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Research Update:
CAP S.A. Ratings Affirmed At 'BBB-' Based On Strong Operating Performance; Outlook Stable

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Overview

- CAP's operating performance is enhanced by strong prices for iron ore.
- We are affirming our ratings on CAP, including the 'BBB-' long-term corporate credit rating.
- The company should be able to finance its expansion plan internally and continue deleveraging while maintaining robust cash holdings.

Rating Action

On June 29, 2011, Standard & Poor's Ratings Services affirmed its long-term counterparty credit rating on Chilean iron and steel products producer CAP S.A. at 'BBB-'. The outlook is stable.

Rationale

The ratings on CAP reflect the company's satisfactory business-risk profile and intermediate financial-risk profile. Its strong positioning as the leading integrated producer in the Chilean steel market mainly underpins its business risk profile. This is partially offset by the commodity-type nature of its businesses, which make profits volatile; and the company's relatively less efficient cost structure, based on its relatively small scale and low-grade ore reserves. The company's strong liquidity position, declining leverage, and enhanced cash flows support its financial-risk profile, as industry conditions for iron ore producers are mostly favorable. These factors mitigate the inherent volatility of CAP's operating cash flow.

During the 12 months ended March 2011, CAP's EBITDA generation peaked at $924 million, compared with $770 million in 2010, $187 million in 2009, and $532 million in 2008. Because we expect 2011 iron ore prices to be 30% higher than they were in 2010, and the company's output to be 12 million tons--10% higher year-over-year--we believe EBITDA could reach $1.1 billion in 2011. This also assumes an output for steel that is 60% higher than it was last year, when the earthquake affected production amid similar prices. We also factored in a substantial decrease in energy prices for CAP under a long-term power purchase agreement that stipulates declining fixed-price tariffs beginning in mid-2011.

We also expect funds from operations (FFO) to be higher than $850 million in 2011, probably declining to $650 million in 2012, assuming lower prices for iron. This operating cash generation would be more than enough to fund the company's investment plan and dividends at 50% of net income without reducing cash reserves meaningfully.

The company used part of its large cash reserves to pay down more than $250 million of debt during second-quarter 2011. As a result, credit metrics should improve. We expect gross debt-to-EBITDA ratios to be less than 1x and FFO-to-debt ratios higher than 90% for 2011 and 2012. Longer term, CAP may be able to continue enhancing its financial risk profile, even though credit ratios and leverage will continue to depend heavily on prices and future investment.

Revenues and profits fully consolidate the operations of Compañía Minera Huasco S.A. (CMH). In April 2010, as part of a transaction that also involved a $401 million equity infusion to the combined entity from Mitsubishi Corp. (MC; A+/Stable/A-1), Compañía Minera del Pacífico S.A. (CMP) and CMH merged. MC became CMP's minority shareholder, with a 25% stake. Prior to the transaction, CAP wholly owned CMP, and CAP and MC each held 50% of CMH.

Liquidity

In our opinion, CAP's liquidity is strong. As of March 31, 2011, the company maintained record cash holdings of $1.06 billion after strong operating performance and the $401 million equity increase that MC contributed to CMP in early 2010. As of the same date, the company's short-term debt amounted to $338 million; according to the company, it paid most of this during second-quarter 2011.

We expect CAP to invest close to $400 million and to pay dividends of less than $200 million in 2011. Under our base-case scenario, we expect the company to generate enough free cash flow to face all these cash drains and end up with cash balances in excess of $900 million by year-end--unless it decides to deleverage further.

Outlook

The stable outlook incorporates our expectation of enhanced credit metrics ahead. A downgrade might follow a deterioration in the company's financial risk profile, which we currently consider somewhat unlikely given the good business momentum in iron operations and the company's willingness to continue deleveraging. A potential upgrade is somewhat limited by the company's business-risk profile involving profits and cash flows that are substantially volatile. Consequently, an upgrade would require very conservative and predictable financial policies that support long-term credit quality through the cycle. For example, we would look for very prudent leverage, an explicit and countercyclical investment policy, flexible dividends, and committed bank lines.

Related Criteria And Research

- Methodology And Assumptions: Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010
- Key Credit Factors: Methodology And Assumptions On Risks In The Mining Industry, June 23, 2009
- Key Credit Factors: Methodology And Assumptions On Risks In The Metals Industry, June 22, 2009
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- 2008 Corporate Ratings Criteria, April 15, 2008

Ratings List

Ratings Affirmed

CAP S.A.

Corporate Credit Rating	BBB-/Stable/--
Senior Unsecured	BBB-

Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.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.