FitchRatings

Fitch Affirms CAP S.A. at 'BBB-'; Outlook Revised to Negative

Fitch Ratings - Chicago - 19 March 2020:

Fitch Ratings has affirmed CAP S.A.'s Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BBB-' and National Long-Term Rating at 'A+(cl)'. Fitch also affirmed CAP's National Equity Rating at First Class Level '2(cl)'.The Rating Outlook is revised to Negative from Stable.

The Negative Outlook reflects the substantial deterioration on CAP's credit metrics during 2019 due to poor operating results in their mining operations after an accident at its main port, and negative operating performance in its steel businesses. Additionally, the Negative Outlook factors in risks in CAP's ability to deleverage to a level consistent with its investment grade category by YE 2020, particularly considering their elevated capex program and increased concerns over the coronavirus pandemic and its potential negative impacts, including supply chain disruptions, delayed shipments, mine closures, tight liquidity in the financial markets, and downward pressures to commodity prices on the back of a global economic slowdown. The Outlook could return to Stable if CAP recovers operating cash flows and if it is able to delever to net debt to EBITDA below 2.0x by the end of 2021.

The rating affirmation is based on CAP's historical conservative financial policies and capital structure, temporarily affected by the accident, along with its demonstrated resilience in periods of price deterioration and a good quality product. CAP's cost structure benefits from its production of high-grade iron ore products (67% iron content), for which it receives a premium over market prices and their capacity to shift its marketing mix to optimize its cash cost of production. The ratings also factor in its relatively small size and low diversification compared to peers.

Key Rating Drivers

Deterioration of Capital Structure: Financial metrics weakened in 2019 as a result of the port accident. The company reported a net debt to EBITDA of 4.1x compared with Fitch's projections of 1.9x. Net interest coverage ratio reached 2.3x at the end of 2019 forcing the company to request a waiver to the local bonds' covenants leverage limits originally established at 2.5x to 2.0x. Fitch expects financial metrics will improve this year to 2.7x still exceeding Fitch's negative sensitivity established at 2.0x.

Weak Operating Performance: During 2019, CAP faced operational headwinds, almost all its business segments reported significant decreases in its EBITDA generation. CMP the largest EBITDA contributor (97% in 2019) experienced a drastic fall in EBITDA to USD194 million versus USD401 million in 2018 as a result of the accident of Guacolda 2 port; EBITDA margins decrease to 24.9% from38.4% in 2018 despite very favorable market conditions for iron ore - 62% FE content of USD93.5 per tonne. The steel business affected by weak prices and higher iron ore prices resulted in a negative EBITDA of USD79 million. Steel processing operations also suffered a decrease in EBITDA and margins suffered despite organic growth that contributed with EBITDA.

Pressured Cash Flow: CAP generated cash flow from operations (CFO) of USD86.5 million at YE 2019 due to a significant reduction in the EBITDA generation and rising working capital needs related to inventory build-up. FCF was negative USD250 million after capex of USD250 million and dividends of USD38 million. This level of

FCF compares negatively with USD2 million in 2018 and USD241 million in 2017. The FCF deficit was financed by funds coming from short-term investments (USD185 million) and a 20% increase in financial debt that reached USD 1.1 billion. The latter includes confirming transactions of its subsidiary Cintac.

Expected Return to Historical Credit Metrics for 2021: CAP targets a net debt-to-EBITDA close to 1.2x for YE 2020. Fitch believes the company will be above this target and Fitch's negative sensitivity, with a path to deleveraging below 2.0x by the end of 2021, through recovery of its CFO generation, above USD300 million per year assuming an average iron ore price of USD75 per tonne in 2020 and USD60 per tonne in 2021 and 2022, according to Fitch mid cycle iron ore prices.

Adequate Business Profile: CAP benefits from its niche market position as a value-added iron ore producer, which provides the company with high realized prices and a buffer against iron ore market volatility. The company is able to adjust its product blend in response to lower premiums to take advantage of its competitive cost structure and maintain good margins.

Long Life Reserves and Resources: CAP had 2.93 billion tonnes of iron ore reserves and 7.99 billion tonnes of resources in 2019, which equates to over 60 years of mine life at an expected production rate of 16 million tonnes per year. The company owns and operates four mines across two regions in northern Chile.

Equity Rating: CAP's equity rating is based on the company's strong credit profile, its long track record in the stock market, and a market presence of 100%. CAP also reports market capitalization of USD822 million, as an important player in the Santiago stock market, and high levels of daily trading volume that averaged USD1,550 thousand over the last month (as of March 2020).

Derivation Summary

CAP's ratings are constrained by scale and diversification factors in Fitch's Rating Navigator, with iron ore comprising by far the largest contribution to EBITDA. Conservative financial management, reflected in a resilient financial profile through the cycle, have offset some of the diversification issues, although this year its operating results have been negatively affected by a fatal accident that disabled its main port for the entire year of 2019. The company is less diversified than Latin American peers Compañia de Minas Buenaventura S.A.A. (BBB-/Stable), Volcan Compañia Minera S.A.A. (BBB-/Negative) and Nexa Resources Peru S.A. (BBB-/Stable) but has significantly longer mine life. CAP's historical credit profile that Fitch expects will return at the end of 2021 is comparable to those of Nexa and Buenaventura and more conservative than that of Volcan. CAP's cash flow concentration from minerals is similar to Minsur S.A.'s (BBB-/Negative); it mainly produces tin. Minsur is in the first quartile of the tin cost curve, with significant participation in the global tin market, while CAP is in the second and third quartiles, with a small presence in the seaborne iron ore market.

CAP's business profile is similar to that of Ferrexpo plc (BB-/Stable), which is among the top five pellet exporters globally at 10.4 million tonnes annually, compared with CAP's pellet production of around 2.8 million tonnes and pellet feed of 9.7 million tonnes. CAP also produces sinter feed, which drives its total iron ore shipments over 16 million tonnes in normal conditions. Ferrexpo benefits from a better position on the global iron ore cost curve, and stronger credit metrics with net leverage close to 1.0x. Ferrexpo's rating is constrained by the Ukrainian Country Ceiling, which incorporates high operating risk, and it is rated two notches above the sovereign. In addition, its Management and Corporate Governance has a score at 'b+' which could be negatively affected by a current investigation, while CAP benefits of a 'bbb' category.

Key Assumptions

-Exchange rate at CLP750 for the whole projected period;

- Fitch mid cycle prices at USD75 per tonne for 2020; and USD60 per tonne for 2021 and 2022;

- Cash costs USD44 per tonne for 2020; and USD40 per tonne for 2021 and 2022;

- Shipments of CMP 15,500 per tonne for 2020; 16,200 per tonne for 2021 and 16,500 per tonne;

- Freight costs of USD21 for the whole period;

- 50% dividend policy;

- Potential insurance compensations are not included.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action

- The Outlook would be revised to Stable if the company is able to recover its net debt to EBITDA ratio below 2.0x on a sustained basis.

Developments That May, Individually or Collectively, Lead to Negative Rating Action

- A negative rating action, in the form of a downgrade, could result from deterioration in the company's capital structure that is not addressed in the short term;

- A sustained period of depressed iron ore prices and/or significant cash outflows due to an elevated capital program or dividends that lead to net debt/EBITDA over 2.0x on a sustained basis;

- A significant and prolonged deterioration in CAP's liquidity position and persistent negative FCF.

Liquidity and Debt Structure

Cap has historically maintained good liquidity levels despite the cyclicality of its business, although it has now been affected by unexpected cash outflows related to the accident. As of YE 2019, the company had USD310 million of cash and cash equivalents in addition to USD500 million in committed credit lines maturing in 2022 and 2023. The company's cash including the committed lines plus projected CFO to short-term debt ratio is 2x. Short-term debt of USD580 million mainly correspond to working capital and pre-export facilities. In 2021, the company faces the maturity of a local bond for USD225 million, which will be fully refinanced with a new bond issuance in the local market. In February 2020, CAP registered at the local regulator two new bond lines of CLF6.0 million (USD220 million) each for 10 and 30 years tenor. Other maturities are USD27.8 million in 2022; UD76 million in 2023 and USD135 in the long term. CAP has low refinancing risk due to its strong access to diversified sources of financing.

Summary of Financial Adjustments

--Restricted cash;

--EBITDA adjusted by dividend to minorities;

--Debt adjusted by confirming transactions.

Unless otherwise disclosed in this section, CAP's highest level of Environmental, Social and Governance (ESG) credit relevance is a score of '3', which implies that ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
CAP S.A.	LT IDR BBB- Affirmed	BBB-
	LC LT IDR BBB- Affirmed	BBB-
	Natl LT A+(cl) Affirmed	A+(cl)
	Nat Equity Rating Primera Clase Nivel 2(cl) Affirmed	Primera Clase Nivel 2(cl)
senior unsecured	LT BBB- Affirmed	BBB-
senior unsecured	Natl LT A+(cl) Affirmed	A+(cl)

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Applicable Criteria

Sector Navigators (pub. 23 Mar 2018)
Metodología de Clasificación de Acciones en Chile (pub. 01 Aug 2018)
Metodología de Calificaciones en Escala Nacional (pub. 02 Aug 2018)
Metodología de Calificación de Finanzas Corporativas (pub. 16 Apr 2019)
Corporate Rating Criteria (pub. 19 Feb 2019)

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