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Credit Opinion: Corporación Nacional del Cobre de Chile

Global Credit Research - 06 Aug 2014

Santiago, Chile

Ratings

Category	Moody's Rating
Outlook	Negative
Senior Unsecured	A1

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Key Indicators

[1]**Corporación Nacional del Cobre de Chile**

	3/31/2014(L)	12/31/2013	12/31/2012	12/31/2011	12/31/2010
EBIT Margin	15.8%	19.0%	44.7%	31.9%	30.9%
Return on Average Tangible Assets (EBIT / Avg. Tangible Assets)	6.9%	8.4%	25.9%	26.1%	25.3%
Debt / Book Capitalization	48.0%	46.0%	42.9%	51.5%	58.0%
Debt / EBITDA	3.4x	2.9x	1.3x	1.1x	1.1x
EBIT / Interest Expense	6.8x	8.9x	18.4x	22.1x	18.3x
FCF / Debt	-22.1%	-18.0%	-19.4%	-17.0%	-20.4%
(CFO - Dividends) / Debt	8.6%	16.4%	14.2%	12.4%	12.9%

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Source: Moody's Financial Metrics

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

- Largest copper producer globally, significant molybdenum production, long lived reserve base

- Margins pressured by increased cost position and weaker copper prices versus historical periods

- Absent government approval to some level of profit retention, significant debt increases will be required to fund strategic growth over the next several years

- Multiple mine operating profile diversifies risk of operating problems

Corporate Profile

Headquartered in Santiago, Chile, Corporacion Nacional del Cobre de Chile (CODELCO) is 100% owned by the Chilean State and is the largest producer of copper globally, holding an approximate 10% share of mined copper production. The company also ranks as one of the top two global molybdenum (moly) producers (as a by-product of copper production) with a market share of approximately 9%. Operating through seven divisions, Chuquicamata, Radomiro Tomic, Ministro Hales, Andina, El Teniente, Salvador, and Gabriel Mistral, CODELCO's operations include several world class mines from a reserve, production capacity, and cost perspective, as well as smelting and refining capability. In addition, CODELCO owns 49% of the El Abra mining operation in Chile and is part of a joint venture with Mitsui & Co. Ltd that owns a 29.5% interest in Anglo American Sur - and CODELCO owns, through this joint venture, 20% of Anglo American Sur. Revenues for the 12 months ending March 31, 2014 were approximately USD 14.8 billion.

SUMMARY RATING RATIONALE

As a government related Issuer ("GRI") - CODELCO is 100% owned by the Chilean government - the A1 foreign currency rating is based upon the following inputs: the baseline credit assessment (BCA) at a3, the Chilean Government's Aa3 bond rating, and high dependence and high support levels.

CODELCO's BCA reflects its position as the world's largest copper producer (approximately 1.79 million metric tons for the 12 months ending March 31, 2014, including its share of El Abra and Anglo American Sur) and the second largest molybdenum producer, its competitive cost position and its substantial reserve base, approximately 75 years at current production levels. The company's multiple mine operating profile, which reduces the degree of operational risk, together with its vertical integration, which encompasses SX/EW and conventional smelting facilities, further support its BCA ranking. This footprint contributes to robust operating performance in a strong copper market and acceptable performance during cyclical downturns.

The BCA incorporates the large investment requirements to increase production and improve ore grades, which we anticipate will require increased debt levels over the next several years, as the major projects, which include El Teniente, Chuquicamata, Radomiro Tomic, and Andina, will require capital expenditures (CAPEX) of over USD 15 billion in the next 3 years. In addition, the potential for production disruptions, the impact of lower ore grades in the near term, ongoing industry wide cost challenges and energy and water costs and challenges in Chile, are key considerations in the BCA. Nonetheless, the company's strategic growth investments, competitive cost position, and production levels support performance over the medium to longer-term although there is likely to be pressure in key metrics such as the EBIT margin, EBIT/interest and debt/Ebitda in the near-term. With the roughly 47% contraction in Ebitda, mainly as a result of lower copper prices and a modest increase in debt levels, CODELCO's leverage as measured by total adjusted debt to Ebitda increased to 3.4x for the last twelve months ended March 2014 (1.4x for the twelve months through March 2013). Given that copper prices remain range bound in the low USD 3/lb trading range, we expect 2014 performance to continue at lower Ebitda levels and a more elevated leverage position as experienced in 2013.

CODELCO's ownership by the Chilean State and the framework in which it operates are also important considerations in the rating. CODELCO's ownership structure requires the company to pay 100% of its income to the Chilean Treasury and the company pays significant amounts in export, royalty and income taxes. Under its present code of corporate governance, approved by the Chilean congress in late 2009, CODELCO can request that it be allowed to retain profits within the company, particularly to support strategic capital expenditures for growth.

Consequently, the BCA contemplates the level of earnings and cash flow generation that the asset base and cost position of CODELCO can generate, and the importance of CODELCO within the Chilean economy. We believe that CODELCO's cash generation capacity on a "normalized basis" is capable of supporting its capital spending requirements and debt obligations and that given CODELCO's budget approval process within Chile, sufficient funds will likely continue available to the company to meet debt obligations.

DETAILED RATING CONSIDERATIONS

CONTINUED SLIDE IN COPPER PRICES PUTS DOWNWARD PRESSURE ON EARNINGS

Weakening economic conditions which have been evident since late 2012 continue to exert downward pressure on copper prices and subsequently, the operating performance of copper mining companies such as CODELCO. Spot LME prices for copper averaged approximately USD 3.18/lb in 2014 until July (a roughly 6% drop from the same period's average in 2013). We see no broad based catalyst for material improvement for the balance of 2014 and believe price risk remains to the downside given the slower than expected economic growth in China (which consumes over 40% of copper output), slow economic recovery in Europe, and an uneven recovery in the U.S..

As CODELCO's revenues are largely concentrated on a single metal - copper - the weak price environment for copper has had a direct impact on the company's performance. For the 12 months ending March 31, 2014, CODELCO's EBIT (including Moody's standard accounting adjustments) was USD 2.3 billion versus USD 2.8 billion during fiscal 2013. Compounding the weaker price environment are rising production, fuel, power and labor costs, along with lower molybdenum prices which serve as a byproduct cost credit. The company's average cash cost of USD 1.59/lb during the first quarter of 2014 is down 6% from the same prior year period, albeit slightly higher than USD 1.57/lb reported during the previous quarter.

The company's 12-month ending March 31, 2014 EBIT adjusted margin at approximately 15.8% is much lower than previous years (44.7% in 2012), and reflect a tightening trend that is expected to remain in the next 12 to 18 months as the impact of lower realized prices and cost inflation becomes reflected in the company's financial results. We recognize, however, that even at presently higher levels, the company's unit cash cost position remains competitive relative to current average copper prices although this position can deteriorate should prices and costs continue to move on a negative trajectory.

In an effort to reduce cost volatility, CODELCO announced on July 9 2014 an international fuel tender of about USD 2.3 billion to assure fuel supply for a 5-year period. This new contract will replace the existing 5-year contract entered in early 2010 with Enex and Petrobras, which expires in April 2015, and will be based on an estimated annual consumption of 530.000 m3 of fuel, at an annual cost of USD 450 million. Energy represents a material portion (between 15%-20%) of CODELCO's operational costs, and its main sources include electricity, fuels and natural gas. Fuel accounts for about one third of total energy costs. This continued focus on cost reduction programs and unit cash costs, together with an improving production and ore grade profile, is expected to somewhat mitigate the magnitude of further profit contraction in 2014 as we expect average copper prices to be no better than the 2013 average.

DEBT BALANCES WILL NEED TO INCREASE TO SUPPORT SUBSTANTIAL CAPITAL SPENDING

CODELCO has increased its capital spending in recent years and has relatively aggressive spending plans over the next several years to maintain and improve its production profile, reverse falling ore grades, and consequently maintain a solid profitability profile. Spending figures in 2013 amounted USD 4.5 billion , from USD 3.7 billion in 2012 and we expect it to remain in the USD 5 billion range in the coming years, as the company has targeted to increase production to roughly 1.9 million metric tons by 2016 (excluding El Abra).

Over the next several years, spending will be prioritized towards developing the company's key structural projects. Ministro Hales started production in early 2014, with ultimate annual production levels, once fully operational, of around 183,000 metric tons of copper and an important level of silver as a by-product. The El Teniente expansion has commenced construction and was around 23% completed by March 31, 2014. The El Teniente project, which is expected to be completed by 2017, will add around 2 billion metric tons of reserves that are estimated to last up to 50 years at current annual production rates of 434,000 metric tons. Meanwhile, the Chuquicamata Underground project is 86% into the early works stage while the Andina and Radomiro Tomic Sulphide expansions, are both in early stages as of March 31, 2014, with Andina having completed feasibility studies and Radomiro Tomic Sulphide still conducting feasibility studies.

These investments remain necessary to strengthen the longer term viability of the company's mining assets, but are likely to require increased debt levels over the next several years although the required amounts will depend upon what levels of profit retention, if any, the government agrees. To illustrate, CODELCO's total adjusted debt at March 31, 2014 is twice the company's debt balance in 2009. As CODELCO's cash flow available for investment is effectively limited to depreciation and other non cash add backs due to the paying out of its income to the Chilean Treasury, further increases in debt are likely to support the capital investments over the next several years. When taken together with our outlook for weaker earnings over the next 12 to 18 months, we expect higher debt to result in tighter credit metrics. This is line with the recent trend of total adjusted debt to Ebitda, which increased to 3.4x for the 12 months ending March 31, 2014 from 1.3x in 2012, and Ebit to interest, which decreased to 6.8x from 18.4x in the same period. Early in July 2014, CODELCO issued EUR 600 million 10-year bonds, as part of the company's liability management strategy. Since proceeds will be used to pay down debt coming due, we do not expect this issuance to materially impact leverage in the mid-term. Leverage will also be affected by a potential additional capitalization from the Chilean government, which will be discussed by Congress later this year.

LIMITED FREE CASH FLOW FOR DEBT REDUCTION

CODELCO's free cash flow generation is limited because of the high dividend payout required to the Chilean

Treasury and the relatively high level of capital expenditures to fund strategic growth initiatives. The company essentially pays 100% of its income to the Chilean treasury through income and export taxes and royalties. On a free cash flow to debt basis CODELCO maps in the Caa range under Moody's Global Mining Methodology, and we expect this to continue given the dividend payout requirements. The importance of CODELCO to the Chilean economy and the requirement that the annual budget presented include interest and debt payment requirements are key elements mitigating the weak mapping in this important metric.

Under its present code of corporate governance, approved by the Chilean congress in late 2009, CODELCO can request that it be allowed to retain profits within the company, particularly to support strategic capital expenditures (CAPEX) for growth. The government has demonstrated its support of CODELCO through its USD 1 billion equity investment in 2009 to support strategic CAPEX and in 2011 approved the retention of USD 376 million of net profits (equivalent to 20% of 2010 net profits). In addition, the government in early 2011 authorized the sale of CODELCO's share in E-CL (fka Edelnor) and the retention by CODELCO of the sales proceeds, and in 2012 approved the retention of USD 800 million of 2011 profits. In 2013, the Ministries of Mining and Finance authorized the capitalization of USD 2.0 billion, which does not represent cash into the company, but rather the retention of the unrealized profit on the exercise of the option in connection with the acquisition of an interest in Anglo American Sur in 2012. On June 30 2014 CODELCO submitted its capitalization plan to the government, and a retention of USD 200 million has been approved.

Although Government support for CODELCO's financing requirements helps mitigate the degree of direct financing that CODELCO will need to raise and demonstrates the importance of the development of these projects to the strategic growth of CODELCO over the medium to longer term, we still expect the debt profile to increase to fairly significant levels over the next several years.

CHINESE DEMAND A KEY DRIVER OF THE COPPER MARKETS

Accounting for roughly 40% of global copper demand, China remains a key driver in the behavior of and prices in the copper markets. In the first quarter of 2014 CODELCO's proportion of sales to China, North America and Europe was 37%, 11% and 15%, respectively, compared with 40%, 15% and 14%, respectively during the same prior-year period and reflects China's continued importance as an end market for CODELCO as more developed regions continue to struggle.

LARGEST GLOBAL PRODUCER WITH PROFITABLE OPERATIONS AND LONG-LIVED RESERVE BASE

With identified mineral resources of approximately 130.2 million metric tons of fine copper - representing roughly 9% of identified mineral resources globally - CODELCO has about 75 years of productive capacity at current levels. The level of reserves is seen as an important determinant in a company's ongoing operating profile and ability to continue to perform. Considering the reserve position held and the various projects in process and under evaluation, CODELCO is expected to maintain and increase production going forward offsetting the impact of declining grades and relatively flat production levels, which have recently been experienced.

In addition to its wholly-owned mines, the company, through a joint venture with Mitsui & Co. Ltd (Mitsui), owns a 20% interest in Anglo American plc's (Anglo American) subsidiary Anglo American Sur ("Anglo Sur"); Mitsubishi Corporation also has an interest in Anglo Sur. After a recently-completed expansion, Los Bronces is expected to produce more than 400,000 metric tons annually for ten years (beginning August 2012 - the date when full ramp-up commenced). CODELCO received a loan from Mitsui (Mitsui loan) to finance the acquisition of the Anglo Sur stake. The Mitsui loan, which has a balance of approximately USD 822.4 million at March 31, 2014, is non-recourse to CODELCO. We view the investment in Anglo Sur as providing CODELCO with an interest in low cost, long-lived mines with attractive cash cost positions and development growth potential with no incremental increase in debt.

Liquidity

CODELCO's liquidity is supported by internally generated funds. It has no committed revolving credit facilities that would provide alternative liquidity.

Rating Outlook

The negative outlook reflects our expectations for reduced earnings and tightening in debt protection metrics and a more muted copper price environment in 2014 as a result of slowing growth rates in China, a major copper consumer, slow economic recovery in Europe, and an uneven recovery in the U.S.. The weaker demand levels and economic concerns have contributed to average copper prices falling about 7% in the first semester of 2014 compared to the same period of 2013. and we believe risk remains to the downside. The lower earnings expectations comes at a time when CODELCO's capital expenditures are increasing as the company implements its strategic plans to increase production and reverse its declining trend in ore grades. While the company has reduced spending expectations for 2014 to about USD 4.4 billion, CAPEX is expected to remain at high levels over the next several years and will require increased debt to cover.

What Could Change the Rating - Down

The BCA and CODELCO's senior unsecured foreign currency ratings could be negatively impacted should earnings contract for a prolonged period, causing a sustainable period of EBIT margins below 22%, interest coverage below 9.0x, or total adjusted debt to Ebitda above 2.5x. In addition, ratings could be negatively impacted by increases in royalties, environmental compliance costs or other regulatory requirements or significant cash copper hedging losses.

What Could Change the Rating - Up

Upside adjustment to the BCA is unlikely due to the company's ongoing reinvestment requirements and the expectation for increased leverage in a business that will continue to exhibit variability in copper supply and demand balances, copper price volatility and input cost challenges.

Other Considerations

MAPPING TO RATING METHODOLOGY GRID

CODELCO's ownership by the Chilean State and the required 100% payout of net income, together with the export, royalty and income taxes paid results in the company's financial profile not being directly applicable to Moody's rating methodology for the global mining industry. However, its performance in certain key rating factors (based upon the three years through March 31, 2014 performance) illustrative of the company's operating strength and world-class operating mines, as well as relatively strong copper prices during the historical periods. The BCA tracks within indicated levels and we expect the foreign currency rating to track within the "A" rating category over the next 12 to 18 months.

Rating Factors

Corporación Nacional del Cobre de Chile

Mining Industry Grid [1][2][3]	**Current LTM 3/1/2014**			[3]**Moody's 12-18 Month Forward ViewAs of 7/17/2014**	
Factor 1 : Reserves (8%)	**Measure**	**Score**		**Measure**	**Score**
a) Reserves (Years)	40	A		> 20	A
Factor 2: Cost Efficiency & Profitability (17%)					
a) Mining EBIT Margin (3-year Average)	26.5%	Aa		30 - 22.5%	Aa
b) Return on Average Tangible Assets (3-year Average)	14.9%	A		15 - 10%	A
Factor 3: Financial Policies (17%)					
a) Debt / Book Capitalization	48.0%	Baa		50 - 75%	Ba
b) Debt / Mining EBITDA (3-year Average)	2.0x	A		1.75 - 2.5x	A
Factor 4: Financial Strength (25%)					
a) Mining EBIT / Interest (3 year Average)	12.3x	Aaa		12 - 9x	Aa
b) FCF / Debt (3-year Average)	-19.3%	Caa		< 0%	Caa
c) (CFO - Dividends) / Debt (3-year Average)	12.9%	Ba		20 - 10%	Ba
Factor 5: Business Diversity & Size (33%)					
a) Business Diversity Score	2.0	Ba		2.0	Ba
b) Net Consolidated Sales (USD billions)	$14.8	Aa		$25 - 10	Aa

Factor 6: "Other" Liabilities Adjustments					
a) "Other" Liabilities to Book Equity	0.0%	Aaa		0.0%	Aaa
Rating:					
a) Indicated Rating from Grid	A3	A3		Baa1	Baa1
b) Actual Rating Assigned	A1	A1		A1	A1

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 3/1/2014(L); Source: Moody's Financial Metrics [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

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