S&P Global
Ratings

RatingsDirect®

Research Update:

CAP S.A. Outlook Revised To Stable From Negative On Skyrocketing Iron Ore Prices, 'BB+' Ratings Affirmed

March 1, 2021

Rating Action Overview

- The record high iron ore prices and recovered volumes of iron ore dispatches after fixing the Guacolda 2 Port improved Chilean-based pellets and steel producer CAP S.A.'s credit metrics considerably, and we expect net debt to EBITDA to remain comfortably below 1.5x in 2021.
- On March 1, 2021, S&P Global Ratings revised its outlook on CAP to stable from negative and affirmed its global scale 'BB+' issuer credit rating on the company and issue ratings on CAP's senior unsecured notes.
- The stable outlook reflects higher cash generation and stronger credit metrics in a favorable scenario for commodity prices. We expect the company to benefit from positive momentum to extend maturities and improve overall capital structure.

PRIMARY CREDIT ANALYST

Francisco Gomez Comelli
Buenos Aires
+ 54 11 4891 2112
Francisco.Comelli@spglobal.com

SECONDARY CONTACT

Flavia M Bedran
Sao Paulo
+ 55 11 3039 9758
flavia.bedran@spglobal.com

Rating Action Rationale

The resumption of Guacolda 2 Port operations recovered volumes affected by the accident in the end of 2018. As a result of the Nov. 22, 2018, fatal accident at the Guacolda 2 Port, CAP's pellets output plummeted in 2019. Logistics costs increased and volumes dropped 37% in 2019 compared to 2018, selling only 9.2 million tons in the year. Given that the construction of the new ship loader and its assembly was completed in December 2019, port services normalized, and we expect 2020 dispatches to recover to 16 million tons, close to 2017 levels.

Commodity prices are in a supercycle. Iron ore and steel prices have reached record levels since many years now and are boosting CAP's profitability and cash flows. Iron ore (62% Fe) reached $170-$180 per ton in Singapore Exchange (SGX), and steel rebar reached $700-$710 per ton at Shanghai Future Exchange (SHFE). Although the company is exposed to the volatility of its commodity-type cash flows, which we reflect in our financial risk assessment to sustain metrics during a weaker cycle environment, leverage is currently protected by its low debt. We expect leverage to remain way below 1.5x and free operating cash flow (FOCF) above 70% in the next 12 to

18 months.

Capital structure is weakening due to the shorter debt maturity profile, but we expect CAP to refinance. The company's debt maturing in 2021 accounts for 68% of total debt, which lowers the weighted average maturity to only 2.1 years. CAP has two domestic bonds of unidad de fomento (UF) 3 million (US$115 million) each maturing in July 1 and September 2021. However, the company had sufficient cash on hand of US$557 million in December 2020 to face the maturities, which will further strengthen with expected sound free cash flows amid positive pricing momentum, and which we believe will allow the company to successfully refinance upcoming debt maturities and improve its overall debt profile.

Outlook

The stable outlook reflects the strong recovery in credit metrics, favorable scenario for commodity prices, and sound cash balance. In this context, we expect leverage to remain way below 1.5x and FOCF above 70% in the next 12 to 18 months.

Downside scenario

We could take a negative rating action if iron ore prices were to sharply decline or the company's volume output doesn't stabilize, which would increase logistics costs. In that scenario, we would expect to see debt to EBITDA consistently close to 2.5x across the cycles, funds from operations (FFO) to debt below 45%, and FOCF to debt below 5%.

Upside scenario

We view an upgrade unlikely because of CAP's business scale and portfolio concentration. In the medium term, more transformational growth could result in higher ratings if CAP increases its operational scale and diversification to support more sustainably stronger profitability and less volatile cash flow metrics.

Company Description

CAP is a Chilean iron ore miner and steelmaker focused on high-quality iron ore production for export markets (mainly China); steel production in the Chilean market; and processing for the construction industry and infrastructure sectors in Chile, Peru, and Argentina. The company has roughly 18 million tons of mining production capacity across four production sites (Los Colorados, El Romeral, Cerro Negro Norte, and Magnetita), of which around 50% comes from the Los Colodaros mine in the Huasco Valley and is dispatched through Guacolda 2 Port, and a steel production and processing capacity of about 1 million tons.

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

Our Base Case Scenario

Assumptions:

- Chile's GDP growth of 5.2% in 2021 and 3.9% in 2022
- Chile's inflation rate of 3.2% in 2021 and 3.1% in 2022
- Chile's average foreign exchange (FX) rate of Chilean peso (CLP) 760 per US$1 in 2021 and of CLP755 per $1 in 2022;
- Average iron ore prices (62% Fe) of $119 per ton in 2021 and $85 per ton in 2022
- Average steel rebar (Shanghai Future Exchange [SHFE]) prices of US$674 per ton in 2021 and US$651 per ton in 2022
- Coal prices of US$130 per ton in 2021 and US$140 per ton in 2022
- Pellet premiums of about US$28 per ton in 2021 and US$30 per ton in 2022
- Cash costs around US$46 per ton in 2021 and 2022
- Freight cost of US$15 per ton starting in 2021 and 2022
- Total iron ore production of 16.5 million tons in 2021 and 2022
- Capital expenditure of about US$460 million in 2021 and US$390 million in 2022, around 75%-80% at iron ore division and around 30% for expansions mainly at Los Colorados and El Romeral sites
- A dividend payout at 50% of previous-year net income

As a result of these assumptions, we reach the following financial metrics:

- EBITDA of US$1.2 billion in 2021 and US$745 million in 2022
- EBITDA margin of about 39% in 2021 and about 28% 2022
- FOCF close to US$255 million in 2021 and US$340 million in 2022
- Debt to EBITDA around 0.3x in 2021 and 0.5x 2022
- FOCF to debt of about 70% in 2020 and 95% in 2022

Liquidity

We assess CAP's liquidity as adequate, with expected liquidity sources close to 1.5x over its uses in the next 12 months. Cash on hand, FFO generation, and available committed credit lines weigh on our adequate liquidity assessment. Due to the Guacolda 2 Port accident, the company asked local bondholders to consent to relax covenants during third-quarter 2019 to third-quarter 2020. However, current ample headroom in the company's debt payment acceleration covenants now supports our assessment.

The debt maturity profile is shortening, with almost 68% of debt maturing in the short term and a UF6 million in bonds (approximately US$200 million) amortizing in the third quarter of 2021. However, we believe the company could easily refinance upcoming maturities.

Principal Liquidity Sources

- Cash and liquid investments of US$557 million as of Dec. 31, 2020
- FFO of about US$955 million for the next 12 months
- $500 million in fully available committed credit facilities (of which US$350 million are due 2022 and US$150 million due 2023)

Principal Liquidity Uses

- Short-term debt of US$495 million as of Dec. 31, 2020
- Working capital outflows of US$240 million for the next 12 months
- Maintenance and expansion capital expenditure of about US$460 million in 2020, which includes investments in the Cerro Negro and Los Colorados mines
- Dividend payment of around US$215 million

Covenant Analysis

Debt payment acceleration covenants include a net debt to EBITDA maximum of 4.0x and a consolidated net interest coverage minimum of 2.5x. We expect ample covenant headroom going forward.

Environmental, Social, and Governance Factors

We tend to view CAP's exposure to environmental and social risks in line with the mining industry. Its mines and tailings dams are fairly remote, and its access to water is covered by its own desalination plant, which in turn enhances its relationship with local communities that are served by the excess water CAP supplies to them.

However, the company suffered the breakage of its ship loader in the Guacolda 2 Port in November 2018. The accident cost the life of one employee and severely limited the company's ability to deliver while it increased operational costs and investments. This event, coupled with the 40 cubic meter spillage of hydrocarbons at Guarello Island on July 27, 2019, increased concerns over management's capabilities to map and control risk exposures in place to ensure appropriate safety measures and avoid future incidents. The fatal accident at the Guacolda 2 Port, the hydrocarbon spillover on Guarello Island, and considerable operating deviation from the 2019 forecast weigh on our fair management and governance score on CAP.

Issue Ratings--Subordination Risk Analysis

Capital structure

As of December 2020, CAP's capital structure mainly consisted of US$419.3 million in bank loans, US$248.1 million local bonds due 2021, US$41.8 million in an international bond due 2036, US$58.8 million in financial leases, and US$15.8 million in hedging and other instruments.

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 Compañía Minera del Pacífico S.A. (an iron ore mining subsidiary) and Compañía Siderúrgica Huachipato S.A. (a steel production subsidiary). Combined, these subsidiaries generate over 90% of CAP's EBITDA.

Ratings Score Snapshot

Issuer Credit Rating: BB+/Stable/--

Business risk profile: Fair

- Country Risk: Intermediate
- Industry Risk: Moderately high
- Competitive position: Fair

Financial risk profile: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bb+

Modifiers:

- Diversification/Portfolio effect: Neutral
- Capital structure: Neutral
- Financial policy: Neutral
- Liquidity: Adequate
- Management and governance: Fair
- Comparable rating analysis: Neutral

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012

- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
CAP S.A.		
Issuer Credit Rating	BB+/Stable/--	BB+/Negative/--
Ratings Affirmed		
CAP S.A.		
Senior Unsecured	BB+	