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Research Update:

Corporacion Nacional del Cobre de Chile 'A+' Long-Term Corporate Credit Rating Affirmed; Outlook Still Stable

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Overview

- Better copper prices and money from its owner are stabilizing Codelco's adjusted leverage at around 3.1x-3.5x. However, we still expect free cash flow deficits ranging from $250 million to $500 million per year that Codelco will finance with capital injections.
- We're affirming our 'A+' long-term corporate credit rating on Codelco. The outlook is stable. The company's stand-alone credit profile (SACP) remains at 'bb'.
- Copper prices above $6,600 per ton favor an upward revision of Codelco's SACP, but that would also require a gradual reduction of gross debt levels. An upgrade to Codelco is unlikely without a parallel rating action on the sovereign.

Rating Action

On Feb. 26, 2018, S&P Global Ratings affirmed its 'A+' long-term foreign currency rating on Chilean government-owned copper miner Corporacion Nacional del Cobre de Chile (Codelco). We also affirmed our 'A+' ratings on its bonds. Codelco's SACP remains at 'bb'. The outlook on the issuer is stable.

Rationale

Our rating on Codelco remains largely driven by the explicit support we expect Codelco to get from its sole owner, Chile (A+/Stable/A-1), in case of need. Because Codelco is closely intertwined with Chile's government, and because its size makes it very relevant for the Chilean economy and mining industry, the government is actively involved in Codelco's business and financial strategies. These factors support our view of an extremely high likelihood of financial support from the owner if needed.

Codelco's internal capacity to generate free cash flow remains limited by the burdensome levies imposed on all Chilean government-owned entities, and by its need to invest $3.5 to $4 billion per year, for the next four years, to sustain its current output and ensure long-term mining viability. We expect free operating cash shortfalls ranging from $250 to $500 million per year through 2020, after capital investments and before dividends and cash contributions from the owner.

Chile taxes Codelco with an effective corporate income tax of about 65% and imposes the obligation to finance the Army (Ley Reservada)--an annual disbursement of around $1.0 billion per year, depending on copper prices. Capital injections in times of low copper prices partially offset this tax scheme. We also expect the government to deploy more funds in the future because the Capitalization Law, passed in 2014, demands a remainder of $1.4 billion through 2019, apart from the $520 million injected in December 2017. The Chilean government also returned $950 million of the "Ley Reservada" to the company in two payments of $475 million in December 2016 and April 2017.

Our updated base case shows leverage hovering between 3.1x and 3.5x, as measured by the adjusted debt-to-EBITDA ratio in 2018 and 2019, while the funds from operations (FFO)-to-debt ratio remains around 25%. Our base case also incorporates the latest updates to the investment plan, which consists of two main projects--Chuquicamata Underground (367 kilotons [kt] per year in 2019) and El Teniente New Mine (432 kt per year in 2023)--and smaller projects like the Andina plant relocation and the overhaul of operations to comply with the new emissions standards. Our main assumptions are:

- Average Chilean peso (CLP) exchange rate of CLP650 per $1 in 2018 and CLP660 per $1 in 2019;
- Inflation rates of 2.8% in 2018 and 3.0% in 2019;
- Copper prices of $6,170 per ton through 2020;
- Copper output of about 1.7 million tons per year (mtpy) in 2018 and growing to 1.8 mtpy in 2019 (not including shares in El Abra and Anglo American Sur);
- 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;
- Capital expenditures (capex) of $4 billion in 2018 and 2019;
- Dividends of around $450 million in 2018 and 2019; and
- Capital injections of $630 million in both 2018 and 2019.

Liquidity

We assess Codelco's liquidity as adequate because we expect cash sources to exceed uses by at least 20% in the next 12 months, and expect the company to continue generating positive cash over uses even if EBITDA were to decline by 15% from our base case.

We also believe the company has strong financial flexibility and open access to credit markets due to its government ownership, which is reflected in the low spreads in its bonds compared with other frequent corporate debt issuers. The company also has no covenants in any of its debts. These factors offset the risks associated with the company's bold capex in the next 12 months and its lack of committed credit lines.

Principal liquidity sources:

- Expected cash position of around $1.2 billion as of Dec. 31, 2017;
- FFO of $3.5 billion and;
- Capital injections of $630 million.

Principal liquidity uses:
- Short-term debt maturities of approximately $750 million;
- Sustaining capex of $2.5 billion; and
- Dividends of about $450 million in the next 12 months.

Outlook

The stable outlook reflects that we don't see any immediate changes to Codelco's leverage profile, nor to our assessment of support from the Chilean government--even in a scenario of better regulation for Codelco. Our ratings and outlook are aligned with an adjusted debt-to-EBITDA ratio of 3.0x-4.0x and a FFO-to-debt ratio of around 25%.

Downside scenario

Assuming our support assessment doesn't change, a one-notch downgrade scenario could arise if we lower Codelco's SACP to 'b+' or if we lower Chile's long-term local currency rating to 'A+' from 'AA-'. The first situation could happen if debt to EBITDA is higher than 5.0x and FFO to debt is below 12% on a consistent basis.

Upside scenario

The chances for an upgrade are minimal in the near future, since it would require a revision of the SACP to 'a' or for us to raise the local currency rating on Chile to 'AA' while Codelco's SACP is at least 'bb+'. However, we could consider revising Codelco's SACP to 'bb+' if the adjusted net debt-to-EBITDA ratio stays close to 3x while FFO to debt is at least 25%-30%. We estimate that Codelco could achieve those ratios if copper prices remain above $6,700 per ton, but an upward revision of the SACP would also require gradual reduction of gross debt levels and neutralizing free operating cash flow.

Ratings Score Snapshot

Corporate credit rating: A+/Stable/--

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

Financial risk: Aggressive
- Cash flow/Leverage: Aggressive

Anchor: bb

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: Neutral (no impact)

Stand-alone credit profile: bb

Sovereign foreign currency rating: A+/Stable/A-1

Likelihood of government support: Extremely high

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Metals And Mining Upstream Industry, Dec. 20, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Metals Retain Their Lustre As S&P Global Ratings Raises Metals Price Assumptions Again, Dec. 4, 2017

Ratings List

Ratings Affirmed

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

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 for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.