and could monetize them in the event additional liquidity is required. This is considered unlikely in the current scenario.

Iron Ore Production Continues Ramp-up at CMP:

Iron ore shipments of 13 million tonnes in 2014 were up from 12 million during 2013. The company is expected to export 16 million tonnes of iron ore products in 2015, increasing to 17 million tonnes from 2016 and 18 million tonnes from 2017. CAP generated EBITDA of USD381 million in 2014, significantly lower than USD665 million during 2013, due to the lower iron ore price scenario and the product sales mix. CAP's total 2014 revenues were USD1.8 billion, of which USD942 million was generated by CMP. This compares to 2013 revenues of USD2.3 billion, corresponding to negative 22% revenue growth in 2014. On a consolidated basis, CAP's EBITDA margins reduced to 21% in 2014 from 29% in 2013 due to the lower price environment and product sales mix for the year.

CMP's operations comprise four mines distributed across two regions in northern Chile. These operations are complemented by three ports at equal distances apart across the two regions, a pellet plant with current capacity of 5.2 million tonnes per year, a magnetite plant, a desalination plant, and an 80km iron ore slurry pipeline that results in low logistical costs for the company. EBITDA per tonne was USD49 in 1Q'14, USD27 in 2Q'14, USD18 in 3Q'14 and USD12 in 4Q'14 equating to USD21 on average in 2014. EBITDA per tonne is expected to remain around USD12 per tonne in 2015 but to increase from 2016 onwards due to higher production volumes, better product mix with higher premium pellet sales, and additional revenues from the desalination plant and transmission line.

Deleveraging Expected through FCF:

Fitch expects the company to return to positive free cash flow (FCF) generation in 2015 at around USD150 million following the completion of the major investment and ramp-up of higher production volumes, and begin to pay down gross debt. CAP traditionally exhibits strong FCF during normal investment periods. Historically, the company has also demonstrated discipline with regard to dividend payments when operating conditions require more liquidity. CAP is also able to scale back or delay its remaining capex to bolster cash flow over the next two years, if required.

The company generated cash flow from operations (CFFO) of USD243 million of in 2014, following a working capital inflow of USD108 million from FFO of USD134 million. This compares to CFFO of USD708 million in 2013, a figure that also benefited from a working capital inflow of USD46 million. FCF for 2014 continued to be negative at USD313 million following capex of USD450 million and dividends of USD105 million but was an improvement over negative USD450 million in 2013 with record capex of USD975 million and dividends of USD230 million for the year.

Long Life Reserves & Resources:

CAP has 8.63 billion tonnes of iron ore reserves (2.28 billion tonnes) and resources (6.35 billion tonnes) that equate to 57 years of mine life at an expected production rate of 15 million tonnes per year. The current investment plan projects production to reach over 18 million tonnes per year by the end of 2017.

CMP's consolidated cash cost of iron ore production during 2014 was USD49 freight-on-board (FOB) per tonne compared to USD56 FOB per tonne in 2013, at a production rate of around 13 million tonnes. This cost is expected to decrease to around USD44 per tonne in 2015. For comparison, the cash cost for Samarco Mineracao S.A. (Samarco, LT IDR 'BBB'/Stable Outlook), a leading iron ore pellet producer owned by Vale S.A. (Vale, LT IDR 'BBB+'/Stable Outlook) and BHP Billiton (BHPB, LT IDR 'A+'/Stable Outlook) in Brazil, was around USD45 per tonne in 2014.

National Equity Rating Rationale:

CAP has a long trading history with over 30 years in the Santiago stock exchange market, standing out as a valuable company in the local market. So far this year the company's market capitalization decreased to USD650 million in March 2015 from USD 2.3 billion in March 2014. The company's shares are highly liquid with a market presence of 100%. with last year's average volume estimated at USD 4.8 million as of February 2015. Equity indicators position CAP within the level 1 category.

KEY ASSUMPTIONS

Fitch's key assumptions within the rating case for the issuer include:

--Iron ore prices of USD65 per tonne in 2015, USD75 in 2016, and long term of USD80 per tonne.

--Sales volumes of 16 million tonnes in 2015, ramping-up to 18 million tonnes by 2017.
--Improvement in product mix with higher magnetite iron ore pellet sales.
--Lower capex of USD150 million in 2015 declining thereafter.
--Net debt to EBITDA ratio to peak in 2015 at 2.7x and below 2x thereafter.

RATING SENSITIVITIES:

CAP is exposed to inherent risks within the mining and steel industries. A downgrade could result from continued deterioration in the company's capital structure that is not addressed in the short term. A sustained period of depressed iron ore prices below Fitch's mid-cycle price assumptions and/or a significant loss of sales volumes that prolongs net debt-to-EBITDA above 2.5x post-2015, factoring-in a peak in net leverage of 2.7x this year, will result in a downgrade. A significant and prolonged deterioration in CAP's liquidity position and persistent negative FCF will also contribute to a negative rating action.

Positive rating action on CAP is not anticipated in the medium term.

Fitch has affirmed the following ratings on CAP S.A.:

--Foreign currency at IDR 'BBB';
--Local currency IDR at 'BBB';
--Yankee bonds due 2036 'BBB';
--National-scale rating at 'AA-(cl)';
--National equity rating at Primera Clase Nivel1(cl).
--Local bonds No. 434 (serie F) at 'AA-(cl)';
--Local bonds No. 435 (serie D) at 'AA-(cl)';
--Local debt issuance program No. 591 at 'AA-(cl)';
--Local debt issuance program No. 592 at 'AA-(cl)'.

The Rating Outlook is Negative.

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Additional information is available at 'www.fitchratings.com'.

Applicable Criteria and Related Research:
--'Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage' (May. 28, 2014).

Additional Disclosure
Solicitation Status