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Research Update:

Corporacion Nacional del Cobre de Chile Upgraded To 'AA-' From 'A' On Closer Link To Chilean Government

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Overview

- We revised the link between the Chilean government and mining company, Codelco, to "integral" from "very strong," which according to our criteria means that the company benefits from an "extremely high" likelihood of support.
- We are raising our foreign currency corporate credit rating on the company to 'AA-' from 'A', which is capped by Chilean's foreign currency sovereign rating. The company's stand-alone credit profile (SACP) remains at 'bbb-'.
- We expect the ratings on Codelco to remain close to, and move in tandem with, those on the sovereign, unless the SACP falls by more than four notches.

Rating Action

On Aug. 5, 2013, Standard & Poor's Ratings Services raised its foreign currency corporate credit rating on Corporacion Nacional del Cobre de Chile (Codelco) to 'AA-' from 'A'. The outlook remains stable.

Rationale

The upgrade reflects the change in our assessment of the link between Codelco and the government to "integral" from "very strong," as the terms are described in our criteria for government-related entities (GRE) (General Criteria: Rating Government-Related Entities: Methodology And Assumptions, published Dec. 9, 2010). We now have more clarity on how closely intertwined Codelco and its shareholder--the government--are in terms of management, strategic and financial monitoring, coordination of debt issuance, as well as in fulfilling a public policy role. In addition, during the past five years, we've seen the government's increasing involvement in Codelco's long-term strategic decisions and financial policies. According to our criteria, an "integral" link between Codelco and the government and its "very important" role in the Chilean economy warrants an "extremely high" likelihood of extraordinary support from the government, leading to an upgrade.

We have also revised Codelco's business risk profile to "satisfactory" from "strong," due to the company's increased efforts to maintain profitability, amid declining ore grades, rising costs, and softer copper prices. We continue

to consider Codelco's financial risk profile as "significant," given its weaker credit metrics due to a significant capex plan and a SACP of 'bbb-'.

Codelco's capex will total about \$20 billion for the next four years, leaving little room for debt reduction or, more probably, would cause debt levels to increase towards 2015. However, the company's need to invest in its mining assets to avoid a material reduction in copper outputs is very important for the government, as that will secure Codelco's long-term ability to continue upstreaming cash to the Chilean treasury.

Our base-case assumptions incorporate copper prices of \$3.30 for 2013, \$3.10 for 2014, and \$2.70 in 2015 and afterwards, copper outputs of 1.70 million tons in 2013 and 1.75 million tons in 2015, and cash costs of about \$1.60 per pound. We assume lower cash costs than \$1.70 per pound reported during the first quarter of 2013 due to a 6% depreciation of Chilean peso in the past few months and increasing volumes from the company's newer operations with marginal higher efficiency.

Under our base case, we expect debt to EBITDA to deteriorate to 3.5x and funds from operations (FFO) to debt of about 20% by 2014, assuming annual net debt increases of about \$1.5 billion in 2013 and \$1.0 billion in 2014. We've assumed capital expenditures of \$4 billion in 2013 and \$3 billion in 2014, instead of the company's report of \$5 billion annually, reflecting some level of flexibility to cope with a more conservative price scenario for copper, as incorporated in our forecast.

Liquidity

We view Codelco's liquidity as "adequate." Sources will likely exceed uses by at least 1.2x in the next couple of years even if EBITDA were to decline by 30%. We also believe that the company has strong financial flexibility and access to credit markets thanks to its government ownership. These factors offset the risks inherent in the company's significant capital expenditures in the intermediate term. In assessing Codelco's liquidity, we've considered the following assumptions:

- Cash reserves of \$1.35 billion as of March 31, 2013;
- FFO of \$3 billion;
- Annual cash dividends of \$840 million--Codelco paid in advance about \$900 million in 2013, so no additional dividend payments are contemplated in our forecast for this year;
- Strong flexibility in capex and dividends in case of weaker copper prices in 2013 and 2014, providing ability to absorb high-impact, low-probability events;
- Very strong financial flexibility thanks to ownership by a highly-rated government; and
- Sound relationship with banks and very good standing in credit markets (Codelco's debt trading close to Chile's sovereign debt).

Outlook

The stable outlook on Codelco incorporates our expectation that the government will provide timely and sufficient support to Codelco, given the company's very important role in the Chilean economy as the world's largest copper producer. Given the current SACP, the rating on Codelco reflects that on the sovereign and is expected to move in tandem with it unless the company's SACP deteriorates by more than four notches. A weaker SACP could reflect a more aggressive capex without a proper funding plan.

Related Criteria And Research

- Standard & Poor's Revises Its Metals Price Assumptions For The Rest Of 2013 Through 2015, June 25, 2013
- Rating Government-Related Entities: Methodologies And Assumptions, Dec. 9, 2010
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Key Credit Factors: Methodology And Assumptions On Risks In The Mining Industry, June 23, 2009

Ratings List

Upgraded

	To	From
Corporacion Nacional del Cobre de Chile Corporate Credit Rating		
Foreign Currency	AA-/Stable/--	A/Stable/--
Senior Unsecured	AA-	A

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