STANDARD & POOR'S

My Credit Profile

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Summary: Corporación Nacional del Cobre de Chile

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Rationale

The 'A' corporate credit rating on Chile-based, state-owned copper producer Corporación Nacional del Cobre de Chile (Codelco) reflects Standard & Poor's Ratings Services' opinion that the Republic of Chile (foreign currency: A+/Stable/A-1; local currency: AA/Stable/A-1+) is highly likely to provide timely and sufficient extraordinary support to Codelco in the event of financial distress. We also assesses Codelco's stand-alone credit profile to be in the 'BBB' category.

In accordance with our criteria for government-related entities, our view of a very high likelihood of extraordinary government support is based on:

- Codelco's "very important" role in the Chilean economy, as it represents a large portion of the country's exports and fiscal revenues; and
- The "very strong" link with the Chilean government, based mainly on its 100% ownership of Codelco, which should continue to influence the company's credit quality because privatization is unlikely, in our view.

Codelco's stand-alone credit profile incorporates its strong market position as the world's largest integrated copper mining company and second-largest producer of molybdenum, with ample high-grade copper ore reserves, a globally competitive cost structure, and integrated operations including copper refining and smelting. However, somewhat offsetting these strengths are the industry's inherent cyclicality, resulting in volatile copper and molybdenum prices and cash flow generation; lack of geographic diversification on the production side, with all operations in Chile; heavy tax and dividend burden from the government; and aggressive financial policy.

Codelco accounts for about 12% of global copper production, and copper represents 75%-85% of the company's total sales. It also benefits from its position as the world's second-largest producer of molybdenum. With ample high-grade copper ore reserves, accounting for about 10% of proved and probable reserves worldwide, the company is a low-cost copper producer. Codelco's cash production costs increased significantly during 2009, to about 93 cents per pound from about 70 cents in 2008, mainly due to a strong decline in molybdenum prices, to about $11 per pound from about $30. This resulted in a significantly lower credit from byproducts. However, we expect the company's cost profile to remain highly competitive globally, given its large economies of scale, relatively high ore grade, and large molybdenum production.

Copper prices decreased significantly, mainly during last-quarter 2008, to about $1.20 per pound in December 2008 from a peak of about $4 per pound in April 2008 and also in first-half 2009 due to the global recession. This has considerably affected Codelco's EBITDA margin, which fell to 37% in the 12 months ended Sept. 30, 2009, from 55% in the 12 months ended Dec. 31, 2007. However, a recovery in copper prices to about $3 per pound in second-half 2009 allowed Codelco to improve its EBITDA margin to 45% that year. We expect EBITDA margins to reach about 45% in 2010-2011, assuming relatively conservative average copper prices of about $2.50 per pound in 2010 and $2.25 in 2011 (currently at about $3.50 per pound).

Codelco has an aggressive financial policy. High capital expenditures and an aggressive dividend policy have resulted in a significant increase in debt in the past five years and deterioration in credit measures since fourth-quarter 2008, a period of significant drops in copper and molybdenum prices. Because of Codelco's rigid and aggressive dividend payout, Standard & Poor's adjusts the company's cash generation by deducting dividend payments from its funds from operations (FFO) when comparing the company's cash generation with its financial debt. This ratio ranged from 15% to 30% in 2004-2007, and it decreased to a negative 14% in 2008 due to extraordinary high capital expenditures and dividends. However, notwithstanding the strong decrease in copper prices, this ratio improved to 27% in fiscal 2009, mainly due to lower dividends--$3.2 billion in 2008 compared with $835 million in 2009.

To provide some relief from Codelco's increasing debt levels and deteriorating credit measures, the Chilean government has decided to capitalize a portion of Codelco's earnings since 2007. On Dec. 4, 2009, the Chilean Ministry of Economy announced a relatively large, $1 billion capitalization of 2008 earnings. This measure should provide significant relief from the company's large cash needs and could allow it to maintain debt at current levels.

Liquidity

Codelco enjoys very good liquidity and financial flexibility, with a good credit risk profile, which allows it to refinance its debt maturities on relatively attractive terms. It placed $600 million in 10-year bonds in January 2009--amid the global credit crunch. Its strong business risk profile and 100% ownership by, and strategic importance to, Chile supports flexibility. However, the company routinely has significant negative discretionary cash flow, mainly due to its high capital expenditures and aggressive dividend payout.

Outlook

The stable outlook incorporates our expectation that the Chilean government would provide timely and sufficient extraordinary support to Codelco in the event of financial distress. Ratings upside would depend on a significant improvement in the company's financial profile and would require a more conservative financial policy. We could lower the ratings if Codelco's financial profile significantly deteriorates, the company's importance to the Chilean government diminishes, or the government privatizes the company.