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Credit Opinion: Corporación Nacional del Cobre de Chile

Global Credit Research - 02 Jul 2015

Santiago, Chile

Ratings

Category	Moody's Rating
Outlook	Negative
Senior Unsecured	A1

Contacts

Analyst	Phone
Barbara Mattos, CFA/Sao Paulo	55.11.3043.7300
Carol Cowan/New York City	1.212.553.1653
Marianna Waltz, CFA/Sao Paulo	55.11.3043.7300

Key Indicators

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

	3/31/2015(L)	12/31/2014	12/31/2013	12/31/2012	12/31/2011
Revenues (USD Billion)	$13.4	$13.8	$15.0	$15.9	$17.5
EBIT Margin	14.0%	14.3%	18.7%	44.5%	31.7%
Return on Average Tangible Assets	5.2%	5.5%	8.3%	26.0%	26.4%
EBIT / Interest Expense	4.5x	4.9x	10.0x	19.6x	25.1x
Debt / EBITDA	3.8x	3.8x	2.9x	1.3x	1.1x
Debt / Total Capital	48.7%	49.3%	46.0%	42.9%	50.4%
(CFO - Dividends) / Debt	18.6%	16.8%	16.7%	27.7%	13.4%

[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

- Multiple mine profile diversifies risk of operating problems

- Margins pressured by weaker copper prices versus historical periods

- Significant debt increases to fund strategic growth partly mitigated by owner's capitalization and profit retention

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 10%. Operating through eight operating divisions, Chuquicamata, Radomiro Tomic, Ministro Hales, Andina, El Teniente, Salvador, Gabriel Mistral, and Ventanas (refinery), 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, 2015 were approximately USD 13.4 billion.

SUMMARY RATING RATIONALE

As a government related Issuer ("GRI"), CODELCO's A1 foreign currency rating is based upon the following inputs: (i) the company´s baseline credit assessment (BCA) at baa1, a measure of its intrinsic risk regardless of its controlling entity; (ii) the Chilean Government's Aa3 bond rating; and (iii) our assumptions of high support from the government of Chile and high dependence between CODELCO and the government. The government support provides three notches of uplift to CODELCO's BCA.

CODELCO's baa1 BCA reflects its position as the world's largest copper producer (approximately 1.85 million metric tons for the twelve months ending March 31, 2015, including its share of El Abra and Anglo American Sur) and the second largest molybdenum producer, its competitive cost position (currently positioned at the second industry quartile) and its substantial reserve base of approximately 70 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 falling ore grades, which we anticipate will require increased debt levels over the next several years -- even considering the recently established law that allows for a USD 4 billion capitalization plan of CODELCO. Major projects identified as under construction or in the feasibility stage, such as Radomiro Tomic, Chuquicamata, El Teniente and Andina, have indicated capital costs aggregating approximately USD 25 billion in the next five years. Nonetheless, we also see the company's investment plans, combined with the aforementioned competitive cost position and production levels, as important supporters of performance over the medium to longer-term, despite ongoing short term pressures.

CODELCO's adjusted leverage as measured by the debt/EBITDA ratio was at 3.8x for the twelve months ended March 2015 -- the increase being largely explained by a softer pricing environment, but, to a lower extent, by higher debt levels as well. Given that copper prices remain range bound between USD 2.50 - 3.00/lb, we expect performance through 2015 to continue at lower EBITDA levels and a more elevated leverage position in comparison to previous years. In addition, the potential for production disruptions, the impact of lower ore grades in the near term, ongoing industry wide rising input costs, and energy and water costs challenges in Chile are also key considerations in the BCA.

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 2.69 in 2015 until June, roughly a 8% drop from the 2014's average . We see no broad based catalyst for material improvement 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, 2015, CODELCO's EBIT (including Moody's standard accounting adjustments) was USD 2.1 billion versus USD 2.9 billion during fiscal-year 2013. Mitigating the weaker price environment and lower molybdenum prices which serve as a byproduct cost credit, are declining production, fuel, power and labor costs. The company's average cash cost of USD 1.36/lb during the first quarter of 2015 is down 14.7% from the same prior year period, and although this level may not sustainable in the long term, cash costs should remain around the USD 1.50/lb.

The company's 12-month ending March 31, 2015 EBIT adjusted margin at approximately 14% is lower than previous years (18.7% in 2013 and 14.3% in 2014), 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 continued to be reflected in the company's financial results. We recognize, however, that 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.

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 2014 amounted USD 3.4 billion , from USD 4.2 billion in 2013 and we expect it to remain in the USD 5 billion range in the coming years. Over the next several years, spending will be prioritized towards developing the company's key structural projects. The El Teniente expansion has commenced construction and was around 33% completed by March 31, 2015. The El Teniente project, which is expected to be completed by 2020, 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 in the early stages of construction (about 20% completed), while the Andina and Radomiro Tomic Sulphide expansions are both in the stage of obtaining the environmental permits.

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 the government agrees and the implementation of the capitalization. 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 in line with the recent trend of total adjusted debt to Ebitda, which increased to 3.8x for the 12 months ending March 31, 2015 from 1.3x in 2012, and Ebit to interest, which decreased to 4.6x from 18.4x in the same period. In 2014, CODELCO issued EUR 600 million 10-year bonds and USD 980 million 30-year bonds, as part of the company's liability management strategy. Besides, the USD 4 billion multi-year (2014-2018) capitalization approved in October 2014 partially reduces the need of additional debt.

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. 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 negative free cash flow as a consequence of the large government take, dividends and large capital expenditures.

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 Chilean government has consistently demonstrated its support to CODELCO, having done so usually by direct capital injections or by allowing for profit retention, as well as by authorizing the sale of CODELCO's share in E-CL (fka Edelnor) in early 2011 and retention of the sales proceeds. Since 2007, the government has authorized the capitalization and retention of about USD 5.4 billion to CODELCO. On March 31, 2014 CODELCO submitted its capitalization plan to the government, and a retention of USD 200 million has been approved on June 30 2014. In October 2014, Congress approved a USD 4 billion multi-year (2014-2018) capitalization bill, which further reinforces CODELCO's importance to the Chilean economy and the company's significant needs for capital investments, besides easing the pressure from weaker copper prices on its credit metrics. On June 30, 2015, the government has authorized USD 225 million in profit retention, and announced that the amount of the equity contribution for this year will be determined in the second half of 2015, based on capex needs.

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 over the next 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 2015 CODELCO's proportion of sales to China, North America and Europe was 42%, 9% and 11%, respectively, compared with 37%, 11% and 15%, 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 reserves of approximately 56.7 million tons of fine copper - representing roughly 8% of reserves globally - CODELCO has about 70 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 29.5% interest in Anglo American plc's (Anglo American) subsidiary Anglo American Sur ("Anglo Sur"); Mitsubishi Corporation also has an interest in Anglo Sur. 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 780.2 million at March 31, 2015, is non-recourse to CODELCO. As per Moody's methodologies, this amount is reflected in Moody's credit metrics as it is consolidated in CODELCO's financial statements. 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 acceptable liquidity is supported by internally generated funds and an average cash balance of USD 1 billion in the past few years. The company has no committed revolving credit facilities that would provide alternative liquidity, but solid access to bank debt and capital markets. Besides, the USD 4 billion multi-year (2014-2018) capitalization bill, approved by Congress in October 2014, will further reinforce CODELCO's liquidity.

Rating Outlook

The negative outlook reflects our expectations for reduced earnings and tightening debt protection metrics 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 8% in the first semester of 2015 compared to average prices in 2014, a trend that continues since 2011-12. Moreover, the lower earnings expectations come at a time when CODELCO's capital expenditures are expected to remain at high levels and will be partly covered with increased debt issuances.

What Could Change the Rating - Down

The ratings could suffer negative pressure should earnings contract for a prolonged period, causing a sustainable period of EBIT margins below 20%, and CODELCO is not able to maintain costs at the levels currently observed. A downgrade could be considered if leverage ratio (total debt to Ebitda) does not return to 2.0x on a sustainable basis over the long-term. A marked deterioration in the company's liquidity position could also precipitate a downgrade.

What Could Change the Rating - Up

Upside adjustment to the rating 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.

Rating Factors

Corporación Nacional del Cobre de Chile

Mining Industry Grid [1][2]	**Current LTM 3/31/2015**		[3]**Moody's 12-18 Month Forward ViewAs of 6/30/2015**	
Factor 1 : Scale (20%)	**Measure**	**Score**	**Measure**	**Score**
a) Revenues (USD Billion)	$13.4	Baa	$12.6	Baa
Factor 2 : Business Profile (20%)				
a) Business Profile	Ba	Ba	Ba	Ba
Factor 3 : Profitability and Efficiency (15%)				
a) EBIT Margin (3 Year Avg)	24.5%	Aa	14.2%	A
b) Return on Average Tangible Assets (3 Year Avg)	10.9%	Baa	5.5%	Ba
Factor 4 : Leverage and Coverage (35%)				
a) EBIT / Interest Expense (3 Year Avg)	9.6x	A	5.3x	Baa
b) Debt / EBITDA (3 Year Avg)	2.5x	Baa	4.1x	Ba
c) Debt / Total Capital	48.7%	Baa	46.8%	Baa
d) (CFO - Dividends) / Debt (3 Year Avg)	19.3%	Ba	16.6%	Ba
Factor 5 : Financial Policy (10%)				
a) Financial Policy	Ba	Ba	Ba	Ba
Rating:				
a) Indicated Rating from Grid		Baa2		Baa3
b) Actual Rating Assigned		A1		A1

Government-Related Issuer	**Factor**
a) Baseline Credit Assessment	baa1
b) Government Local Currency Rating	Aa3
c) Default Dependence	High
d) Support	High
e) Final Rating Outcome	A1

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 3/31/2015(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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