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Ratings

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CAP S.A.

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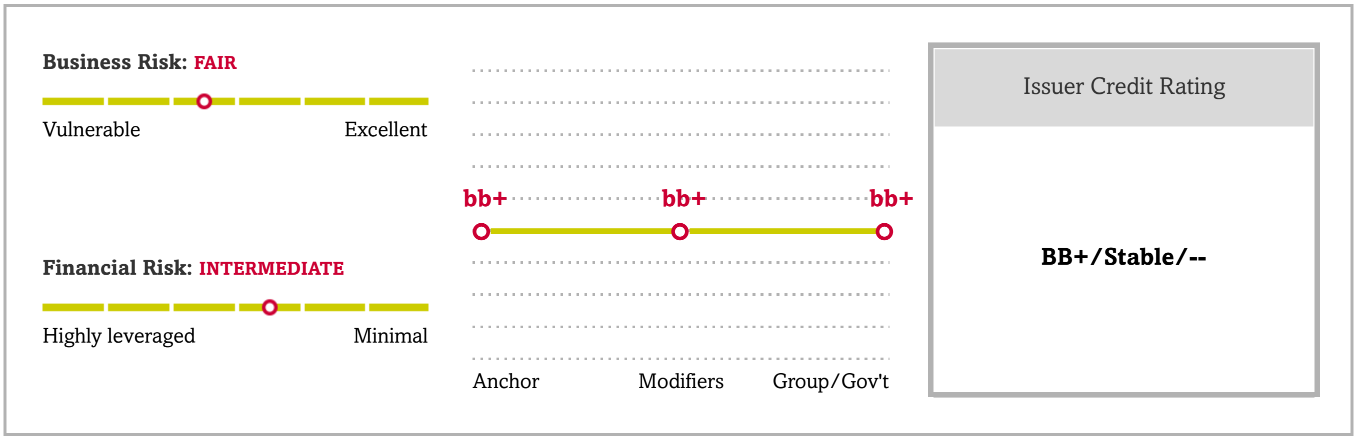


Credit Highlights

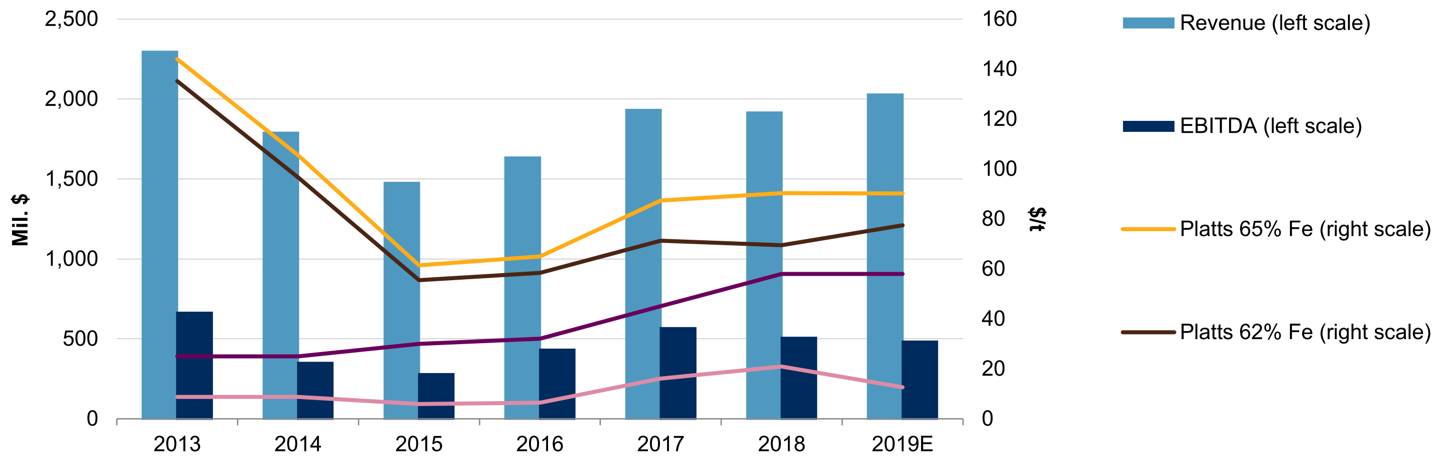
Overview

Key strengths	Key risks
Well positioned in the niche market of high-grade iron ore (around 67% iron content).	Operational disruptions due to the loss of the ship loader at the Guacolda 2 Port.
Low debt and strong liquidity.	Limited product diversification thus high exposure to market downturns.
Long life of iron ore reserves (about 60 years).	Small scale of operations: around 16 million tons (MT) of iron ore and around 800 kilotons (KT) of steel.
Prudent financial policy to protect balance sheet from iron ore price swings.	Asset concentration in Chile.

High exposure to commodity price volatility. CAP's modest scale compared with global iron producers and its cash generation's dependence on mining activities results in a high correlation between its results and movements in iron ore prices and premiums.

Chart 1

CAP's Revenue And EBITDA Generation Versus Iron Ore Prices



E--Estimate. Source: S&P Global Ratings.

Favorable iron ore prices and premiums. Recent supply constraints have strengthened iron ore prices. CAP should benefit from the lower global supply of pellets, combined with increasing demand for high quality iron ore from China, which should support continued high pellet premiums.

Increasing investment pipeline over the next few years. After low capital expenditures (capex) levels due to unfavorable market conditions, we expect CAP to focus its investments on both a permanent fix of the ship loader at Port Guacolda 2 as well as on asset efficiencies, which should increase the company's iron ore output after this year.

Outlook

The stable outlook reflects our expectation that CAP will be able to partly offset the side effects of losing the ship loader at the Guacolda 2 Port--which increases logistic costs and limits export capacity--by using nearby ports and by the higher iron ore prices. We expect that the company's steel, infrastructure, and logistics businesses will continue to contribute positively to CAP's cash generation. Thus, we forecast credit metrics to remain strong over the next several quarters, with debt to EBITDA below 2x, funds from operations (FFO) to debt above 80%, and positive free operating cash flow (FOCF) generation this year, despite higher capex levels.

Downside scenario

We could take a negative rating action if iron ore prices were to decline, and CAP's offsetting measures weren't sufficient to prevent significantly weaker cash flows. In that scenario, we would expect to see debt to EBITDA above 2x, FFO to debt below 45%, and FOCF to debt below 5%.

Upside scenario

Although unlikely in the next 12 months, we could raise the ratings if CAP improves its operational scale and diversification to more sustainably support stronger profitability and less volatile cash flow metrics.

Our Base-Case Scenario

Assumptions

- Chile's GDP growth of 3.3% in 2019 and 3.1% in 2020.
- Chile's average foreign exchange (FX) rate of CLP670 per $1 in 2019 and CLP 680per $1 in 2020.
- Average iron ore prices of $78 per ton in 2019 (including realized prices for 2019's first three months), $70 per ton in 2020, and $65 per ton in 2021.
- Coal prices at $180 per ton in 2019, but declining to $160 in 2020.
- Cash costs about $47 per ton in 2019 due to the Guacolda accident and around $41 after that.
- Freight cost of $12 per ton from 2019 onwards.
- Total iron ore production of 14 million tons in 2019, affected by the port accident, and then increasing to 16 million tons in 2020 as provisional shiploaders are put in place.
- Pellet premiums of about $58 per ton in 2019, gradually declining to $55 in 2020.
- Capex of about $240 million in 2019 and 2020, including expenditures related to the port accident, such as the acquisition of a new shiploader for the Las Losas Port and the fabrication of a provisional shiploader for Guacolda II, as well as expansion capex at the Cerro Negro Norte and Los Colorados mines.
- Dividend payout at 50% from 2019 onwards.

Key Metrics

	2018A	2019E	2020E
EBITDA margin (%)	26.5	23.8	24.3
Debt to EBITDA (x)	0.9	0.9	0.8
FFO to debt (%)	67.9	81.6	90.3
FOCF to debt (%)	30.4	22.7	31.4

All figures are S&P Global Ratings adjusted.

A--Actual. E—Estimate.

Base-case projections

Cash cost. We expect the company's cash cost to increase to $47 per ton this year, mainly due to lower output and expenses related to the port accident. We expect it to then stabilize at $41 per ton in 2020 when the company returns to normal output levels. We forecast gross margins around 31% in 2019 and 2020.

Higher iron ore prices supporting robust cash generation. We believe that higher prices should partially mitigate lower iron ore output and higher cash costs this year, which should allow the company to counterbalance lower EBITDA this year compared to last year.

Port Guacolda II. We expect a fix to the ship loader to be completed by the end of 2020; involving the acquisition and construction of a new ship loader.

Investments in base metals. Our projections don't include potential investments from CAP into other base metals in order to diversify operations. If this occurs, it could affect future cash flow generation and leverage metrics.

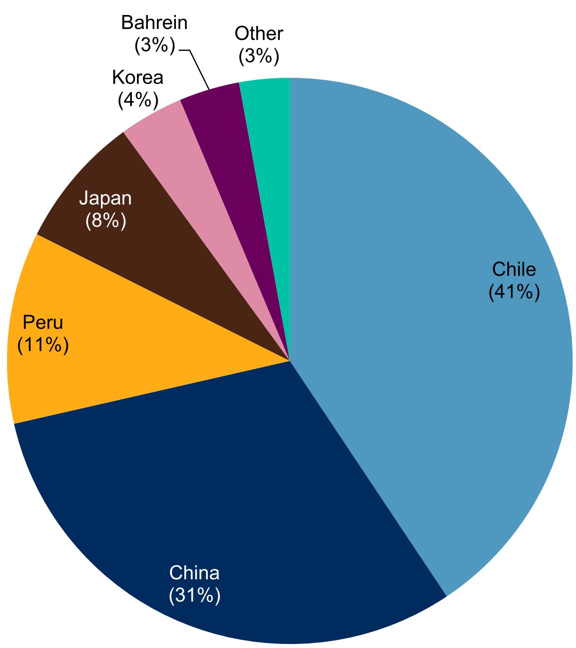
Company Description

CAP is a Chilean iron ore miner and steel maker focused on high quality iron ore production for export markets (mainly China), steel production for the Chilean market, and steel processing for the construction, industry, and infrastructure sectors in Chile, Peru, and Argentina. The company has roughly 18 million tons of mining production capacity from four production sites (Los Colorados, El Romeral, Cerro Negro Norte, and Magnetita) and a steel production and processing capacity of about 1 million tons.

Along with its mining and steel activities, which represent around 90% of the company's EBITDA, CAP also operates a seawater desalination plant, which delivers water to CAP's Cerro Negro Norte mine and magnetite plant and to the surrounding city; a power transmission line; and a multipurpose port (Las Losas port). These three operations generate the remaining 10% of CAP's EBITDA.

Chart 2

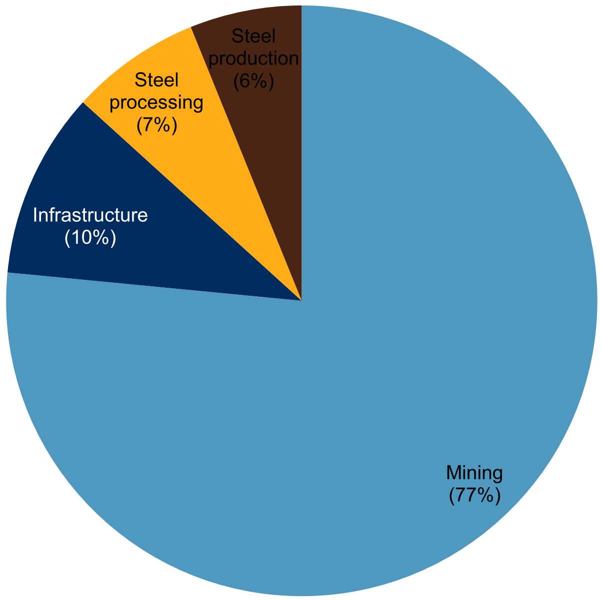
Revenue Breakdown By Region
2018



Source: S&P Global Ratings.

Chart 3

CAP's EBITDA By Business Unit



Source: S&P Global Ratings, data from CAP.

CAP is controlled by Invercap S.A. (31.3%), a group formed by families that participated in CAP's original privatization. Mitsubishi Corporation is also a relevant shareholder of CAP with a 19.3% stake.

Business Risk

We assess CAP's business risk profile as fair, reflecting its niche market position but small size compared to other miners. CAP has focused on improving the efficiency of its concentration and pelletizing its iron ore assets in order to compensate for the high cash cost of its mines. We observe that CAP has been able to adequately shift production between pellets, pellet feed, and iron ore in order to adapt to market conditions and maintain adequate margins, which should continue making its cash generation resilient.

Competition against steel imports in Chile affect CAP's steel production, reflected in the company's negative to breakeven margins for this business unit. CAP has focused on increasing steel exports, accessing new markets such as Colombia, in order to make the business unit profitable. The company also reduces the impact of import competition through its steel processing activities, which uses its distribution channel to import steel and further develop it to sell value-added products to different sectors in Chile, Peru, and Argentina. We don't expect much change in the dynamics of CAP's steel operations, because a turnaround would require significant investments in the company's assets, which are not part of the company's investment pipeline for the next few years. However, we do expect some minor increase in CAP's steel processing volumes, stemming from the incorporation of the assets it acquired in Peru last year: the Calaminon modular construction company and the Sehover and Signovial road infrastructure and services companies.

The company's infrastructure business, which includes the Las Losas port, has had a shift in the normal course of business due to the unplanned exports out of Huasco Valley (CAP's current solution to the Guacolda 2 port accident). Once this shift is normalized, we believe that there is a medium term growth potential if CAP is able to increase its port services to third parties, since the Las Losas utilization rate is currently around 30%.

Peer comparison

Table 1

CAP S.A. -- Peer Comparison

Industry Sector: Metals

	CAP S.A.	**Rio Tinto PLC**	**Vale S.A.**	**Usinas Siderurgicas de Minas Gerais S.A.**	**Fortescue Metals Group Ltd.**
Rating as of April 15, 2019	BB+/Stable/--	A/Stable/A-1	BBB-/Negative/--	B/Positive/--	BB+/Stable/--
	--Fiscal year ended Dec. 31, 2018--	**--Fiscal year ended Dec. 31, 2018--**	**--Fiscal year ended Dec. 31, 2018--**	**--Fiscal year ended Dec. 31, 2018--**	**--Fiscal year ended June 30, 2018--**
(Mil. $)					
Revenues	1,917.1	40,522.0	36,575.0	3,548.3	6,887.0
EBITDA	507.9	17,590.0	16,671.5	610.6	3,197.5
FFO	457.1	13,277.0	14,143.8	442.8	1,739.5
Interest expense	50.9	1,327.0	1,478.7	124.2	349.0
Cash interest paid	50.8	711.0	1,399.7	147.6	396.0
Cash flow from operations	283.8	12,578.0	12,888.8	54.2	1,381.5
Capital expenditures	142.7	5,430.0	3,590.0	112.0	901.0
Free operating cash flow	141.1	7,148.0	9,298.8	(57.8)	480.5
Discretionary cash flow	27.7	(4,014.0)	4,803.8	(90.2)	(417.5)
Cash and short-term investments	474.9	13,025.0	5,816.0	437.4	863.0
Debt	463.9	9,586.2	25,792.3	1,932.2	4,573.1
Equity	3,342.3	49,823.0	44,832.0	4,054.8	9,732.0
Adjusted ratios					
EBITDA margin (%)	26.5	43.4	45.6	17.2	46.4
Return on capital (%)	8.7	20.9	16.8	3.7	13.0
EBITDA interest coverage (x)	10.0	13.3	11.3	4.9	9.2
FFO cash interest coverage (x)	10.0	19.7	11.1	4.0	5.4
Debt/EBITDA (x)	0.9	0.5	1.5	3.2	1.4

Table 1

CAP S.A. -- Peer Comparison (cont.)					
FFO/debt (%)	98.5	138.5	54.8	22.9	38.0
Cash flow from operations/debt (%)	61.2	131.2	50.0	2.8	30.2
Free operating cash flow/debt (%)	30.4	74.6	36.1	(3.0)	10.5
Discretionary cash flow/debt (%)	6.0	(41.9)	18.6	(4.7)	(9.1)

Financial Risk

CAP's intermediate financial risk profile incorporates our assumption that disruptions in iron ore shipments this year related to the port accident will affect the company's profitability. However, this should be partly mitigated by high iron ore prices and continued high pellet premiums. In this context, we forecast debt to EBITDA at 0.9x in 2019, decreasing to 0.8x in 2020 as operations begin to return to normal.

Additionally, the higher capex of about $240 million in 2019 will likely affect FOCF generation. The capex relates to expenses to cover the port accident as well as efficiencies in mining production sites.

We also note that the company is exposed to the volatility of its commodity-type cash flows, although leverage is currently protected by its low debt position.

Financial summary

Table 2

CAP S.A. -- Financial Summary					
Industry Sector: Metals					
	--Fiscal year ended Dec. 31--				
	2018	**2017**	**2016**	**2015**	**2014**
Rating history	BB+/Stable/--	BB+/Stable/--	BB/Stable/--	BB+/Watch Neg/--	BBB-/Negative/--
(Mil. $)					
Revenues	1,917.1	1,931.6	1,635.6	1,475.3	1,789.8
EBITDA	507.9	567.0	433.5	280.6	350.5
FFO	457.1	513.8	414.8	243.4	322.6
Interest expense	50.9	54.9	52.3	43.3	31.4
Cash interest paid	50.8	53.2	18.7	37.2	27.9
Cash flow from operations	283.8	441.4	353.6	201.6	234.2
Capital expenditures	142.7	99.2	58.3	54.0	441.9
Free operating cash flow	141.1	342.2	295.3	147.6	(207.7)
Discretionary cash flow	27.7	261.1	284.1	100.8	(312.8)
Cash and short-term investments	474.9	700.2	785.7	667.9	348.2
Gross available cash	474.9	700.2	785.7	667.9	348.2
Debt	463.9	513.6	711.8	931.9	995.0
Equity	3,342.3	3,263.8	3,177.8	3,160.8	3,159.7

Table 2

CAP S.A. -- Financial Summary (cont.)

Industry Sector: Metals

	--Fiscal year ended Dec. 31--				
	2018	**2017**	**2016**	**2015**	**2014**
Adjusted ratios					
EBITDA margin (%)	26.5	29.4	26.5	19.0	19.6
Return on capital (%)	8.7	9.7	5.7	2.1	4.4
EBITDA interest coverage (x)	10.0	10.3	8.3	6.5	11.1
FFO cash interest coverage (x)	10.0	10.7	23.1	7.5	12.6
Debt/EBITDA (x)	0.9	0.9	1.6	3.3	2.8
FFO/debt (%)	98.5	100.0	58.3	26.1	32.4
Cash flow from operations/debt (%)	61.2	85.9	49.7	21.6	23.5
Free operating cash flow/debt (%)	30.4	66.6	41.5	15.8	(20.9)
Discretionary cash flow/debt (%)	6.0	50.8	39.9	10.8	(31.4)

FFO--Funds from operations.

Liquidity

We view CAP's liquidity as strong, supported by its available committed credit lines, cash on hand, and positive FFO generation. We expect liquidity sources will exceed uses by over 1.5x over the next 12 months, and net sources would remain positive even with a 30% decline in EBITDA.

Principal Liquidity Sources

- Cash and liquid investments of $475 million as of Dec. 31, 2018;
- FFO of around $400 million for the next 12 months; and
- $500 million fully available committed credit facilities in 2018 (of which $350 million are due in 2022 and $150 million in 2023).

Principal Liquidity Uses

- Short-term debt of $320 million as of Dec. 31, 2018.
- Working capital outflows of $80 million for the next 12 months;
- Maintenance and expansion capex around $240 million in 2019, which includes the Cerro Negro mine efficiencies; and
- Dividend payout of 50% of previous year's net income.

Covenant Analysis

Covenant requirements include net debt to EBITDA equal to or below 4.0x and consolidated interest coverage greater than or equal to 2.5x. We do not expect covenant pressures, given that we forecast CAP to have headroom of more than 80% on these covenants in 2019.

Environmental, Social, and Governance Factors

Mining in Chile is predominantly located in arid places with few small mining towns nearby, so domestic miners deal with less social or environmental friction than in other countries. There's also little evidence of environmental problems in Chile's long mining history. A combination of factors supports fairly low environmental exposure: the government actively monitors mining activity with world-class regulation for waste treatment and safety, companies have high standards of social responsibility after decades of intensive mining, and the population has embraced mining as the country's main economic activity.

Since 1970, Chile has banned the construction of tailings dams using the upstream construction method because of the country's exposure to earthquakes. Since 2011, mine and surrounding facility closures have had to follow several legal procedures, which involve a concrete closure plan among other requirements. The main source of friction for domestic miners has been water, which is scarce in northern Chile where most of the mining activity occurs, and so CAP S.A. has a desalination plant for this purpose.

CAP maintains adequate protection and accident prevention measures on its iron ore filtering systems. The company predicts it will further increase its investments in prevention measures in the next few years.

Issue Ratings--Subordination Risk Analysis

Capital structure

As of December 2018, CAP's capital structure mainly consisted of a $238.5 million local bond, $44.6 million in international bonds, $60 million in financial leases, $1.5 million in financial overdrafts, $20 million in hedging and other instruments, and $463.1 million in bank loans. Most debt is issued at CAP's operating subsidiaries.

Analytical conclusions

We rate CAP's senior unsecured notes at the same level as the issuer credit rating, given that the notes receive a full and unconditional upstream guarantee from CAP's main cash generating subsidiaries, namely CMP and Compañía Siderúrgica Huachipato S.A. (steel production subsidiary). Combined, these subsidiaries generate over 80% of CAP's EBITDA.

Reconciliation

Table 3

Reconciliation Of CAP S.A. Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. $)

--Fiscal year ended Dec. 31, 2018--						
CAP S.A. reported amounts						
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**
	827.5	2,027.3	507.8	318.2	507.9	334.4
S&P Global Ratings' adjustments						
Cash taxes paid	--	--	--	--	--	--
Cash taxes paid - Other	--	--	--	--	--	--
Cash interest paid	--	--	--	--	(50.8)	--
Postretirement benefit obligations/deferred compensation	14.0	--	--	--	--	--
Accessible cash & liquid investments	(427.4)	--	--	--	--	--
Asset retirement obligations	49.8	--	--	--	--	--
Nonoperating income (expense)	--	--	--	12.3	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	(50.6)
Noncontrolling interest/minority interest	--	1,315.0	--	--	--	--
EBITDA - Gain/(loss) on disposals of PP&E	--	--	(5.9)	(5.9)	--	--
EBITDA - Other	--	--	6.0	6.0	--	--
Total adjustments	(363.6)	1,315.0	0.1	12.4	(50.8)	(50.6)
S&P Global Ratings' adjusted amounts						
	Debt	**Equity**	**EBITDA**	**EBIT**	**Funds from operations**	**Cash flow from operations**
	463.9	3,342.3	507.9	330.6	457.1	283.8

Ratings Score Snapshot

Issuer Credit Rating

BB+/Stable/--

Business risk: Fair

- **Country risk:** Intermediate
- **Industry risk:** Moderately high
- **Competitive position:** Fair

Financial risk: Intermediate

- **Cash flow/Leverage:** Intermediate

Anchor: bb+

Modifiers

- **Diversification/Portfolio effect:** Neutral
- **Capital structure:** Neutral
- **Financial policy:** Neutral
- **Liquidity:** Strong
- **Management and governance:** Satisfactory
- **Comparable rating analysis:** Neutral

Related Criteria

- Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Metals And Mining Upstream Industry, Dec. 20, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	**Intermediate**	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	**bb+**	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of April 26, 2019)*	
CAP S.A.	
Issuer Credit Rating	BB+/Stable/--
Senior Unsecured	BB+
Issuer Credit Ratings History	
12-Apr-2017	BB+/Stable/--
18-Jan-2017	BB/Watch Pos/--
21-Mar-2016	BB/Stable/--
22-Dec-2015	BB+/Watch Neg/--
07-May-2015	BB+/Stable/--
13-Apr-2015	BB+/Watch Neg/--
30-Jan-2015	BB+/Negative/--
03-Oct-2014	BBB-/Negative/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.