

Global Credit Research - 18 Jun 2010

Santiago, Chile

Ratings

Category	Moody's Rating
Outlook	Stable
Senior Unsecured	A1

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Key Indicators

Corporación Nacional del Cobre de Chile	12/31/2007	12/31/2008	12/31/2009
EBIT Margin	43.1%	28.1%	27.6%
Debt / Book Capitalization	44.3%	51.0%	43.1%
Debt / EBITDA	0.5x	1.0x	1.1x
EBIT / Interest Expense	29.8x	17.0x	14.0x
FCF / Debt	18.4%	-40.7%	10.8%
(CFO - Dividends) / Debt	54.6%	0.2%	45.1%

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 operating profile, involved in mining, smelting and refining
- > Increasing cost position, but still competitive
- > Increasing leverage expected to fund strategic growth

Corporate Profile

Headquartered in Santiago, Chile, Corporación Nacional del Cobre de Chile (CODELCO) is 100% owned by the Chilean State and is the largest producer of copper globally, holding an approximate 11% share of global copper production. The company also ranks as one of the top two global molybdenum producers (as a by-product of copper production) with a market share of approximately 14%. Operating through five divisions, Codelco Norte, Andina, El Teniente, Salvador and Ventanas, 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.

SUMMARY RATING RATIONALE

As a government related Issuer ("GRI"), the A1 rating on CODELCO's senior unsecured debt reflects the baseline credit assessment ("BCA") at the low end of the 5-7 range. CODELCO's BCA reflects its position as the world's largest copper producer (approximately 1.8 million metric tons in 2009 including its share of El Abra), its competitive cost position and its solid reserve base, approximately 70 years at current production levels. CODELCO'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 ore grades, which Moody's anticipates will increase leverage over the next several years. However, the government's \$1 billion equity investment in 2009 will mitigate the absolute level of

debt needed to support such expenditures. Although 2009 performance reflects the contraction in copper prices in the early part of the year, the company's performance remained acceptable and is expected to improve significantly in 2010 on stronger copper fundamentals. Nonetheless, we expect that the potential for production disruptions, lower ore grades and ongoing cost challenges will all weigh against CODELCO's near term earnings potential. However, the company's strategic growth investments, competitive cost position, and production levels support performance over the medium to longer-term.

DETAILED RATING CONSIDERATIONS

IMPROVED COST POSITION BUT UPWARD PRESSURE LIKELY

CODELCO continues to evidence a competitive cost position although cash costs have been increasing in recent years. In 2009 the company's total costs reduced to \$1.58/lb reflecting more favorable exchange rates as well as the benefits of higher grades mined and improved recoveries. However, principally reflecting the drop in molybdenum prices, direct cash costs, after by-products, rose to \$0.93/lb from \$0.70/lb in 2008. CODELCO's direct cash cost position benefits from its substantive molybdenum production (22,000 metric tons in 2009), which provides by-product offsets to its gross cost base. With the significant fall-off in steel production in 2009 molybdenum prices fell to an average of about \$24/kg in 2009 from \$63/kg in 2008 period. Given our outlook for steel demand and utilization rates for 2010, we expect CODELCO's by-product cost benefit to improve but not to 2008 levels. Although we expect costs to be challenged going forward as key input costs increase in an improving economic environment and grades and recovery rates are likely to continue to fluctuate, similar trends are evident in the overall copper industry. We therefore expect CODELCO to remain cost competitive and able to generate good profits.

In addition, availability of sufficient water supply and cost will become an increasing issue over time for copper producers in Chile.

LEVERAGE LIKELY TO INCREASE TO SUPPORT AGGRESSIVE 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 and to reverse falling ore grades. Although such expenditures will pressure performance in the near term, they strengthen the longer term viability of the company's mining assets. These projects include a roughly \$1.1 billion investment at the Andina division to increase capacity as well as expansions at El Teniente North Pilar, and RT Sulphides at Codelco Norte. A number of other projects, including Andina Phase II at an estimated cost of \$4.8 billion to increase copper production by 390,000 tonnes, remain in the feasibility stage. Given that CODELCO's cash flow available for investment is limited to depreciation and other non cash add backs, (roughly \$950 million in 2009), further increases in debt are likely. However, the \$1.0 billion equity investment by the government in 2009 meaningfully mitigates 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.

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 in recent years to fund strategic growth initiatives. On a free cash flow to debt basis CODELCO maps in the Caa range under Moody's global mining methodology, and Moody's expects this to continue given the dividend payout requirements. However, we expect the company to manage its overall debt levels within the context of its resources and an acceptable leverage position. 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 weak mapping in this important metric.

LARGEST GLOBAL PRODUCER - LONG LIVED RESERVE BASE

With proven, probable and inferred reserves of approximately 122 million tons of fine copper - representing roughly 10% 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. With 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 that has recently been experienced.

Liquidity Profile

CODELCO's liquidity is supported by internally generated funds. It has no committed revolving credit facilities that would provide alternative liquidity. This is seen as mitigated by the budget process previously mentioned.

Rating Outlook

The stable reflects our expectation that CODELCO will show improved earnings performance in 2010 on an improved copper price relative to the low levels reached in 2009. The outlook also considers the significant investment requirements, in the order of \$15 billion, which CODELCO has over the next number of years to maintain and increase its copper production levels, and anticipates that CODELCO will continue to take a balanced approach relative to the timing of investment commitments and the level of debt to be incurred. In addition, the outlook captures our expectation that copper prices will remain volatile and vulnerable to the downside due to a slowing in copper imports into China, which is the dominant player in the market, and concerns over the economic health of certain European countries.

What Could Change the Rating - Up

Upside adjustment to the BCA 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.

What Could Change the Rating - Down

The BCA and CODELCO's senior unsecured foreign currency ratings could be negatively impacted should earnings contract for a prolonged period, causing a sustainable period of EBIT margins below 22%, interest coverage below 9.0x, or debt/EBITDA above 2.5x. In addition, ratings could be negatively impacted by increases in royalties, environmental compliance costs or other regulatory requirements or significant cash copper hedging losses.

Other Considerations

CODELCO's ownership by the Chilean State and the framework in which it operates are also important considerations in the rating. CODELCO's ownership structure requires the company to pay 100% of its income to the Chilean Treasury and the company pays significant amounts in export, royalty and income taxes. As a consequence, its cash flow available to cover capital expenditures and debt repayments is limited to depreciation and other non cash-add backs. The ratings incorporate the company's substantial capital expenditure program over the next several years and the anticipated incremental increases in debt financing. However, the BCA contemplates the level of earnings and cash flow generation that the asset base and cost position of CODELCO can generate, and the importance of CODELCO within the Chilean economy. Moody's believes that CODELCO's cash generation capacity on a "normalized basis" is capable of supporting its capital spending requirements and debt obligations and that given CODELCO's budget approval process within Chile, sufficient funds will continue available to the company to meet debt obligations.

CODELCO operates under Decree Law 1.350 and is required to submit its proposed annual budget to the Ministries of Mining and Finance for approval. As part of the annual budget, CODELCO must include a debt amortization budget, inclusive of interest and principal. In addition, CODELCO can propose to retain a portion of its earnings, although there is no assurance that such a request would be approved. However, in early December 2009 the Chilean government provided \$1 billion in equity to CODELO. This follows the January 2009 approval by the government for CODELCO to retain \$1 billion in pre-tax profits to help fund its 2009 capital investments, in light of the significant drop-off in earnings as copper prices fell.

The medium dependence and high support factors consider the moderate correlation of default risk between the company and the Chilean government and the importance of the company to Chile respectively.

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. However, its performance in certain key rating factors (based upon the three years through December 30, 2009 performance) is illustrative of the company's operating strength and world-class operating mines. We expect the indicated rating to track within the "A" rating category over the next twelve to eighteen months

Rating Factors

Corporación Nacional del Cobre de Chile

Mining Industry	Aaa	Aa	A	Baa	Ba	B	Caa
Factor 1: Reserves (8%)							
a) Reserves (Years)			40.0				
Factor 2: Cost Efficiency & Profitability (17%)							
a) Mining EBIT Margin (3-year Average)	31.3%						
b) Return on Average Tangible Assets (3-year Average)	31.5%						
Factor 3: Financial Policies (17%)							
a) Debt / Book Capitalization				43.1%			
b) Debt / Mining EBITDA (3-year Average)	0.8x						
Factor 4: Financial Strength (25%)							
a) Mining EBIT / Interest (3 year average)	18.9x						
b) FCF / Debt (3-year Average)							-4.5%
c) (CFO - Dividends) / Debt (3-year Average)			32.7%				
Factor 5: Business Diversity & Size (33%)							
a) Business Diversity Score					2.0		
b) Net Consolidated Sales (USD billions)		\$12.1					
Factor 6: "Other" Liabilities Adjustments							
a) "Other" Liabilities to Book Equity	0.0%						
Rating:							
a) Grid-Indicated Rating from Methodology			A2				
b) Actual Rating Assigned			A1				



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