STANDARD & POOR'S

RATINGSDIRECT®

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Corporacion Nacional del Cobre de Chile

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Table Of Contents

Corporacion Nacional del Cobre de Chile

Corporate Credit Rating
Foreign Currency
A/Stable/--

Major Rating Factors

Strengths:
- Worldwide leading competitive position;
- Large and high-quality mining reserves;
- Low-cost operations;
- Integrated operations that include copper refining and smelting capabilities;
- Strong incentives for its creditworthy parent, the Republic of Chile, to provide support to Codelco if necessary, given the company's strategic role for the Chilean economy; and
- Adequate debt maturity profile.

Weaknesses:
- Commodity-type industry market;
- Aggressive financial policy;
- High tax and dividend burden imposed by the Chilean government; and
- Limited geographic and business diversification.

Rationale

The ratings on Chile-based copper producer Corporación Nacional del Cobre de Chile (Codelco) reflect the company's strong market position as the world's largest integrated copper mining company, with ample high-grade copper ore reserves, its globally competitive cost structure, and its direct ownership by, and strategic importance to, its 100% shareholder, the Republic of Chile (Foreign Currency: A+/Stable/A-1; Local Currency: AA/Stable/A-1+). These strengths are partly counterbalanced by the industry's inherent cyclicality, which results in volatile copper prices and cash flow generation; a lack of geographic diversification on the production side, with all operations in Chile; the heavy tax and dividend burden imposed by the Chilean government; and the company's aggressive financial policy.

Standard & Poor's rates Codelco according to our criteria for government-related entities. We consider Codelco a public-policy-based company, because it plays a pivotal public role in the Chilean economy. Codelco's stand-alone creditworthiness has weakened significantly since 2002 due to increased debt levels used to finance the gap between the company's cash flow generation and its high capital expenditures and dividend payments. However, the ratings are ultimately supported by the company's strategic links to the government, including its 100% ownership and control by the Chilean government and its national importance. We expect the company's close links with the government to continue to influence its credit quality, as we consider privatization unlikely.

Codelco accounts for about 10% of copper production worldwide, and the copper products are sold to a relatively well-diversified client base. Copper accounts for about 80% to 90% of total sales, but the company also benefits from its position as the world's second-largest producer of molybdenum. Codelco's ample high-grade copper ore reserves account for about 20% of proven, probable, and possible reserves worldwide, and have enabled the company to achieve large economies of scale and to rank among the world's lowest-cost copper producers. Although we expect Codelco's production costs to increase modestly during the next several years because of a slow natural decline in ore grade, we expect that the company's cost profile will remain in the lowest cost-quartile of the industry's cost curve.

During 2006 and the first nine months of 2007, Codelco reported very high profitability and cash flow generation due to the very favorable pricing environment for copper (about $3.20 per pound in the first 11 months of 2007). This is evidenced on Codelco's EBITDA margin that reached 60.1% in fiscal 2006 and 56.2% in the last 12 months as of Sept. 30, 2007, compared with 57.7% in 2005, 49.6% in 2004, and 33.5% in 2003. Nevertheless, debt still increased, driven by high capital expenditures and dividend payments. Capital expenditures could reach about $1.5 billion for 2007 and will probably require an increase in debt of less than $500 million. Codelco's debt rose to $4.4 billion as of Sept. 30, 2007, including commercial debt with China's state-owned Minmetals Nonferrous Metals Co. Ltd. (MinMetals). This represents an increase of about 18% since Dec. 31, 2005 and 120% since Dec. 31, 2002.

In March 2006, Codelco and MinMetals signed a long-term commercial agreement under which Codelco will sell 55,750 tons per year for 15 years to a joint venture 50% owned by both companies. Codelco collected a $550 million advance payment from the joint venture. We view this payment as similar to long-term financial debt that will gradually decrease every year as copper is delivered. However, this transaction involves only a minor portion of Codelco's production, and thus does not significantly affect its cash flows or credit quality.

When comparing Codelco's cash flow generation capacity with its financial debt, because the company's dividend policy is relatively fixed, we adjust the cash flow generation figures by deducting dividend payments from the company's funds from operations (FFO). Although all cash flow measures improved in 2006 as a result of higher copper prices, we expect the ratio of adjusted cash generation (FFO less dividends) to total debt, which reached 26% in 2006, to deteriorate in 2007 as Codelco pays dividends on the extraordinary results of 2006.

On Feb. 12, 2007, the Chilean Ministry of Economy announced a $313.5 million capitalization of Codelco's 2006 earnings and the creation of a $400 million reserve fund to finance capital expenditures. Although these measures are a credit positive for Codelco, they provide only minor relief for the company's high cash needs. If the Chilean government decides to significantly reduce dividend payments, however, Codelco's adjusted debt service coverage ratios could meaningfully improve.

Liquidity

Codelco's liquidity is adequate and benefits from the company's very good financial flexibility. This flexibility is supported by its strong business risk profile and 100% ownership by, and strategic importance to, the Republic of Chile, which is evidenced by its fluid access to the global and local financial markets at very attractive interest rates. However, the company routinely has significant negative free cash flow due to its 100% dividend payout to the government and debt-financed capital expenditures. Nevertheless, Codelco has a favorable debt structure, with no debt maturities in the fourth quarter of 2007 and manageable debt maturities of about $300 million in 2008. A fair number of the company's debt instruments contain, among other non-financial covenants, a change-of-control clause that allows for the acceleration of most of its debt on the loss of majority ownership by the Chilean Republic.

Outlook

The outlook on Codelco is stable. The stable outlook incorporates our expectations that the Chilean government, if necessary, will support Codelco, given the company's strategic importance to the Chilean economy. Ratings upside depends on a significant improvement in Codelco's financial profile and would require a more conservative financial policy. The ratings on Codelco could be lowered if there is a significant deterioration of the company's financial profile, and/or a perception that the company's importance to the Chilean government is diminishing, or a potential privatization.

Business Description: World's Largest Copper Producer

Created in 1976 by Decree Law No. 1,350, Codelco is an autonomous company 100% owned by the Republic of Chile. The company's strategic importance to Chile and its very high relevance to the country's GDP, exports, and fiscal revenues are key issues when considering parent support and Codelco's overall credit strength.

With a total production of 1.78 million metric tons of copper in 2006, and with copper reserves of about 190 million metric tons, Codelco is the world's largest copper producer, accounting for 11% of worldwide copper production and around 20% of worldwide copper reserves. In addition, Codelco is the largest worldwide producer of molybdenum, with a total production of 27,204 tons in 2006, representing around 15% of worldwide production.

Strong Business Risk Profile Due To Leading Industry Position

Codelco's strong business risk profile reflects the company's leading position in the worldwide copper sector, which mainly derives from its ample high ore grade reserves, low production cost, and its strategic links to the Chilean government. These strengths are partly offset by the company's exposure to the highly cyclical copper industry, which results in volatile copper prices and cash flow generation, and by the geographical concentration of its copper production.

Country risk

Codelco's operations are concentrated in Chile. Codelco's board of directors is appointed by the president of Chile, and most of the company's strategic decisions are approved by the president and the ministries of mining and finance. Standard & Poor's does not expect a change in ownership in the near term, which would have to be approved by Congress. A sale of a minority equity stake would trigger a revision of the level of parent support incorporated into the rating on Codelco.

Chile's public institutions are stronger than those in other Latin American countries, and the level of corruption is perceived to be lower, according to international surveys. Also, Chile's long-term productivity and growth prospects should improve through growing investment in infrastructure and education, although its workforce is less educated on average than the workforce of similarly rated Republic of Korea (A/Stable/--).

Chile is one of the few emerging-market economies to gain strong credentials thanks to the implementation of countercyclical fiscal and monetary policies. These policies are of particular importance given the country's dependence upon commodities, copper in particular. This policy framework was consolidated and strengthened through the passage of a Fiscal Responsibility Law in 2006, which was supported across the political spectrum. The government is currently addressing still-pending issues on the macroeconomic agenda with medium- to long-term impact, such as additional modifications to the already-reformed pension system, the capitalization of the central bank, and measures targeting competitiveness. The pension reform will allow Chile to move toward wider and more generous coverage in a prudent and fiscally sustainable way. This reform is expected to continue to reduce economic growth volatility over the medium and long term, matching Chile's economic performance to that of higher-rated governments.

The implementation of Chile's structural fiscal rule (now supported by law) in the context of extraordinarily high copper prices is resulting in strong fiscal surpluses and a rapid drop in debt. Chile's net general government debt level is approaching zero (only 3% of GDP by the end of 2006) once government assets saved in the countercyclical fiscal funds are taken into account. Consensus on the need to maintain this conservative approach to protect Chile's macroeconomic framework from volatile commodity prices is high across the political spectrum. While the current target of 1% of GDP for the structural fiscal surplus could vary in the future depending upon the progress in dealing with the issues that justify the surplus (future pension costs and capitalization of the central bank), the strong commitment from Chilean Administrations to sound fiscal policies is expected to remain.

Codelco is the largest cash contributor to the Chilean government, mainly through income tax and dividends. Codelco's cash contributions reached an extraordinary high $8.3 billion in 2006 (compared with an already-high $4.4 billion in 2005 and $3 billion in 2004) as a consequence of the high copper prices. Codelco is subject to a special tax and dividend regime that includes--on top of the regular 17% corporate tax applicable to private companies in Chile--a 10% tax on exports of copper and related byproducts and a 40% special tax over its pretax earnings as a state-owned company. In addition, almost 100% of net income is commonly upstreamed to the Chilean government as dividends.

Industry characteristics

As is typical for a commodity industry, copper is cyclical, reflecting the particular nature of its supply (e.g., new mines, mine reopenings, and expansions) and demand growth.

Worldwide copper demand of about 17 metric tons is mainly concentrated in the infrastructure and construction sectors, which are highly correlated with the evolution of each country's economic activity. The largest copper consumer is China (about 21% of worldwide demand in 2006), followed by the U.S. (12.5%), Japan (7.5%), Germany (8.2%), South Korea (4.9%), and Italy (4.7%). Supply is somewhat concentrated in Latin America, which represents about 45% of total worldwide production, and in Chile in particular, which is the largest producer (with around 5.5 million metric tons per year, about 35% of worldwide production). An additional 25% of worldwide production comes from copper mines located in North America, Asia, and Australia.

The continuing increase in global copper demand during 2006 and 2007, fueled mainly by China's steady growth, at a time of very low inventory levels resulted in copper prices' reaching an extraordinary high of $4 per pound on the London Metals Exchange during May 2006 and closed fiscal 2006 with a considerably high $3.05 per pound. In 2007, copper prices decreased quite significantly to about $2.60 in January and February but jumped again to about $2.90 in March, $3.50 in April and May and $3.60 in July. Since then, prices have gradually decreased to still historically high levels of around $3 per pound. Overall, 2007's average annual copper price is expected to reach a new record at around $3.2 per pound compared with $3.06 for 2006, $1.67 in 2005, $1.30 in 2004 and 70-80 cents in the 1998-2003 period. The presence of speculative funds and various issues such as labor strikes and natural disasters that affected supply in 2006 and 2007 also contributed to the extraordinary high prices and volatility. Standard & Poor's is using conservative copper prices of $2.50 per pound for 2008, $2.00 per pound for 2009, and $1.50 per pound for 2010.

Competitive strengths and operations

Codelco has a strong market position deriving from its standing as the world's largest copper producer and from its large and high-grade reserves, which result in low production costs on a worldwide basis. According to U.S. Geological Survey estimates, Codelco's proven, probable, and inferred reserves reach around 190 million metric tons and represent about 100 years of current production levels of about 1.8 million metric tons per year and around 20% of total worldwide copper reserves. Also, Codelco is the second largest worldwide producer of molybdenum, with an annual production of about 30,000 tons, representing about 17% of worldwide production. Revenues from molybdenum represented 10% of total sales in fiscal 2006, and are projected to account for 10% to 20% of Codelco's total sales in the next five years, depending on the volatility of copper and molybdenum prices.

Codelco's operations are concentrated in Chile, where the company operates four mining units: Codelco Norte in the northern Atacama Desert (which provided 56.1% of Codelco's total copper production in 2006), El Teniente near the Santiago metropolitan region (25.0%), Andina (14.1%), and Salvador (4.8%).

Codelco also faces high product concentration, as copper represents about 80% to 90% of total sales. However, Codelco enjoys a well-diversified client base, with its 10 largest customers accounting for about 30% of total sales. Although the company supplies more than 90% of its clients under annual contracts, the majority of these clients have had relationships longer than 30 years with Codelco. In addition, Codelco's revenues were adequately distributed from a geographical standpoint in 2006, with Asia as the largest market (accounting for about 34% of total physical shipments), followed closely by Europe (32%), North America (17%), and South America (17%). As opposed to other copper producers in Chile, such as Minera Escondida Ltda. (BBB+/Stable/--), Codelco's operations are vertically integrated, as it has smelting and refining capacity to process 100% of its own copper production. This allows the company to operate with some autonomy from the concentrated base of independent smelters worldwide.

Codelco has devised an aggressive expansion strategy for the next five years to increase copper production to about 2 million metric tons by 2011, in spite of a natural decline in the ore grade of its reserves. Target production does not consider the joint venture El Abra (50% owned by Codelco and 50% by Phelps Dodge), which has an annual copper production of about 210,000 metric tons.

Operating costs have increased for the copper industry worldwide in the past three years, not only due to the natural decline of the ore grade of the existing mines, but also due to the higher prices of grinding balls, other steel-based raw materials, energy, and rubber. These higher prices were partly a result of the worldwide economic growth. However, Codelco continues benefiting from a competitive cost structure on a global basis, with a total production cost of about $1.30 per pound and an average production cash cost of around 80 U.S. cents per pound, considering a conservative credit of about 10 U.S. cents per pound from molybdenum. Although the expected natural decline in ore grade to 0.8%-0.9% in the period from 2008 to 2010 (from 0.92% in 2005, 0.94% in 2004, 0.97% in 2001, and 1.02% in 2000) would gradually increase Codelco's total production cash costs during the next five years to 75-85 cents per pound, assuming no variation in the cost of raw materials, Standard & Poor's expects the company to maintain its low-cost position on a global basis.

Standard & Poor's does not expect the higher cost of power and risk of power supply shortages in Chile (resulting from the Argentine government's restrictions on natural gas exports) to affect Codelco's copper output. The Chilean Northern Interconnected Electric System (SING) has been facing frequent natural gas supply shortages since May 2007. Spot power prices jumped above $100 per MWh in 2007 from about $50 per MWh in 2006. We believe that there will be very little gas available (less than 2 million cubic meters per day) in the SING from 2008 onwards.

However, we expect new coal-fired capacity and a liquefied regasification plant to be available from 2010 onwards. In the transition period between 2008 and 2009, power prices are expected to remain at high levels due to the expected high consumption of liquid fuels (mainly diesel oil). Standard & Poor's will closely monitor power supply risk to assess any potential impact on Codelco's operations.

Labor is another source of concern that could put pressure on Codelco's operating costs, and is a relevant for its competitive position. Labor costs have significantly increased since 2003 partly due to the strong revaluation of the Chilean peso against the U.S. dollar.

Profitability/peer comparison

Codelco's operating margin compares very well with that of global industry peers because of its low production cost deriving from its large and high-grade copper reserves. With the exception of Minera Escondida (a Chilean non-integrated copper producer), Codelco's operating margins per metric ton produced and EBITDA margins per total sales are higher than those of peers. In the 1997-2006 period, when the average copper price was $1.15 per pound, EBITDA margin averaged 40.0%. It dropped to 27.7% in 2001, when the average copper price reached 72 cents per pound, and peaked at 60.1% in 2006, when the average copper price reached $3.05 per pound. Standard & Poor's expects that even under a conservative price environment of about $1.2 per pound, EBITDA margin should remain above 35%.

Financial Policy

Codelco has a very aggressive financial policy. Its capital expenditures and dividend payout resulted in a debt increase of about 120% since December 2002 despite of the huge recovery of copper prices since 2003.

Financial Risk Profile: High Capex And Dividends Resulted In A Significant Rise In Debt

Codelco's financial risk profile has deteriorated since 2002, mainly as a result of the significantly higher debt ($4.4 billion in Sept. 2007, including the $550 million debt with MinMetals, from $1.5 billion in December 2001) and a highly volatile cash flow generation. the company plans to continue expanding copper production capacity to about 2 million metric tons per year by 2010 through the implementation of an aggressive capital expenditures plan. If the company's dividend policy is maintained, Standard & Poor's expects Codelco's credit measures to continue deteriorating in the next few years. However, the company benefits from a smooth debt maturity profile and very good financial flexibility.

Accounting

Codelco's financials are prepared according to Chilean GAAP and in U.S. dollars. The following are the main adjustments that we made on the company's financial statements:

- Total debt levels include the $501 million agreement with MinMetals.
- Dividends are deducted from operating cash flow generation.

In addition, Codelco's liabilities include a relatively high $1.3 billion in provisions (as of Sept. 30 2007), which are mainly related to potential severance payments, as shown in the following breakdown:

- Severance payments: $865 million ($39 million short term; $825 million long term). Chilean public companies have to make a severance payment to most of its staff members when he/she leaves the company, even in a case of resignation. This payment is basically equal to one month per year of service.
- Taxes payable: $260 million (100% short term, as this is an ordinary item).
- Salaries and vacations: $255 million (100%, as these are ordinary items).
- Health care plan: $187 million (100% long term).
- Asset retirement obligations: $179 million (100% long term).
- Freight, energy, and related items: $24 million (100% long term; ordinary items).
- Contingencies: $76 million (100% long term).
- Other items: $213 million (includes $88 million related to a profit sharing plan).

Cash flow adequacy

Although Codelco's cash flow is highly volatile because of the significant fluctuations in copper prices, the company's low-cost position allows it to enjoy adequate cash flow generation. During 2004, 2005, 2006, and the 12 months ended Sept. 30, 2007, the company posted an extraordinary $4.1 billion, $6.1 billion, $10.3 billion, and $9.7 billion in EBITDA, respectively, compared with $800 million to $1.3 billion in the period from 1998 to 2003. These EBITDA levels oscillated between 50% and 60% of total sales and between 140% and 220% of total debt (including debt with MinMetals).

Cash flow generation has improved since fiscal 2004, thanks to a jump in average copper prices. However, payments to the government of about $4.4 billion in fiscal 2005 and $8.3 billion in fiscal 2006, and capital expenditures of about $1.8 billion and $1.2 billion, respectively, resulted in negative free cash flow generation after dividends and increases in debt of almost $800 million and about $750 million, respectively (including debt with MinMetals). Nevertheless, total debt remained stable at $4.4 billion in the nine months ended Sept. 30, 2007.

Codelco has an aggressive capital expenditure plan of about $1.5 billion per year for the 2008-2011 period with the objective to increase its copper production to about 2 million metric tons by 2011 (not considering El Abra). This investment program includes the development of the Gaby project (about $900 million), with a total production of about 150,000 tons per year by 2009. In addition, it includes the expansion of copper production capacity by 50,000-100,000 tons per year to about 1 million tons per year at El Teniente division by 2011.

Given Codelco's relatively rigid 100% dividend payout, Standard & Poor's adjusts the company's cash generation by deducting dividend payments from the company's FFO when comparing the company's cash generation with its financial debt. Although traditional cash flow measures improved as a result of the higher copper prices, Codelco's adjusted cash generation (FFO less dividends) to total debt decreased to a relatively weak 19.7% in 2005 but improved to 28.7% for 2006, mainly as a result of the high dividends and debt. Following this trend, adjusted FFO interest coverage decreased to 6.4x in 2006, compared with 9.3x in 2002. Standard & Poor's projects that Codelco will remain very aggressive in terms of capital expenditures and dividend payments in the next five years. However, Codelco's adjusted debt service coverage ratios could significantly improve further if the Chilean government decides to reduce dividend payments or carries a downward revision of investments.

Capital structure

Codelco's aggressive financial strategy has resulted in increasing leverage in the past few years. Total debt (including debt with MinMetals) to capitalization reached 46.0% as of Sept. 30, 2007 (compared with 35% in 2001), and is high for the company's rating level, although that risk is partly mitigated by the company's adequate debt maturity profile. Annual debt maturities do not exceed $750 million. Although most of Codelco's debt is in U.S. dollars, foreign exchange risk is adequately covered because most of the company's cash generation is strongly linked to foreign currency. In addition, the company has a low exposure to variable interest rates because around 83% of its debt (mostly bonds) has fixed-rate interest averaging 5.6%. Standard & Poor's expects this low exposure to continue. The company's capital structure may deteriorate further in the next few years due to the company's very aggressive capital expenditure plan and high dividend payments.

Codelco enjoys very good financial flexibility, mainly due to its strong business risk profile and its strategic links with the Chilean government. This is evidenced by its fluid access to the capital markets under very attractive conditions.

Ratings Detail (As Of December 28, 2007)*		
Corporacion Nacional del Cobre de Chile		
Corporate Credit Rating		
Foreign Currency		A/Stable/--
Senior Unsecured		
Foreign Currency		A
Corporate Credit Ratings History		
14-Jan-2004	*Foreign Currency*	A/Stable/--
16-Apr-2002		A-/Positive/--
23-Oct-1997		A-/Stable/--
Business Risk Profile		Strong
Financial Risk Profile		Aggressive
Debt Maturities		
2008 $300 mil. 2009 $600 mil. 2012 $600 mil. 2013 $500 mil. 2014 $500 mil. 2025 $208 mil. 2035 $500 mil. 2036 $500 mil. (As of Sept. 30, 2007, excluding accrued interest and the 15-year amortizing $501 million commercial debt with MinMetals Nonferrous Metals Co. Ltd.)		

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.