

Rating Action: Moody's downgrades CODELCO to A3; negative outlook

Global Credit Research - 11 Mar 2016

New York, March 11, 2016 -- Moody's Investors Service has downgraded to A3 from A1 the long-term senior unsecured rating for Corporacion Nacional del Cobre de Chile (CODELCO). At the same time, Moody's has lowered CODELCO's baseline credit assessment (BCA) to ba2 from baa1. The outlook remains negative. These rating actions conclude the review initiated on January 21, 2016.

Ratings changed:

..Issuer: Corporacion Nacional del Cobre de Chile

...Senior Unsecured Regular Bond/Debenture Jan 15, 2019, downgrade to A3

...Senior Unsecured Regular Bond/Debenture Nov 4, 2020, downgrade to A3

...Senior Unsecured Regular Bond/Debenture Nov 3, 2021, downgrade to A3

...Senior Unsecured Regular Bond/Debenture Jul 17, 2022, downgrade to A3

...Senior Unsecured Regular Bond/Debenture Aug 13, 2023, downgrade to A3

...Senior Unsecured Regular Bond/Debenture Jul 09, 2024, downgrade to A3

...Senior Unsecured Regular Bond/Debenture Sep 16, 2025, downgrade to A3

...Senior Unsecured Regular Bond/Debenture Sep 21, 2035, downgrade to A3

...Senior Unsecured Regular Bond/Debenture Oct 24, 2036, downgrade to A3

...Senior Unsecured Regular Bond/Debenture Jul 17, 2042, downgrade to A3

...Senior Unsecured Regular Bond/Debenture Oct 18, 2043, downgrade to A3

...Senior Unsecured Regular Bond/Debenture Nov 04, 2044, downgrade to A3

The outlook for the ratings is negative

RATINGS RATIONALE

The downgrade of CODELCO's ratings to A3 and the lowering of its BCA to ba2 reflect Moody's view that the company's credit profile and operations remain solid, but incorporate the impact of the volatility and downward pressure of copper prices in CODELCO's credit metrics, lower earnings expectations and the large expansion phase with substantial capital expenditures (CAPEX) needed to increase production and reverse the declining trend in ore grades. Copper prices in the range between USD 2.0 to 2.5/lb will maintain CODELCO's credit metrics, particularly margins, leverage and interest coverage, under pressure.

As a government related issuer ("GRI"), CODELCO's A3 foreign currency rating is based on the following inputs: (i) the company's baseline credit assessment (BCA) of ba2, 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 currently provides five notches of uplift to CODELCO's BCA.

CODELCO's ba2 BCA reflects its position as the world's largest copper producer (approximately 1.89 million metric tons in the full year 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 law enacted in October 2014 by the Chilean Congress that allows for a USD 4 billion capitalization plan of CODELCO. We estimate capital expenditures for major projects identified as under construction or in the feasibility stage, such as Radomiro Tomic, Chuquibambilla, El Teniente and Andina, to be between USD 5 to 6 billion between 2016-2018. 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 pressures.

CODELCO's adjusted leverage as measured by the debt/EBITDA ratio was at 5.8x for the twelve months ended September 2015 -- the increase being largely explained by a softer pricing environment, but by higher debt levels as well. Codelco issued USD 2 billion in bonds due in 2025, and part of the proceeds will be used to finance capital expenditures. Given that copper prices remain between USD 2.00 -- 2.50/lb, we expect performance through 2017 to continue at lower EBITDA levels and a more elevated leverage position in comparison to previous years. The execution of the capital increases by the Chilean government will be an important factor to reduce the need for further debt issuances.

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.

CODELCO's A3 ratings consider the continued support of the Chilean government, which will help mitigate the increase in leverage during the challenging price environment and high capex program. Besides, given CODELCO's budget approval process within Chile, sufficient funds will likely continue available to the company to meet debt obligations. The company's ownership by the Chilean State and the framework in which it operates are important considerations in the rating. CODELCO's ownership structure requires the company to pay 100% of its income to the Chilean Treasury and, in addition, 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 to retain profits within the company, particularly to support strategic capital expenditures 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. Profit retentions in the amount of USD 200 million and USD 225 million have been approved in June 2014 and 2015, respectively. 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. In October 2015, the government authorized USD 600 million in capital increase as part of the capitalization.

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, and in developed countries. The weaker demand levels and economic concerns have contributed to average copper prices falling about 20% in 2015, 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.

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. Still, upward pressure on the ratings or outlook could be considered if copper prices improve significantly, easing existing pressure on metrics. An upward rating movement would require that CODELCO maintains a strong liquidity position, reduce debt levels, with interest coverage metrics (EBIT/interest expense) staying above 3.5x times, at a minimum.

The ratings could suffer negative pressure should earnings contract for a prolonged period, causing a sustainable period of EBIT margins below 7%, and CODELCO is not able to maintain costs at the levels currently observed. A downgrade could be considered if leverage ratio (total adjusted debt to Ebitda) does not evidence a trend back to 3.5x on a sustainable basis over the long-term. A marked deterioration in the company's liquidity position could also precipitate a downgrade. Any indication of a decline in the level of support from the government of Chile would also put downward pressure on the company's ratings.

The principal methodology used in these ratings was Global Mining Industry published in August 2014. Other methodologies used include the Government-Related Issuers methodology published in October 2014. Please see the Ratings Methodologies page on www.moodys.com for a copy of these methodologies.

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%. Revenues for the 12 months ending September 30, 2015 were around USD 12.5 billion.

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