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### Research Update:

# CAP S.A. 'BBB-' Rating Affirmed On Strong Financial Performance; Outlook Stable

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## Research Update:

# CAP S.A. 'BBB-' Rating Affirmed On Strong Financial Performance; Outlook Stable

## Overview

- CAP has strengthened its balance sheet, reduced nominal debt levels, and maintained high cash reserves.
- We are affirming our long-term corporate credit rating on CAP at 'BBB-'.
- The stable outlook reflects our opinion that CAP's strong balance sheet should support sizable investment plans and future iron ore price volatility.

## Rating Action

On March 28, 2012, Standard & Poor's Ratings Services affirmed its long-term corporate credit rating on Chilean iron and steel producer CAP S.A. at 'BBB-'. The outlook is stable.

## Rationale

Our rating on CAP reflects our understanding that the company enjoys a "satisfactory" (as our criteria define it) business risk profile and an "intermediate" financial risk profile.

Main supporters of CAP's business risk profile are its adequate cash cost position on its iron ore operation and its 60% share in the Chilean flat and long steel markets. Those factors help counterbalance some competitive vulnerabilities brought about by CAP's small share of the global seaborne ore market, higher production costs than dominant players given the need to concentrate the ore, narrow geographic diversification, and small scale of its steel products division, whose operating efficiency is well below industry average. We view the company's limited business profile as a potential cap to the rating.

CAP's strong liquidity, very low financial leverage, and robust operating cash generation (although volatile) continue to support its financial-risk profile. These factors should, in our view, support a robust investment program in coming years and help the company withstand potentially weaker prices without major weakening of its credit metrics.

Iron ore prices remained strong during 2011 and support high operating margins. Although in fourth-quarter 2011 iron prices slipped about 15%-20% relative to the first nine months of the year, they remain at record levels of about \$140 per ton. This positive environment pushed CAP's EBITDA to record levels of \$1.185 million despite the underperformance of its crude steel division, which is suffering from high iron and coal prices, both representing

about 50% of direct costs.

Mirroring record EBITDA generation, CAP's cash flow from operations peaked at \$780 million in 2011, up from \$508 million in 2010 and \$348 million in 2009. The company used \$331 million in capital expenditures and other investments, distributed \$322 million in dividends, and paid down debt for \$223 million, which reduced nominal debt by 37% while keeping robust cash balances (of \$883 million by year end 2011). We are assuming 2012 iron prices will be 23% lower than 2011 averages, and steel prices will remain constant, leading to strong cash flow from operations (more than \$800 million in 2012 and 2013). This cash would fund annual investments of \$500 million and dividends in the \$200 million to \$300 million area. Although its expansion plan is bold (the company is investing to increase production of iron ore to 18 million tons per annum by 2015), we expect CAP to finance its capital expenditures fully with internal cash generation. This should not put pressure on its current financial strength.

According to our projections, CAP's capital structure would remain conservatively leveraged, with debt-to-capitalization ratios of less than 30% and a debt-to-EBITDA ratio of less than 1x in 2012 and 2013.

## **Liquidity**

We view CAP's liquidity as "strong." We expect cash sources to override uses by at least 70% in 2012. Our estimates for the next 12 months include the following cash sources and uses:

- Cash holdings of \$133 million and short-term bank deposits of \$750 million as of Dec. 31, 2011;
- Cash flow from operations of about \$800 million to \$900 million;
- Capital expenditures of \$750 million;
- Dividend payments of some \$200 million; and
- Low scheduled debt amortizations, totaling \$121 million in 2012 and between \$40 million and \$70 million in 2013 and 2014.

We expect cash sources to exceed uses by at least 50%, even if EBITDA were to decrease by 30%. Although CAP does not benefit from committed credit lines with creditworthy financial institutions, we don't see that as a constraining factor given the company's robust cash balances (estimated at \$150 million). In addition, CAP's financial flexibility benefits from ample room under the current covenant package stated on the terms and conditions of its domestic bonds, and a very good standing in the Chilean domestic debt market.

## **Outlook**

The stable outlook reflects our perception that CAP's business profile will keep us from raising the ratings unless the company achieves a more efficient cost structure throughout its growth phase, which might be attained by developing its higher-quality reserves. We believe a world-class cash-cost

position in the iron ore business segment will provide CAP with enough protection from downside price scenarios, help it mitigate higher transportation costs to Asian markets, and offset its underperformance in the steel-making division. Once we get evidence of such robust operating efficiency, we could consider raising the ratings.

We also expect CAP's financial risk profile to remain robust while the company expands its iron capacity. We see the maintenance of a very robust financial stance as a cornerstone for the ratings to improve, due to the company's commodity-type nature. A downgrade is unlikely due to CAP's financial-profile strength.

## Related Criteria And Research

- 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
- 2008 Corporate Ratings Criteria, April 15, 2008

## Ratings List

Ratings Affirmed

CAP S.A.

Corporate Credit Rating  
Senior Unsecured

BBB-/Stable/--  
BBB-

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