STANDARD & POOR'S RATINGSDIRECT

RESEARCH

CAP S.A.

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Major Rating Factors

Corporate Credit Rating

BBB-/Stable/--

Strengths:

- Integrated steel producer with large reserves of iron ore and limestone;
- Strong competitive position and large share in its core market, the growing Chilean economy;
- Long-term commercial relationship with its main customers; and
- Good financial profile.

Weaknesses:

- Cyclical industry (iron ore products, flat and long steel),
- Small size and exposure to competitive pressures from larger global producers with higher-quality iron ore reserves,
- Higher cost structure than that of peers as a result of lower-scale operations and lower-grade ore, and
- Aggressive capital expenditure plan, mainly aimed at expanding iron ore production capacity.

Rationale

The 'BBB-' ratings on Chile-based integrated ferrous metal holding company CAP S.A. reflect its satisfactory business risk profile and intermediate financial risk profile. The former is based on the company's strong competitive position as the country's sole integrated steel producer, its dominant market share in the small but growing Chilean steel market, and on its relatively large medium- and long-term export contracts for iron ore. However, these strengths are partly offset by the company's small size on a global scale and the relatively low ore grade of its mining reserves, which result in a higher cost structure than that of its large competitors (mainly high-grade Brazilian and Australian mines). Also, CAP is exposed to the cyclicality of the iron ore and steel industries, which results in volatile prices for its iron ore and its flat and long steel products. The company's intermediate financial profile reflects its projected adequate leverage and debt service coverage ratios (DSCR), partly offset by its volatile cash flow generation, aggressive capital expenditure plan in the period from 2006 to 2010, and, to a lesser extent, dividend payments (around 50%).

We expect CAP's net debt levels to peak at around US$500 million to US$550 million by 2008-2009 in spite of the projected good cash flow generation deriving from a favorable pricing environment for iron ore and steel products. This is mainly due to the aggressive capital expenditure program aimed at expanding the company's capacity to produce iron ore and, to a lesser extent, steel products, following the strategy of monetizing the company's mining reserves. Total debt is projected to start decreasing more significantly by 2010, when two sizable mining expansion projects are expected to start operations.

Standard & Poor's Ratings Services expects CAP's total debt to EBITDA to range between 2x and 3x in the 2007-2009 period, and its EBITDA interest coverage and funds from operations (FFO) to total debt to reach about 6x and 30%, respectively. However, when dividend income from the company's 50% owned subsidiary Compañía Minera Huasco S.A. (CMH) is added to cash flow generation, total debt to adjusted EBITDA, adjusted EBITDA interest coverage, and adjusted FFO to total debt are projected to reach about 2x, 8x, and 30% to 40%, respectively, in that period.

CAP produces and sells iron ore products through Compañía Minera del Pacífico S.A. (CMP) and CMH, and steel products mainly through Compañía Siderúrgica Huachipato S.A. (Huachipato). The company has a diversified ownership structure, since its major shareholder, the Chilean holding company Invercap S.A., holds a 31.32% equity stake. Invercap is 21.24% owned by Cia. Explotadora de Minas, a Chilean holding company majority owned by Juan Rassmuss, vice president of CAP's board of directors. The remaining almost 70% equity stake of CAP is mainly owned by Mitsubishi Corp., Chilean pension funds, and other financial investors.

Liquidity

CAP's relatively high cash position is expected to enhance its liquidity and financial flexibility. Its cash position reached US$284 million as of Sept. 30, 2006, after the issuance of the US$200 million bond, and is expected to decrease to about US$50 million to US$100 million by 2008 as a result of high capital expenditures. In addition, CAP has access to uncommitted bank lines of about US$150 million, and its liquidity benefits from a smooth debt maturity profile, with annual debt maturities below US$70 million for the next 10 years.

Outlook

The stable outlook reflects Standard & Poor's expectations that CAP will generate adequate levels of cash flow (including dividends from subsidiaries) for the next five years, which, combined with the recent US$200 million fixed-rate bond issue, should allow it to finance its aggressive capital expenditure plan, distribute moderate dividends, and face sizable debt maturities in 2010 and 2011. Upgrade potential is somewhat limited by the company's relatively high cost structure, which derives from its small size and low ore grade of its mining reserves in comparison with those of its peers. A downgrade could result if a significant decrease in sale prices results in a strong reduction in cash flow generation that affects the company's ability to internally finance a large portion of its aggressive capital expenditures.

Business Description: Iron Ore And Steel Products Are Main Segments

CAP is a Chilean holding company mainly engaged in the production and sale of iron ore products (through its 99.9% owned Chilean company CMP and its 50% equity stake in CMH) and steel products (mainly through its 99.9% owned Chilean company Huachipato). CAP also holds 33.4% of Cintac S.A., a leading tube and pipe producer in Chile with a market share exceeding 40%. CAP's main parent, Invercap, owns an additional 29% stake in Cintac. In 2006, Cintac purchased the Mexico-based Imsa Group's Chilean operations, which included two well-known product innovation companies--Instapanel S.A. and Varco Pruden Chile Ltda.--engaged in the production of structures, panels, steel framings, and building structures mainly for the Chilean construction sector. In addition, CAP is engaged in other, noncore businesses. These include copper production through its 27% stake in Compañía Minera Carmen de Andacollo, a small Chilean copper mine located in Region IV, and the production of manganese (which is used to produce steel) through its 98.7% subsidiary Manganesos Atacama S.A.

The ownership structures of CAP and Invercap are detailed in the following two charts.

Table 1

CAP S.A. Ownership

Owner	%
Invercap S.A.	31.32
Mitsubishi Corp.	12.51
AFP Provida S.A.	5.06
Citibank N.A.	3.75
Inversiones Rand Ltda.	3.75

Cia. Explotadora de Minas	2.53
Fundacion CAP	2.19
AFP Habitat S.A.	1.94
Inversiones AEGIS Chile S.A.	1.40
Penta Corredores de Bolsa S.A.	1.38
Inversiones Monterrey Ltda.	1.31
Others	32.86

Table 2

Invercap S.A. Ownership Structure

Owner	%
Cia. Explotadora de Minas	24.21
Lacerta S.A.	8.89
Fundación CAP	8.25
Inversiones Rand Ltda.	8.19
Inversiones Hierro Viejo Ltda.	7.06
Sycaruse S.A.	5.40
Goran S.A.	4.99
Inversiones Monterrey Ltda.	3.43
Inversiones AEGIS Chile S.A.	3.37
Others	26.24

Business Risk Profile: Satisfactory Due To Good Competitive Position

Overall, CAP has a satisfactory business risk profile, which mainly reflects its good competitive position as the sole integrated steel producer in Chile. However, these strengths are partly offset by its small size as an iron ore and steel producer on a global basis, which results in relatively low economies of scale and a higher cost structure than that of its peers (CVRD, Rio Tinto, and BHP Billiton), and by its exposure to the cyclicality of those industries, which results in relatively high volatility in the price of its products (iron ore products and flat and long steel). CAP has devised a relatively aggressive expansion strategy to monetize its relatively large iron ore reserves. This strategy consists of strong growth in the iron ore business while the company maintains its large market share in the relatively small but growing Chilean steel market.

Country risk

CAP's production facilities are concentrated in the Republic of Chile. The ratings on the Republic of Chile reflect its strong policy framework supported by rules-based fiscal and monetary policies, a maturing political consensus on key elements of economic policy, a political commitment to an open economy, and a low and declining public debt burden. The change of administration in 2006 did not alter the course of economic policy, consensus on which is backed by an impressive track record of growth, stability, and a rapid reduction in poverty. Public-sector gross debt is projected to fall to 20% of GDP in 2006 from nearly 40% in 2002, thanks to rapid GDP growth and impressive fiscal surpluses. However, the ratings are constrained by a relatively narrow economic base and resulting vulnerability to cyclical economic performance due to the fluctuating price of copper and net external debt burden that is still high when compared with that of its peers. The Republic of Chile's total external debt, estimated at slightly less than 100% of current-account earnings in 2005, is higher than that of most similarly rated sovereigns.

Natural resources, led by the mining sector, account for around 12% of Chile's GDP, compared with the 16% share held by manufacturing. While Chile has successfully used its natural resources to prosper, the comparatively small size of the more technologically advanced sectors of the economy gives it a weaker economic profile than that of some of its rating peers.

Industry characteristics

Overall, CAP has a higher cost structure than that of its large peers, and faces the natural cyclicality and volatility of the iron ore and steel sectors on a global basis, although those credit weaknesses are partially offset by its very strong competitive position in the growing Chilean steel market, as well as by medium- and long-term export contracts of iron ore products. Thus, this volatility is mostly reflected in a relatively volatile pricing environment for iron ore and steel products.

CAP is a very small player in the iron ore and steel markets on a worldwide basis. In 2005, it produced 7.3 million tons of iron ore products and 1.1 million tons of steel products, compared with worldwide production of around 1.5 billion tons and about 1.1 billion tons, respectively. CAP exports about 80% of its iron ore products (mainly to Asia) through medium- and long-term contracts, and enjoys a large market share in the different segments of the steel market (flat and long steel products) in Chile. This results from the advantages provided by the vertical integration of its operations and from its position as the largest iron ore producer in Chile. In addition, CAP's steel business in Chile is somewhat protected from the competitive pressures of larger international players because of its integrated operations, the natural barrier generated by freight costs, and the flexibility of being close to its clients, with just-in-time production agreements with its main customers. However, CAP is exposed to the price volatility of iron ore and steel in the international market because iron ore is mostly exported, and the behavior of international markets influences prices of steel products in the domestic market given that Chile is an open economy.

During 2005, CAP's sales of iron ore and steel products reached US$233 million and US$647 million, respectively, which represented 26% and 74% of total consolidated sales. Iron ore products should represent about 35% of CAP's consolidated sales after the expected increase in production capacity to about 15 million tons by 2010.

Iron ore. In 2005, CAP produced 7.3 million tons of iron ore products (fines, lumps, pellet feeds, and pellets), which represented only about 0.5% of worldwide supply (about 1.5 billion tons). (Three companies--CVRD, Rio Tinto, and BHP Billiton--represent about 75% of the worldwide iron ore products market.) In addition, CAP enjoys large reserves of iron ore (magnetic ore) and limestone (about 18 years and 20 years of 2005's production, respectively). However, the ore grade of the mineral is low (about 40% to 50% ore grade levels) when compared with that of top mines in Brazil and Australia. Table 3 shows the evolution and projected production mix of the iron ore business:

Table 3

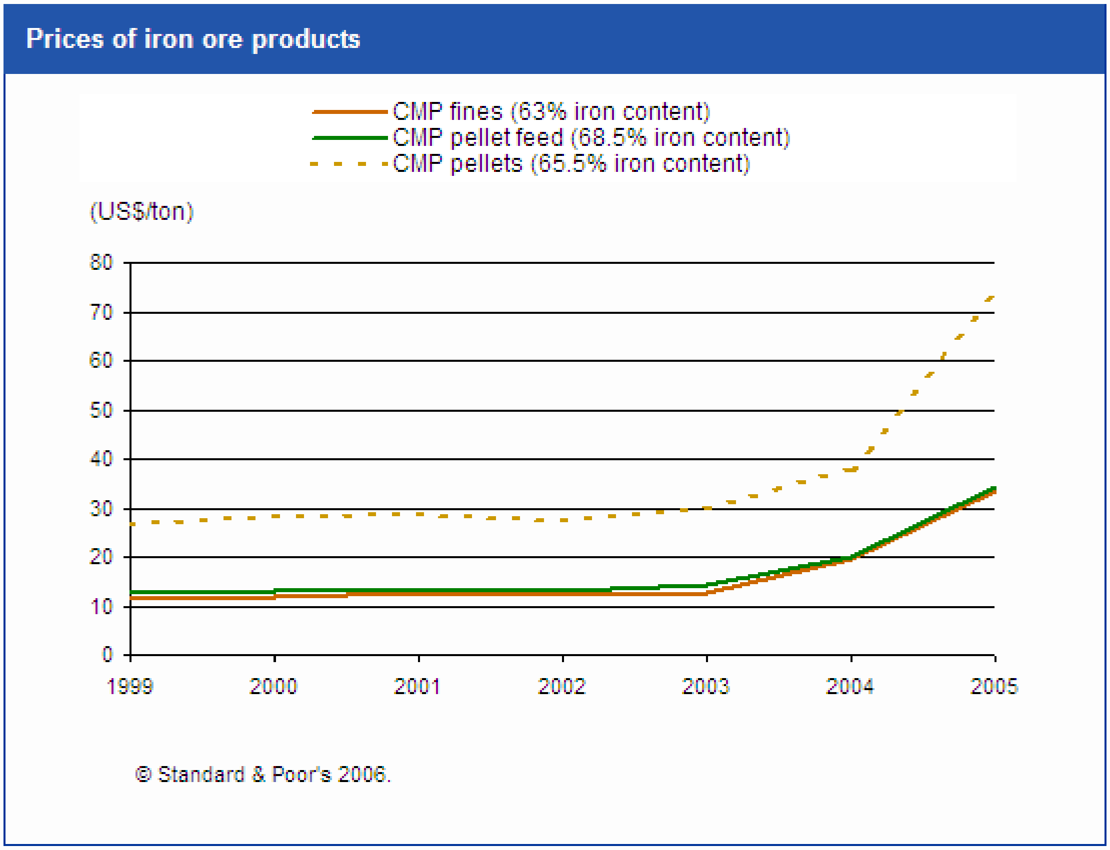
Iron Ore Production Mix

Product	**2005**	**2006 (projected)**	**2010 (projected)**
(Mil. tons)			
Iron ore pellet	4.1	4.1	9.1
Iron ore pellet feed	1.6	2.6	4.6
Iron ore lumps and fines	1.3	1.3	1,2
Waste pellets	0.3	0.3	0.3
Total	7.3	8.3	15.3

CAP will expand its iron ore production capacity by three million tons by the fourth quarter of 2007 through a roughly US$170 million investment (Hierro Atacama, phase I) in the 2006-2007 period. Also, management is evaluating the possibility of expanding this capacity by four million additional tons (Hierro Atacama, phase II) by the first quarter of 2010 through a US$265 million investment in the 2007-2010 period.

CAP carries out its iron ore operations through two companies: its 99.9% owned CMP and 50% owned CMH. In 2005, CMP produced 1.9 million tons of iron ore (643,000 tons of lumps, 335,000 tons of fines, and 901,000 tons of pellet feed). Of this amount, 1.3 million tons were exported mainly to Asia, and the rest was sold to Huachipato. In addition, CMP purchases from CMH about 5.5 million tons of "preconcentrate," which is used to produce pellets (about 4.1 million tons), pellet feed (about 700,000 tons), lumps (about 300,000 tons), and waste pellets (about 300,000 tons). These products are then sold back to CMH (at cost plus a fee), which exports them mainly to Asia. As a result, about 80% of CAP's consolidated iron ore production is exported mainly to Asia through long-term supply contracts, and the remaining 20% is sold to Huachipato. CAP has outstanding medium- and long-term supply contracts with POSCO in Korea; JFE Steel Corp., Kobe Steel Ltd., and Nisshin Steel Co. Ltd. in Japan; and Hangzhou Iron & Steel Co. and Jinan Iron & Steel Co. Ltd. in China, among others. Sale prices for these contracts are reset once a year, being exposed to relatively high volatility as evidenced in chart 1:

Chart 1

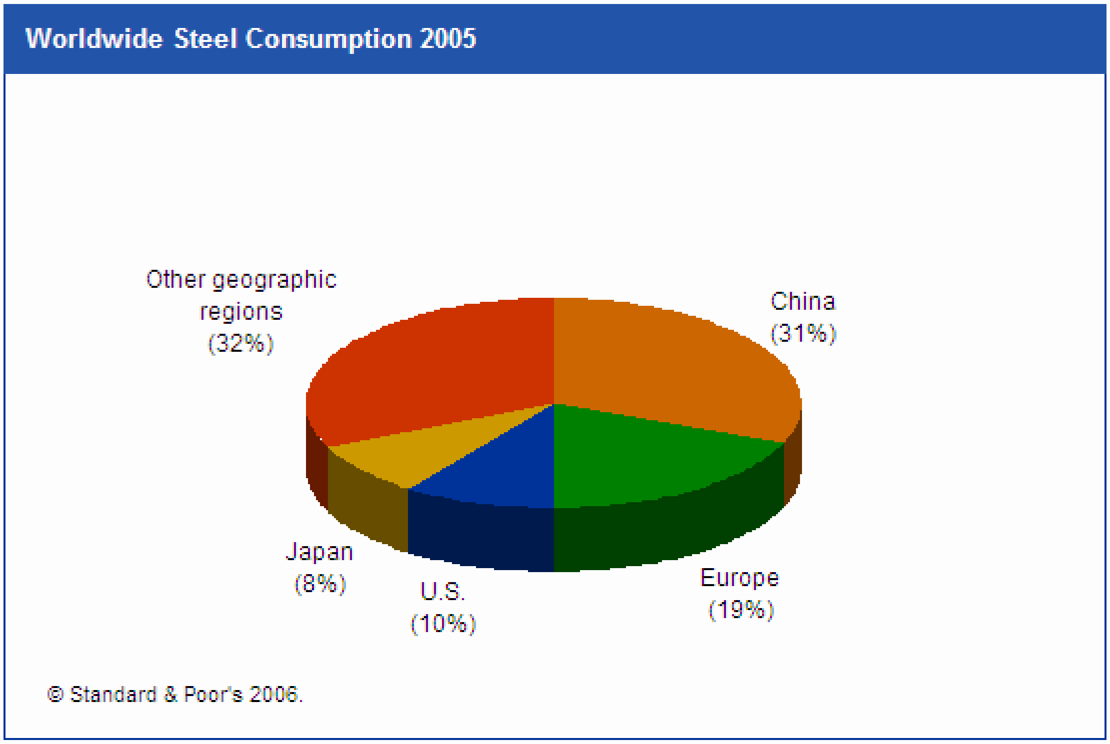


Steel products. CAP is the leader in the small Chilean steel market, and benefits from the privileged position of having integrated operations and being the largest iron ore producer in Chile.

Demand

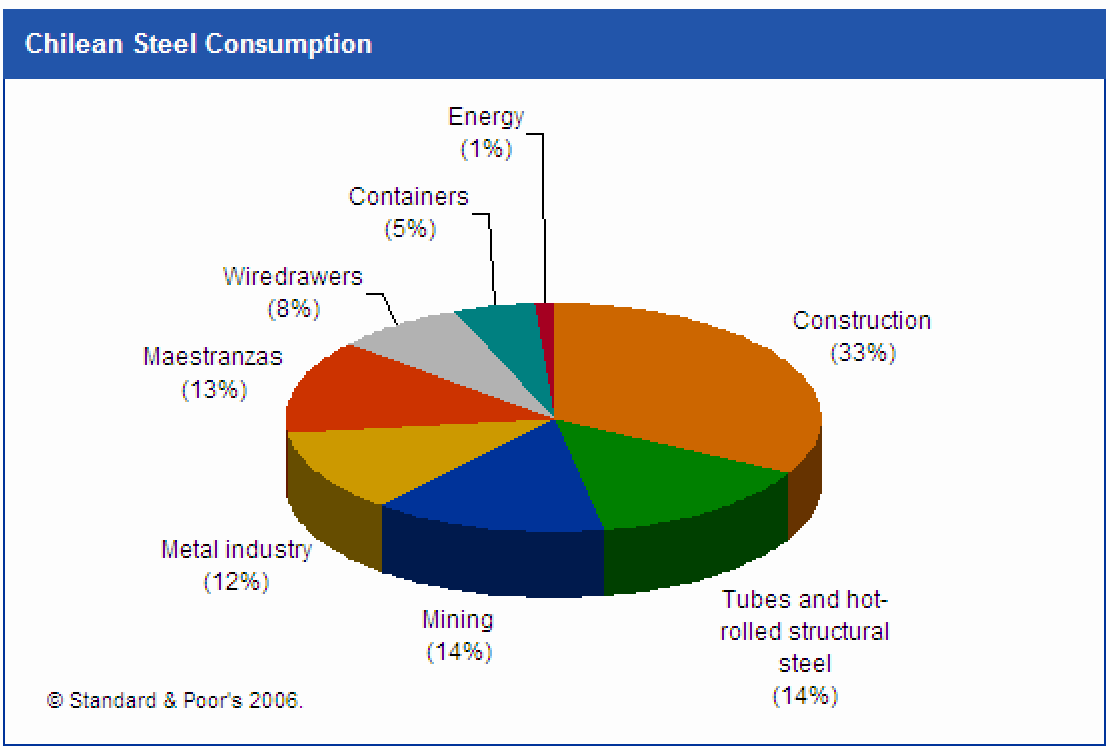
Chart 2 shows the breakdown of steel consumption (apparent steel use) per geographic region in 2005:

Chart 2



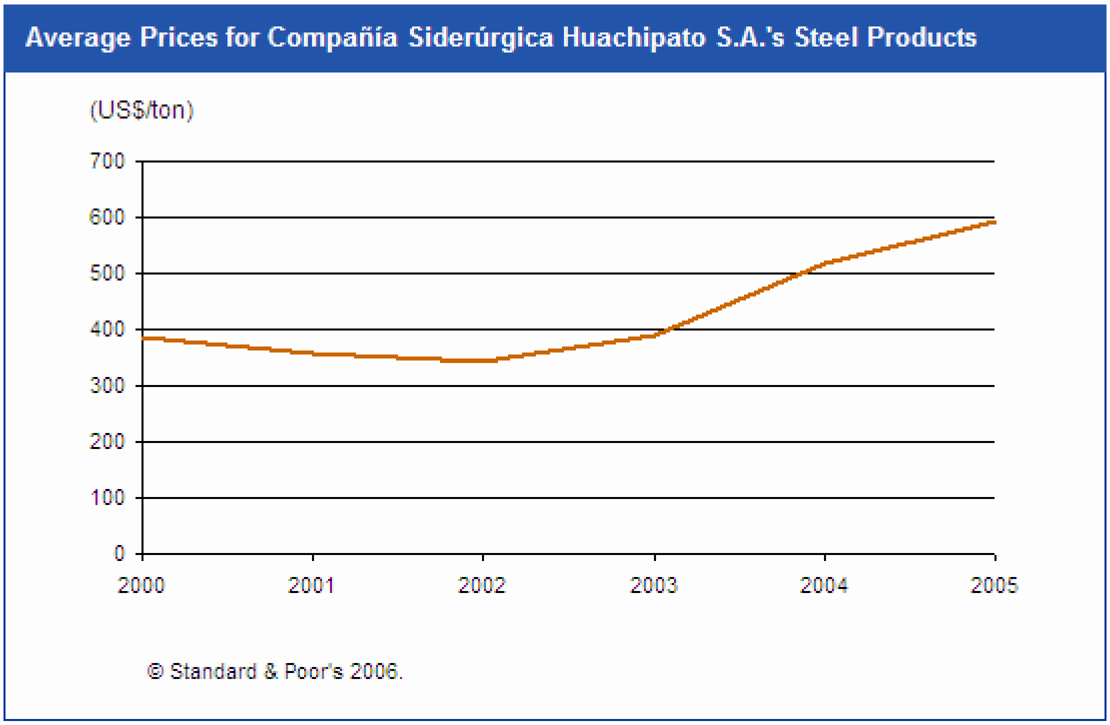
Steel demand in Latin America in 2005 reached about 63 million tons, which represented around 6% of total consumption worldwide. The main consumers in the region are Brazil, with about 23 million tons per years, Mexico, with 22 million tons, Argentina, with 5 million tons, and Chile, with around 2 million tons. In Chile, demand breaks down as follows:

Chart 3



Steel consumption in Chile comes mainly from the construction, mining, and metal manufacturing industries. CAP has maintained a share of 1.1 million tons, over 60%, of its target market of around 1.6 million tons, and over 50% of the total domestic steel market of about 2 million tons per year. The company leads the Chilean steel market with sales of around 1.1 million tons (52%), followed by imports of about 0.7 million tons (35%) and local producer Gerdau AZA S.A. with total sales of around 0.3 million tons (13%) per year. Per capita consumption of steel is relatively low (about 140 kilograms per year) in Chile due to its modest industrial activity, although it is growing at relatively high rates of around 5% per year mainly fueled by the construction and mining sectors. However, prices for steel products are exposed to relatively high volatility, as chart 4 reveals:

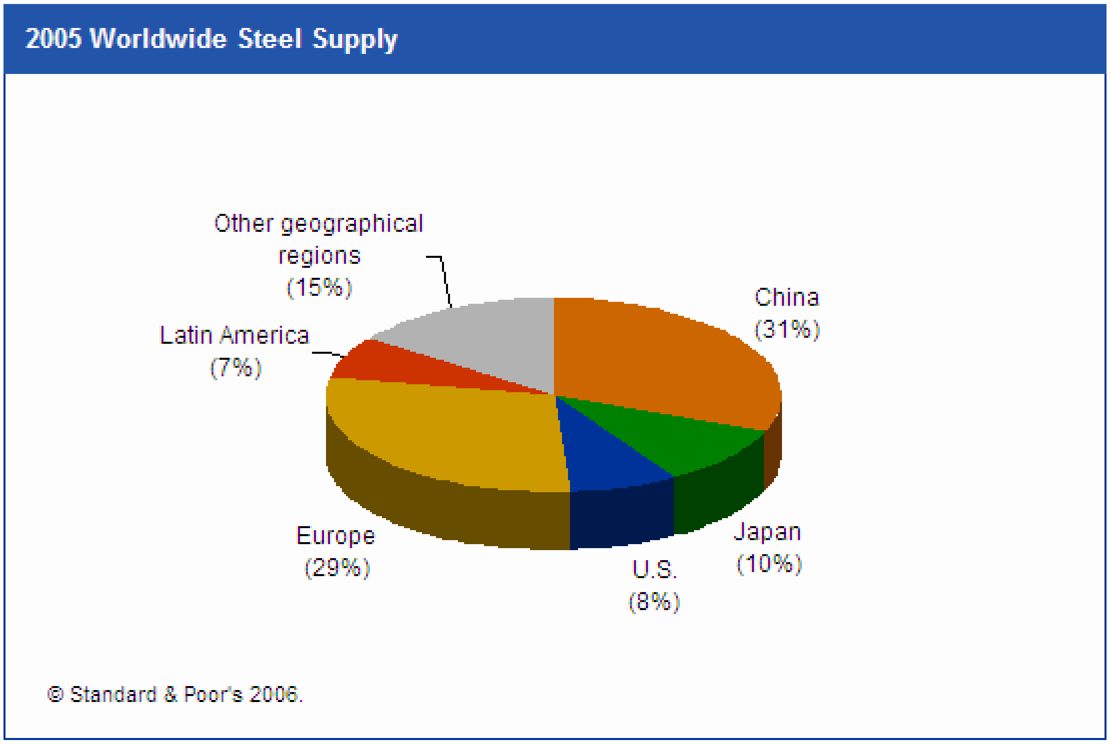
Chart 4



Supply

Supply of steel products worldwide is relatively well diversified, with the largest integrated steel producer, the Arcelor-Mittal group, accounting for approximately 11% of total production. Other producers represent less than 5% of global supply. However, there is some geographical concentration, as China and Asia represent about 30% and 45% of supply, as shown in chart 5:

Chart 5



In Latin America, steel producers are generally concentrated in the local market given their relatively low economies of scale. The exception is Brazil, where large steel producers such as Gerdau are important exporters because supply exceeds local demand by about 10 million tons per year. Total steel production in the region in 2005 reached 78 million tons, which represented about 7% of world supply. The main producers in the region were Brazil, with about 32 million tons per year, Mexico, with around 16 million tons, and Argentina, with 5 million tons. Chile produces a relatively low 1.2 million tons per year. While Brazil is a large steel exporter, shipping about 10 million tons per year, and Argentina small, exporting about 1 million tons per year, Mexico and Chile are net importers of about 5 million tons and 0.7 million tons per year, respectively.

Competitive strengths and operations

Iron ore mining facilities. CAP operates, through CMP, two iron ore mining sites: Los Colorados in the Huasco Valley and El Romeral in the Elqui Valley, in northern Chile. Los Colorados, 50% owned by CAP and 50% by Mitsubishi, supplies about 5.3 million tons of iron ore preconcentrate to the Huasco pellet plant, which converts preconcentrate into pellets for sale back to CMH at cost plus a margin. CMH exports those pellets, mainly to Asia. El Romeral has a short useful life. It operates stockpile deposits, and may begin underground mining by 2009.

Iron ore industrial facilities. CAP operates, through CMP, El Algarrobito's dry magnetic crushing and concentration plant (1.2 million tons of ore per year), and a pellet plant (5.2 million tons per year of pellets and other products). In addition, CMP operates Los Colorados' dry magnetic crushing and concentration plant, with a processing capacity of 6.5 million tons of ore per year. The plant is 50% owned by CMP and 50% by Mitsubishi. And in the Elqui Valley, CAP operates, through CMP, El Romeral's grinding and concentration plant, with a processing capacity of two million tons of pellet feed per year, and a wet magnetic crushing and concentration plant, with a total processing capacity of four million tons of concentrates per year. El Romeral supplies fines, lumps, and pellet feed to Huachipato, and exports the same to Asia.

CAP benefits from having mines located close to ports (30 to 150 kilometers away, versus 400 to 700 kilometers in the case of Brazilian and Australian mines), which results in lower transportation costs, especially via train. Also, CAP benefits from being the largest port operator in Chile. However, it faces higher ship transportation costs than most Australian companies when exporting to Asia, because of its geographic location.

As previously mentioned, the company's ambitious capital expenditure program includes several expansion projects:

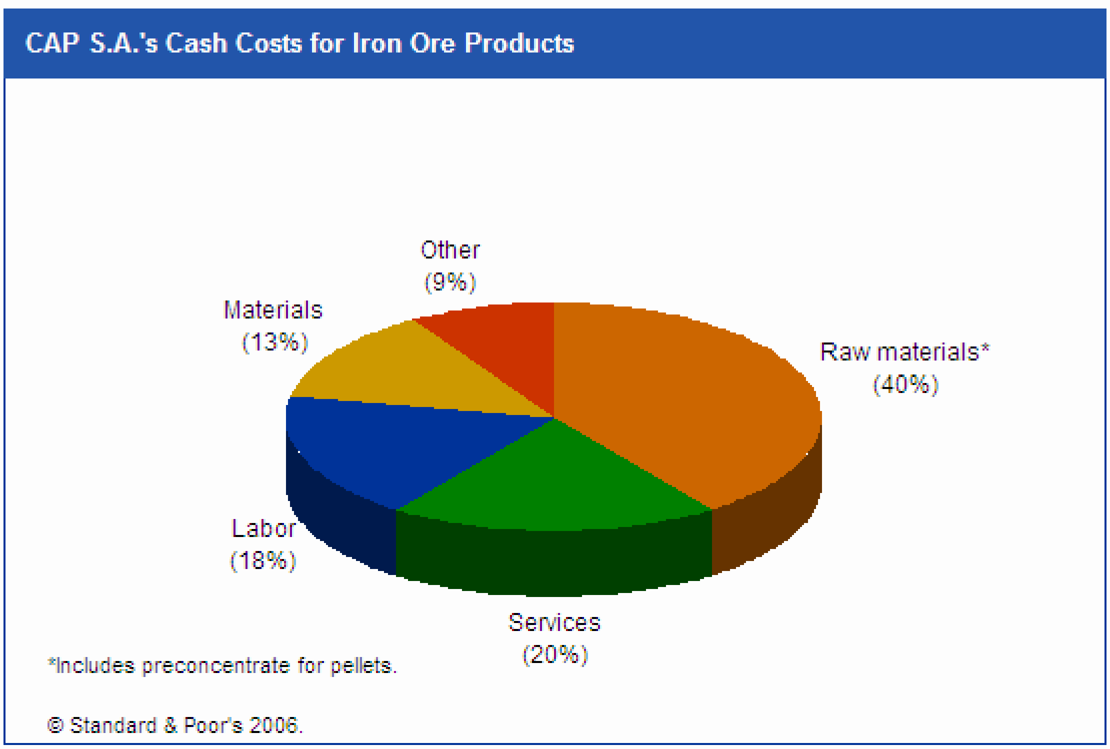
- Hierro Atacama phase I's pellet feed production capacity will be increased by three million tons per year for about 15 years. CMP will also process ore reserves in the Candelaria Mine tailings. This project is expected to begin in the fourth quarter of 2007.
- Hierro Atacama phase II's pellet feed production capacity will be increased by four million tons per year for about 20 years through the processing of ore from the Cerro Negro Norte mine. This project is expected to begin by 2010.

Steel facilities. CSH operates steel facilities at Huachipato in southern Chile. CSH can produce a variety of long steel products, such as grinding bars, reinforcing bars, and wire rod, as well as flat steel products, such as hot- and cold-rolled coils. CSH can produce 1.1 million tons per year of long and flat steel products, and its facilities include a 500,000 ton-per-year coke processing plant, two blast furnaces with a pig iron capacity of 1.3 million tons per year, and a basic oxygen furnace with a liquid steel capacity of 1.25 million tons per year. As part of the expansion plan, CAP is aiming at expanding liquid steel capacity at Huachipato by approximately 200,000 tons by the end of 2007.

Cost position

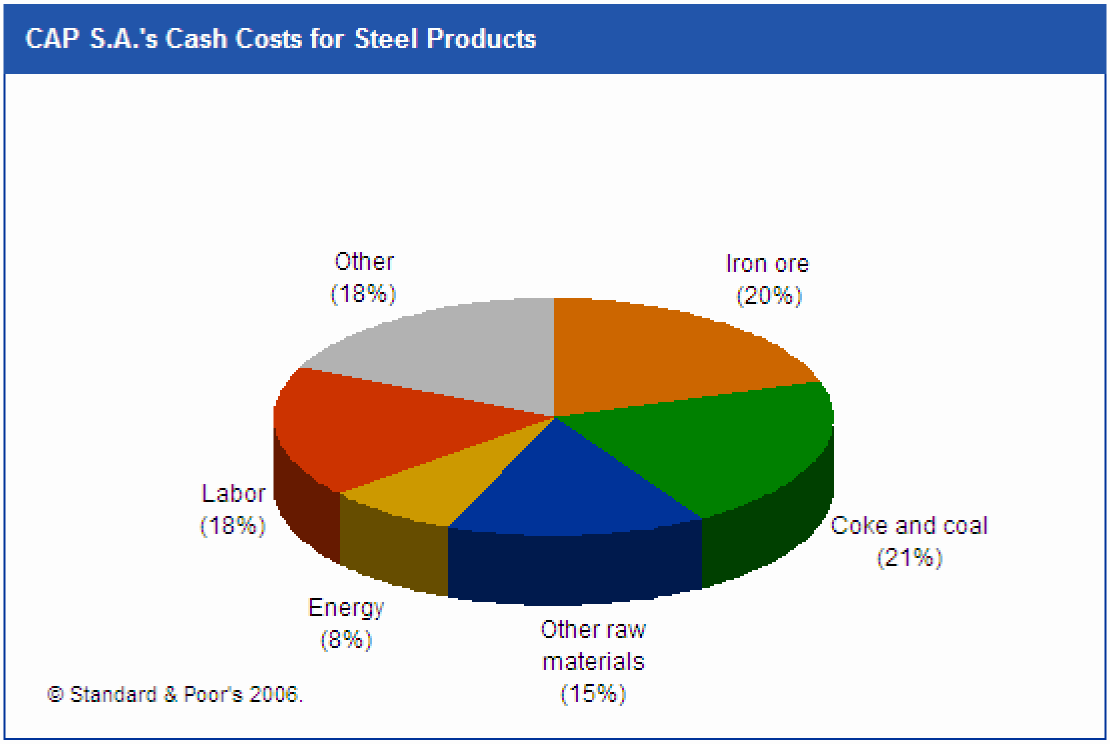
While the cash costs of CAP's iron ore products are higher than those of most of its peers due to its smaller scale, this is somewhat mitigated by the availability of long-term sale contracts with most of the company's export clients. The breakdown of the company's cash costs for iron ore products is as follows:

Chart 6



CAP enjoys a solid market position in the Chilean steel market, as evidenced by its large market share, given its integrated operations and because its size as the largest domestic steel producer. The breakdown of the company's cash cost for steel products is as follows:

Chart 7



Labor issues

Approximately 80% of CAP´s work force is covered by collective bargaining agreements expiring in 2010. CMP has not experienced any work force disruptions in the past 20 years, and CMH over the past 10 years. Labor contracts are in place for El Romeral mines (from June 2006 to May 2010), CMP HuascoValley (from October 2006 to September 2010), and CMH (from January 2007 to December 2010).

Peer comparison

CAP has higher cash costs than those of large peers such as CVRD, Rio Tinto, and BHP Billiton, due to lower economies of scale and the lower ore grade of its mining reserves. CAP's profitability is volatile and reflects the inherent cyclicality of the iron ore and steel industries. This is reflected in volatile sale prices and operating costs (for coal, energy, and freight, for example), evidenced by EBITDA margin and ROE that oscillated from 15% to 29% and from a negative 2.5% to 29%, respectively, in the period from 2001 to 2005. In addition, CAP's lower scale and higher cost structure is reflected in its relatively low EBITDA margin. Iron ore and steel prices are expected to decline, but the effect would be partly offset by the upcoming relatively large capacity expansion. As a result, EBITDA margin is expected to oscillate between 17% and 25% in the period from 2006 to 2010, which would result in attractive ROE levels exceeding 10%.

Financial Risk Profile: Intermediate Due To Decent Debt Measures And Volatile Cash Flow

Overall, CAP has an intermediate business risk profile, which reflects its adequate debt levels and DSCRs offset by volatile cash flow generation (including dividends received from CMH) deriving from the inherent cyclicality of the iron ore and steel businesses. In addition, the company's large capital expenditure plan for the period from 2007 to 2010 and, to a lesser extent, dividend payouts (around 50%) are expected to pressure its good but volatile cash flow generation.

Accounting

CAP reports its financial statements in accordance with Chilean GAAP and in U.S. dollars. CAP is a holding company, consolidates with subsidiaries CMP and Huachipato, and uses the equity method with noncontrolled subsidiaries such as CMH, Minera Carmen de Andacollo, and Cintac. However, CAP will consolidate with Cintac as of fiscal 2006 because of its indirect control over the company deriving from the recent acquisition of an additional equity stake in the holding company NOVACERO S.A., which controls Cintac. CAP manages CMH through its 99.9% owned CMP. Given the long-term nature of the investment and the high integration between CMH's and CMP's operations, Standard & Poor´s considers dividends that CAP receives from CMH as part of CAP's operating cash flow generation, and adjusts the latter to include them.

Corporate governance/Risk tolerance/Financial policies

CAP has implemented a more aggressive business and financial policy (as compared with its relatively conservative usage of debt over the past few years), as evidenced by debt to capitalization and debt to adjusted EBITDA (including dividends received from CMH) of 39.1% and 2x, respectively, in 2005. The recent issuance of the US$200 million fixed-rate bond has already triggered an increase in CAP's debt to US$546 million as of Sept. 30, 2006, although the company has maintained a high US$284 million cash position. These high liquidity reserves are projected to mainly go toward financing phases I and II of the Hierro Atacama project. Nevertheless, liquidity contingencies and refinancing risk have been relatively well offset by the company's adequate debt structure (a great portion of which is long term) and good cash flow generation.

Cash flow adequacy

CAP centrally manages the cash flows of CMP and Huachipato, and receives 50% of dividends paid by CMH. CAP's consolidated cash flow generation is volatile, having oscillated between about US$40 million in 2001-2002 (without adjusting for dividends received from CMH) and about US$160 million in 2004-2005, mainly due to the boost in prices for iron ore and steel (although the increase is also explained by a 15% increase of its steel production capacity). The price increase was mainly a result of the increase in weighted average sale prices of iron ore and steel products to about US$23 and US$550 per ton, respectively, in 2004-2005 from around US$19 and US$350 per ton in 2001-2002. Standard & Poor's projects that CAP will generate about US$150 million to US$250 million per year and receive at least US$40 million to US$50 million in dividends from CMH in the period from 2007 to 2010, which would be mainly applied to finance the company's large capital expenditure plan of about US$150 million per year and also to distribute dividends to its shareholders. As a result, CAP is projected to have tight free cash flow generation, given its aggressive capital expenditures to increase its production capacity of iron ore to 15 million tons in 2010 from seven million tons in 2005, and its steel production capacity to 1.45 million tons by 2007. In addition, Standard & Poor's expects CAP to maintain a flexible dividend payout of about 50% of net income.

Capital structure/Asset protection

CAP has reported moderate leverage, with total debt to total capitalization of 39.1% as of Dec. 31, 2005, and total debt to adjusted EBITDA (including dividends received from CMH) of 2x in 2005. Standard & Poor's expects CAP to finance its large capital expenditure plan with its own cash flow generation and the proceeds of the recently issued US$200 million fixed-rate long-term bond, and to maintain a relatively large cash cushion in the 2007-2008 period. In addition, Standard & Poor's expects CAP's net debt levels to peak at around US$500 million to US$550 million by 2008-2009 and start decreasing by 2010, when two sizable mining expansion projects are expected to start operations. Standard & Poor's expects CAP's total debt to adjusted EBITDA to reach about 2x in the 2007-2009 period.

CAP enjoys a smooth debt maturity profile, with annual debt maturities below US$70 million for the next 10 years. In addition, CAP faces manageable foreign exchange risk, given that most of its revenues and about 80% of its debt is in U.S. dollars. However, CAP is exposed to interest variations, as about 55% of its outstanding debt is at variable interest rates.

Liquidity/Short-term factors

CAP's relatively high cash position enhances its liquidity and financial flexibility. Its cash position reached US$284 million as of Sept. 30, 2006, after the issuance of the US$200 million bond, and is expected to decrease to about US$50 million to US$100 million by 2008 as a result of high capital expenditures. CAP seeks to maintain a minimum cash position of about US$50 million. In addition, it has access to uncommitted bank lines of about US$150 million and benefits from the previously mentioned smooth debt maturity profile.

Ratings Detail (As Of 18-Dec-2006)*	
CAP S.A.	
Corporate Credit Rating	BBB-/Stable/--
Senior Unsecured	

Foreign Currency	BBB-
Corporate Credit Ratings History	
01-Sep-2006	BBB-/Stable/--
Business Risk Profile	Satisfactory
Financial Risk Profile	Intermediate

Debt Maturities

2007 US$27 mil.
2008 US$2.1 mil.
2009 US$27.1 mil.
2010 US$64.6 mil.
2011 US$64.6 mil.
2012 US$39.6 mil.
2013 on US$301.1 mil.

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.