

# RatingsDirect®

---

## Research Update:

# Corporacion Nacional del Cobre de Chile Downgraded To 'A+' From 'AA-'; Outlook Stable

### Primary Credit Analyst:

Diego H Ocampo, Sao Paulo (55) 11-3039-9769; [diego.ocampo@standardandpoors.com](mailto:diego.ocampo@standardandpoors.com)

### Secondary Contact:

Flavia M Bedran, Sao Paulo (55) 11- 3039-9758; [flavia.bedran@standardandpoors.com](mailto:flavia.bedran@standardandpoors.com)

## Table Of Contents

---

Overview

Rating Action

Rationale

Outlook

Rating Score Snapshot

Related Criteria And Research

Ratings List

## Research Update:

# Corporacion Nacional del Cobre de Chile Downgraded To 'A+' From 'AA-'; Outlook Stable

## Overview

- Lower copper prices continue to pressure Codelco's credit quality.
- We are lowering the ratings on Codelco to 'A+' from 'AA-'.
- The stable outlook reflects our view that the company's leverage profile has some leeway before we would consider another downgrade, and that we believe the Chilean government will inject capital into it in the next two years.

## Rating Action

On Feb. 5, 2016, Standard & Poor's Ratings Services lowered its ratings on Corporación Nacional del Cobre de Chile (Codelco) to 'A+' from 'AA-'. The outlook is stable.

We also lowered our stand-alone credit profile assessment (SACP) to 'bb-' from 'bb+'.

## Rationale

The downgrade reflects our expectation that Codelco will post weaker cash-flow leverage metrics in the next two years, in light of sinking copper prices and declining the ore grades of its mineral base. These factors, combined with its bold investment plan through 2019, forewarn of growing cash flow deficits that range from roughly \$1 billion in 2016 and \$2 billion in 2017 to nearly \$3 billion in 2018--even assuming capital injections from the Chilean government of \$2.4 billion through 2018.

Our updated base case now incorporates copper prices of \$4,600 per ton in 2016, \$4,850 per ton in 2017, and \$5,100 in 2018, leading adjusted debt to EBITDA ratios to slip towards 5x-5.5x and FFO to debt to slide to around 15% in the 2016-2018 period. The revised base-case scenario lead us to lower our financial risk profile assessment to highly leveraged from aggressive and to lower our assessment of its stand-alone credit profile (SACP) to 'bb-' from 'bb+'.

Although now one notch lower, Codelco's ratings continue to benefit from a meaningful uplift on the basis of extraordinary financial support from the Chilean Government. The dip in Codelco's creditworthiness is a cause of concern to us, but we continue to believe the company has an extremely high

likelihood of receiving government financial support, in case of financial distress. In reaching that conclusion, we have particularly taken past capital injections into consideration, as well as the government's commitment to further deploying capital to the issuer under its Capitalization Law. Despite the current environment, Codelco has contributed significant cash flows to the central government in the form of dividends and ad-hoc taxes and it is highly probable that it will continue to do so once the investment phase is ended.

Nevertheless, we will continue to monitor the government's actions to mitigate deterioration in Codelco's balance sheet. Our assessment of sovereign support may be adversely affected if, in our view, the government fails to take timely and adequate measures to address potential erosion of Codelco's financial health.

Our base-case incorporates a revised investment plan that deals with the lower price environment, with a meaningful reduction in 2016, increasing thereafter. We believe our capital expenditure (capex) assumptions might be further trimmed or delayed if prices remain low--but it is highly likely that the three main expansion projects that sustain output levels through 2030 will remain in place. We estimate that those three projects [namely Chuquicamata Underground (367kt per year), El Teniente New Mine level (432kt per year) and RT Phase II (354kt per year)] would demand an aggregated investment of roughly \$11.5 billion, during the next six years. Our main assumptions include:

- Average Chilean peso (CLP) exchange rate of CLP730 per dollar in 2016, CLP725 in 2017, and CLP725 in 2018;
- Inflation rates of 3.7% in 2016 and 3.3% in 2017 and 2018;
- Copper prices of \$4,600 per ton in 2016, \$4,850 per ton in 2017, and \$5,100 in 2018;
- Copper output of about 1.7 million tons through 2018;
- Molybdenum production of 28,000 tons per year with prices at \$6 per pound;
- Declining cash costs of \$1.31 per pound in 2016, \$1.29 in 2017, and \$1.28 in 2018, due mainly to the weaker Chilean peso;
- A 10% tax rate on exports, according to Law 13.196 (Ley Reservada);
- A 40% additional tax rate on Codelco's earnings before taxes, according to Decree Law 2.398;
- Capex of \$3.4 billion in 2015, \$2.9 billion in 2016, and \$4 billion in 2017 and \$5 billion in 2018; and
- Capital injections of \$2.4 billion through 2018.

Based on those assumptions, we arrive at the following credit measures:

- Adjusted EBITDA of \$3.2 billion in 2016, \$3.6 billion in 2017, and \$4 billion in 2018 (including dividends from equity investments in Anglo American and El Abra of \$100 million per year, pension adjustments of \$350 million and operating lease adjustments of about \$1 billion);
- Debt to EBITDA ratios ranging between 5x and 5.5x through 2018; and
- Funds from operations (FFO) to debt ratios slightly below 15% through 2018.

All else being equal, if copper prices were to stabilize at \$2.1 per pound,

the resulting credit metrics would be as follows:

- Debt to EBITDA of 5.5x in 2016, growing to 6.5x by 2018; and
- FFO to debt ratios of 14% in 2016, declining towards 10% by 2018.

## **Liquidity**

We continue to assess Codelco's liquidity as "adequate" because we expect cash sources to exceed uses by at least 20% in the next 12 months. We believe the company will continue to generate free cash surpluses even if EBITDA were to decline by 15%, relative to our base case.

We also believe the company has strong financial flexibility and open access to credit markets thanks to its government ownership, which is reflected in the low spreads in its bonds compared with other frequent corporate debt issuers. These factors offset the risks associated with the company's significant capex in the next 12 months and its lack of committed credit lines.

### Sources of Liquidity:

- Estimated cash position of around \$1.6 billion as of Dec. 31, 2015;
- FFO of \$1.3 billion;
- Estimated working capital cash inflows of around \$300 million; and
- Capital injections of \$800 million.

### Uses of Liquidity:

- Short-term debt maturities of \$545 million; and
- Minimum capex levels of \$2 billion.

## **Outlook**

The stable outlook incorporates our views that there is some leeway for Codelco's credit metrics to worsen before we contemplate a further potential downward revision.

## **Downside Scenario**

A negative rating action would follow a downward revision of the SACP to 'b+', which could be driven by adjusted debt to EBITDA ratios persistently above 6x and FFO to debt below 10% and/or a weakening liquidity profile. Such a scenario could be driven by copper prices persistently below \$2.1 per pound, absent meaningful mitigating measures such as capex reduction or capital injections.

We could also lower the ratings if we believe the Chilean government's capacity or willingness to provide timely support has diminished. For reference, if we were to lower the likelihood of government support to very high then the final ratings on Codelco would move to 'BBB', assuming no changes to the current SACP.

## Upside Scenario

We could consider an upgrade if the pressure on leverage ratios softens either due to better prices or if the government decides to inject more capital in 2016 and 2017, bringing debt to EBITDA ratios back to the 4x-5x range.

## Rating Score Snapshot

Corporate Credit Rating: A+/Stable/--

Business risk: Satisfactory

- Country risk: Intermediate
- Industry risk: Moderately high
- Competitive position: Satisfactory

Financial risk: Highly Leveraged

- Cash flow/Leverage: Highly Leveraged

Anchor: b+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: bb-

Sovereign foreign currency rating: AA-

Likelihood of government support: Extremely high

## Related Criteria And Research

### Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Metals And Mining Upstream Industry, Dec. 20, 2013
- Corporate Methodology, Nov. 19, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

### Related Research

- Standard & Poor's Revises Its Price Assumptions For Metals On Continuing Price Weakness, Jan 22, 2016

## Ratings List

Downgraded; CreditWatch/Outlook Action

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

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com) and at [www.spcapitaliq.com](http://www.spcapitaliq.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

Copyright © 2016 Standard & Poor's Financial Services LLC, a part of McGraw Hill Financial. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgement as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, [www.standardandpoors.com](http://www.standardandpoors.com) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.com) and [www.globalcreditportal.com](http://www.globalcreditportal.com) (subscription) and [www.spcapitaliq.com](http://www.spcapitaliq.com) (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).