CAP S.A. 'BBB-' Ratings Affirmed On Expected Robust Financial Performance, Outlook Remains Stable

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Overview

- We expect Chilean iron ore and steel products producer CAP to maintain its financial strength even amid lower iron prices.
- We are affirming our 'BBB-' ratings on CAP.
- The stable outlook reflects our expectation that the company will maintain adjusted debt to EBITDA below 2x and funds from operations (FFO) to debt at about 50% through 2017.

Rating Action

On May 5, 2014 Standard & Poor's Ratings Services affirmed its 'BBB-' ratings on CAP S.A. The outlook remains stable.

Rationale

Our ratings on CAP S.A. reflect our revision of the company's business risk profile to "fair" from "satisfactory" and its financial risk profile "modest" from "intermediate."

We now view CAP's business risk profile as "fair" mainly because the company's mining business is concentrated in only four mines in northern Chile, two of which are expected to provide about 70% of production in 2015 and afterwards. Previously, we used to give more weight in our analysis to the operating efficiency profile because that's typically the main strength that commodity-type businesses rely on to cope with price volatility. However, mining operations around the world are increasingly challenged by operating disruptions due to multiple reasons (strikes, natural disasters, environmental scrutiny, machinery malfunctioning, etc.). Therefore, we consider the lack of asset diversification as an overriding credit factor.

The partly offsetting factors are CAP's fairly efficient cost structure that allows it to produce pellet feeds with a high iron content (67%) at a fairly competitive cash cost (about $50 per ton). This is supported by the magnetite nature of CAP's iron reserves which are cheaper to concentrate (as opposed to typical hematite nature).

"Modest" financial risk profile reflects CAP's history of financial conservativeness and our expectation that it will maintain low leverage through 2017 even amid lower iron prices. CAP has gone through a significant expansion, which demanded close to $2 billion in 2012-2014 with high 2014 investment levels as well. Still, we expect debt metrics to remain in line with the company's "modest" financial risk profile even if iron prices were to be $10 per ton lower than those of our price deck.

Our base case assumes:

- Benchmark iron ore prices of $110 per ton in 2014 and $100 afterward, delivered in China (iron content of 62%);
- Average cash costs of about $50 per ton;
- Aggregated EBITDA margins for the steel and steel products businesses improving to 5% in 2014 and 8% in 2015 and thereafter thanks to reduced coal and iron ore costs;
- Iron ore volumes of about 15 million tons in 2014 rising to 18 million tons in 2015 and thereafter;
- Flat and long steel output slightly below 750,000 tons per year in 2014 and afterwards and steel products volumes of about 350,000 through 2017; and
- Capital expenditures of $660 million in 2014 and $400 million per year afterwards.

Based on these assumptions, we arrive at the following credit measures:

- Average EBITDA levels of $660 million in 2014 decreasing to $630 million in 2017 (with margins ranging between 25% and 29%);
- Stable adjusted debt to EBITDA of about 1.6x through 2017; and
- FFO to debt of about 50% through 2017.

Liquidity

We view CAP's liquidity as "adequate." We expect cash sources to exceed uses by at least 20% in 2014 and to remain free cash flow positive in even if EBITDA were to decline by 15%. Our liquidity assessment incorporates the following assumptions:

- Cash and near-term investments of $309 million as of Dec. 31, 2013;
- FFO of about $535 million;
- Available committed credit lines of $350 million through 2019;
- Short-term debt of $136 million;
- Capital expenditures of $660 million; and
- Dividend payments of $55 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 stable outlook reflects our expectation that CAP's relatively conservative financial leverage will help it offset eventually lower prices of iron ore and that any future investment trend won't jeopardize its financial stance.

Upside scenario

An upgrade is currently somewhat unlikely as we believe CAP's asset concentration in a few mines and overall small business scale limit its business risk profile, despite its adequate cost position in iron, which is but still in the middle of the global cost curve.

Downside scenario

A potential downgrade may follow a deterioration in CAP's balance sheet either due to weaker results and cash flows or to more aggressive investment policies relative to our base case. Adjusted debt to EBITDA persistently above 2x may signal such a deterioration.

Ratings Score Snapshot

Corporate Credit Rating: BBB-/Stable/--
Business risk: Fair

- Country risk: Low
- Industry risk: Moderately high
- Competitive position: Fair

Financial risk:
- Cash flow/Leverage: Modest

Anchor: bbb-

Modifiers
- Diversification/portfolio effect: Neutral, no impact
- Capital structure: Neutral, no impact
- Liquidity: Adequate, no impact
- Financial policy: Neutral, no impact
- Management and governance: Satisfactory, no impact
- Comparable rating analysis: Neutral, no impact

Related Criteria And Research

- Corporate Methodology, Nov. 19, 2013
- Methodology and assumptions: Liquidity descriptors for global corporate issuers, January 2, 2014
- Key Credit Factors for the metals and mining downstream industry, Dec 20. 2013
- Key credit factors for the metals and mining upstream Industry Dec 20, 2013

Ratings List

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