Credit Opinion: Corporacion Nacional del Cobre de Chile

Corporación Nacional del Cobre de Chile

Santiago, Chile

Ratings

Category	Moody's Rating
Outlook	Stable
Senior Unsecured	Aa3

Contacts

Analyst	Phone
Carol Cowan/New York	212.553.4999
Brian Oak/New York	212.553.2946

Key Indicators

Corporación Nacional del Cobre de Chile

	2004	2005	2006	2007
EBIT MARGIN %	**34.7%**	**40.6%**	**47.6%**	**43.1%**
EBIT / INTEREST	**19.93x**	**22.52x**	**34.47x**	**29.80x**
DEBT / CAPITALIZATION	**43.0%**	**49.0%**	**41.3%**	**44.3%**
DEBT / EBITDA	**0.88x**	**0.78x**	**0.45x**	**0.54x**
CFO - DIVIDENDS / DEBT	**32.3%**	**26.8%**	**43.7%**	**54.6%**
FCF / DEBT	**2.60%**	**-21.87%**	**13.22%**	**18.36%**

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Corporate Profile

Headquartered in Santiago, Chile, Corporacion Nacional del Cobre de Chile 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.

Rating Rationale

In accordance with Moody's government-related issuer rating methodology, CODELCO's Aa3 rating on its foreign currency senior unsecured notes reflects the combination of the following inputs:

Baseline credit assessment (BCA) tracking in a 5-7 range on a scale of 1 to 21 (1 being the highest)

A1 local currency rating of the Chilean government

Medium dependence

High support

CODELCO's BCA, range of 5-7 reflects the company's position as the world's largest copper producer (1.665 million metric tons in 2007, including its share of El Abra), its good debt protection measures through the copper cycle, its competitive cost position and the longevity of its reserves, 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.

However, the BCA range of 5-7 also considers CODELCO's relatively large investment requirements to improve production and ore grades, which Moody's anticipates will increase leverage at a time of rising cash costs amidst softening copper prices and a weak demand outlook Given the current pricing backdrop in-line with weak end market demand, Moody's anticipates CODELCO to exhibit some downward margin pressure, reflective of higher input costs for sulfuric acid, labor, and energy as well as increased financing costs. However, its strategic growth investments, competitive cost position, and production levels support performance over the medium to longer-term. Additional factors considered in the rating include challenges facing the company with respect to costs, particularly energy and its availability, given the tight supply situation within Chile.

CODELCO's ownership by the Chilean State and the framework in which it operates are important considerations in the rating. As a state owned entity, CODELCO is required 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, the strong coverage metrics provided by earnings levels, 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 2006 CODELCO and the Ministry of Finance entered into an agreement whereby CODELCO was able to retain approximately $714 million of net profits toward financing capital projects in its pipeline, which has reduced the funding required in 2007.

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. In 2007, CODELCO contributed US$7.9 billion to the Chilean treasury ($8.3 billion in 2006) and accounted for roughly 25% of exports (25% in 2006) from Chile.

Rating Drivers

The key rating factors currently influencing CODELCO's ratings are:

Competitive cost position but challenges exist

CODELCO continues to evidence a competitive cost position although cash costs have been increasing over recent periods and were $0.60/lb for the six months through June 2008, up from $0.27/lb for the comparable 2007 period and $0.40/lb for fiscal 2007. CODELCO's cost position benefits from its substantive molybdenum production (27,857 metric tons in 2007), which provides byproduct offsets to its gross cost base. While moly prices remain strong in 2008, averaging $33.24/lb through June 2008, the company continues to be challenged by increased input costs, particularly energy, lower ore grades and recovery rates, and exchange rate movement. In addition cost performance (and production) through June was negatively impacted by labor strife and poor weather.

Chile derives roughly half of its copper energy needs from hydropower, which has been pressured by the worst drought in 50 years and given that Argentina is restricting the sale of natural gas into Chile, the majority of the country's natural gas plants are running on fuel oil; leading to a rescue package for Chile's largest gas supplier to the northern region, GasAtamaca. Moody's anticipates that new energy capacity will not be installed until at least 2010, exacerbating the tight supply situation and power shortages over the next several years. In addition, availability of sufficient water supply will become an increasing issue over time for copper producers in Chile.

Moody's expects CODELCO's net cash costs to remain challenged over the next twelve to fifteen months with ongoing pressure from energy, sulfuric acid and labor costs coupled with the expectation of reduced molybdenum byproduct credits--resulting from decreased production and demand destruction in major steel consuming sectors such as automotive and construction. Currency fluctuations will also add volatility to costs. Despite the expectation for softening copper prices from the high levels seen in the first half of 2008, Moody's recognizes CODELCO's ability to generate solid operating earnings despite copper price contraction and cost challenges.

Substantive expansion pipeline - additional debt likely

CODELCO has increased its capital spending in recent years and has relatively aggressive spending plans over the next several years to maintain and improve is production profile to reverse falling ore grades. Despite the recent downward spiral in copper prices somewhat attributable to the slowdown in the global industrial production cycle, CODELCO's projects are based on production costs between $1.60/lb and $1.70/lb, leaving considerable cushion for their long term viability. These include the Gaby project with an approximate $1 billion capital cost and a roughly $700 million investment at the Andina division to increase capacity to 92,000tpd from currently 72,000tpd. Gaby is expected to reach full production levels of 150,000 metric tons in 2009. Given that CODELCO's cash flow available for investment is limited to depreciation and other non cash add backs, (roughly $830 million in 2007), further increases in debt are likely, absent further retention of profits being allowed for investment purposes.

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 over the near term but improve as major projects are completed and production and recovery rates increase. The importance of CODELCO to the Chilean economy and the requirement that the annual budget presented include interest and debt payment requirements as well as the 2006 agreement to allow a portion of profits to be retained to support capital investments are key elements in mitigating the mapping in these two metrics.

Largest global producer with long lived reserve base

With proven, probable and inferred reserves of approximately 120 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 currently being experienced.

Liquidity

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 outlook reflects Moody's expectation that while copper market fundamentals and prices will exhibit considerable volatility over the next twelve months, pricing will remain at levels to generate good earnings performance for CODELCO despite expected continued cost pressure, although the recent weakening of the Chilean peso will alleviate some of the cost increases experienced to date in 2008. Moody's anticipates the near balanced supply/demand position for copper in 2008 will shift to a surplus in 2009 as demand further weakens in-line with the broader global economic slowdown; however, the longer-term demand outlook for copper remains favorable, particularly for emerging economies such as China. The outlook also incorporates Moody's view that CODELCO will continue to prudently manage its overall debt levels while pursuing its strategic growth objectives.

What Could Change the Rating - Up

Upside rating potential is limited due to the company's ongoing reinvestment requirements and the expectation for increased leverage in an industry that will continue to exhibit variability in copper supply and demand balances, copper price volatility and input cost challenges. These considerations will continue to constrain upward movement in the BCA.

What Could Change the Rating - Down

The BCA and CODELCO's senior unsecured foreign currency ratings could be negatively impacted should the EBIT margin fall below 22% and remain at that level, the interest coverage ratio track at 9.0x or less, or the debt/EBITDA ratio exceed 2.5x. In addition, ratings could be negatively impacted by increases in royalties, environmental compliance costs or other regulatory requirements.

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. However, its performance in certain key rating factors (based upon the three years through December 30, 2007 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 as the company is still reasonably profitable during periods of depressed copper pricing.

Rating Factors

Corporación Nacional del Cobre de Chile

Mining Industry	**Aaa**	**Aa**	**A**	**Baa**	**Ba**	**B**
Factor 1: Reserves						
a) Reserves (Years)			X			
Factor 2: Cost Efficiency & Profitability						
a) EBIT Margin	41.6%					
b) Return on Assets	52.1%					
c) Other Liabilities / Equity	0.0%					
Factor 3: Financial Policies						
a) Debt / Capital				44.3%		
b) Debt / EBITDA	0.6x					
Factor 4: Financial Strength						
a) Interest Coverage	27.5x					
b) (CFO - Dividends) / Debt		41.7%				
c) Free Cash Flow / Debt					3.2%	
Factor 5: Business Diversity & Size						
a) Business Diversity Score			5			
b) Size		$17.0				
Rating:						
a) Indicated Rating from Methodology		A				