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Research Update:

CAP S.A. 'BB' Ratings Placed On CreditWatch Positive On Higher Prices And Stronger Operating Performance

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Table Of Contents

Overview

Rating Action

Rationale

CreditWatch

Ratings Score Snapshot

Related Criteria

Related Research

Ratings List

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Overview

- Consistently higher iron ore prices, along with CAP's improved operating efficiency and lower capex, are likely to bolster the company's credit metrics and liquidity in the next 12-18 months.
- We have placed our 'BB' ratings on Chile-based steel and iron ore producer on CreditWatch with positive implications.
- The positive CreditWatch listing reflects that an upgrade is possible in the next 90 days if we believe the company will maintain stronger credit metrics, such as debt to EBITDA below 3x, funds from operations (FFO) to debt of 30% and free operating cash flow (FOCF) to debt of around 15%, on a consistent basis and even amid volatile iron ore prices. Maintaining such metrics will depend on the company's financial policy, capex plan and cushion to sustain a low leverage during industry downturns.

Rating Action

On Jan. 18, 2017, S&P Global Ratings has placed its 'BB' corporate and issue-level ratings on CAP S.A. on CreditWatch with positive implications.

Rationale

The CreditWatch placement reflects an upgrade potential if better iron ore prices and cost-cutting initiatives continue to strengthen CAP's metrics than we have previously expected.

The ratings on CAP reflect its somewhat modest scale of operations both in the iron ore and steel segments, which adds volatility to credit metrics, despite the historically low the company's debt. However, its cost-cutting measures and focus on its more profitable operations, combined with higher-than-expected iron ore prices, has generated FOCF in excess of \$200 million per year and improved financial metrics and liquidity in recent quarters.

We continue to expect a volatile pricing environment for iron ore and steel, given demand uncertainties while supply is expected to continue to increase over the next few years. On the other hand, pellet premiums have increased somewhat following the suspension of the operations of Samarco Mineração S.A. (D/--/--) since late 2015. The latter can help CAP keep stronger financial

metrics and a cushion to maintain leverage below 3x even under a less benign environment for iron ore prices.

CreditWatch

We expect to resolve the CreditWatch in the next 90 days as we review the company's forecast under higher pricing assumptions, improved operating efficiency, and revised production levels for steel and iron ore, as well as updated investment plan and liability management strategy.

Ratings Score Snapshot

Corporate credit rating: BB/Watch Pos/--

Business Risk Profile: Fair

- CICRA: Moderately High
- Competitive Position: Fair

Financial Risk Profile: Significant

- Cash flow/Leverage: Significant

Anchor: bb

Modifiers:

- Diversification/Portfolio Effect: Neutral
- Capital Structure: Neutral
- Financial Policy: Neutral
- Liquidity: Adequate
- Management and Governance: Satisfactory
- Comparable Rating Analysis: Neutral

Related Criteria

- 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
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - Industrials: Methodology For Standard & Poor's Metals And Mining Price Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 07, 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
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Related Research

S&P Global Ratings Revises Its Price Assumptions For Metals For 2017-2018 And Adds Assumptions For 2019, Jan. 17, 2017

Ratings List

CreditWatch Action

	To	From
CAP S.A.		
Corporate Credit Rating	BB/Watch Pos/--	BB/Stable/--
Senior Unsecured	BB/Watch Pos	BB

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