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RESEARCH

Corporacion Nacional Del Cobre De Chile

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ISSUER CREDIT RATING	
Corporacion Nacional del Cobre de Chile	
Corporate Credit Rating *Local currency*	A+/Negative/--
Corporate Credit Rating *Foreign currency*	A/Stable/--

AFFIRMED RATING	
Corporacion Nacional del Cobre de Chile	
Sr unsecd debt *Foreign currency*	A

Business risk profile:
Strong
Financial risk profile:
Aggressive
Debt maturities:
As of Dec. 31, 2005 (not including accrued interest):
2006 $300 million
2008 $300 million
2009 $600 million
2012 $600 million
2013 $500 million
2014 $500 million
2025 $200 million
2035 $500 million
Collateralization:
Not meaningful
Bank lines/Liquid assets
Because of its top-tier position in the worldwide copper industry and its strategic importance for the Chilean Government, Codelco has very good access to the global and local financial markets. As is the common practice in Latin America, Codelco does not currently have committed lines of credit.

Corporate credit rating history:

	Local Currency	Foreign Currency
Jan. 14, 2004	A+	A
Nov. 8, 2002	A+	A-

Major Rating Factors

Strengths:

- Worldwide leading competitive position

- Low-cost producer
- Large and high-quality mining reserves
- Integrated operations that include copper refining and smelting capabilities
- Strong incentives for its strong parent, the Republic of Chile, to provide support if necessary, given Codelco's strategic role for the Chilean economy
- Adequate debt maturity profile

Weaknesses:

- Aggressive investment policy in the context of the high tax and dividend burden imposed by the Chilean government
- Commodity-type industry market
- Limited geographic and business diversification

Rationale

The ratings on Chilean-based copper producer Corporación Nacional del Cobre de Chile (Codelco) mainly reflect the company's strong market position as the world's largest integrated copper mining company with ample high-grade copper ore reserves, its highly competitive cost structure on a global basis, and its direct ownership by and strategic importance to its 100% shareholder, the Republic of Chile (FC: A/Stable/A-1; LC: AA/Stable/A-1+). These strengths are partly balanced by the inherent cyclicality of the industry, which results in volatile copper prices; a lack of geographic diversification on the production side, with all operations located in Chile; and the high tax and dividend burden imposed by the Chilean government. These factors, together with Codelco's very aggressive investment program, have resulted in growing debt levels in spite of the strong cash-flow generation in the past two years derived from high copper prices worldwide.

Standard & Poor's Ratings Services rates Codelco according to our criteria for rating government-supported entities. As such, we assign a stand-alone rating and then factor in the government's potential credit support. Codelco's stand-alone creditworthiness has been deteriorating as a result of the weakening of the company's financial risk profile, but its ultimate rating has been supported by its strategic links to the government, including its 100% ownership and control by the Chilean government and its importance for the country. Furthermore, although Codelco's aggressive expansion strategy in a context of high dividend payments requires additional funding sources, we deem privatization unlikely. Thus, the company's close links with the government will continue to influence its credit quality.

Codelco is the world's largest integrated copper producer, accounting for approximately 11% of copper production worldwide, which is sold to a relatively well-diversified client base. Copper accounts for approximately 80%-90% of total sales, but the company also benefits from its position as one of the world's largest producers of molybdenum.

Codelco's ample high-grade copper ore reserves, which account for approximately 20% of proven, probable, and possible global reserves worldwide, allow it to achieve large economies of scale and 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 the 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 worldwide.

During 2005, Codelco continued reporting very high profitability and cash-flow generation as a result of the favorable pricing environment for copper and molybdenum. Nevertheless, debt continued increasing as Codelco devoted most of the increase in cash flows to fund very high capital expenditures and dividends.

Codelco's EBITDA margin reached a record high of 57.7% in 2005 (compared with 49.6% in fiscal 2004 and 33.5% in 2003), mainly reflecting the significant increase in the average copper price that reached $1.67 per pound compared with $1.30 per pound in 2004 and $0.81 per pound in 2003.

Given that Codelco's dividend policy is relatively fixed, we adjust the company's cash generation by deducting dividend payments from the company's funds from operations (FFO) to compare its cash generation capacity with its financial debt. Although traditional cash-flow measures improved, Codelco's adjusted cash generation (FFO less dividends)-to-total debt ratio decreased to a weak 19.7% in 2005 and 21.2% in 2004 from 32% in 2002, mainly as a result of the 86% debt increase from December 2002 to December 2005 (27% in 2005 alone).

In March 2006, Codelco and China's state-owned Minmetals Nonferrous Metals Co. Ltd. signed a long-term commercial agreement through which Codelco will sell 55,750 tons per year for 15 years to a joint venture (50% owned by each of the companies). The agreement also includes an option for Minmetals to participate in the equity of the Gaby project if it takes place. This transaction involves only a minor portion of Codelco's production and does not significantly affect its cash flows or credit quality.

The foreign currency rating on Codelco is not higher than that on the sovereign, reflecting our expectation that the government of Chile is highly likely to interfere with Codelco's ability to service its debt under a sovereign default scenario.

Liquidity
Codelco's liquidity is adequate and benefits from the company's very good financial flexibility, which results from its solid business risk profile and which is evidenced by its fluid access to the global and local financial markets at very attractive interest rates. Codelco's liquidity is expected to remain adequate, based on the company's strong ownership and flexibility to reduce, if necessary, its large capital expenditure plan. Codelco does not currently have committed lines of credit.

Codelco is fully in compliance with nonfinancial covenants included in its financing documents. Most of the company's long-term debt instruments contain, among other nonfinancial covenants, a change-of-control clause that allows for the acceleration of most of its debt upon the loss of majority ownership by the Chilean Republic.

Outlook

The stable outlook on the foreign currency corporate credit rating reflects that on the sovereign. The negative outlook on the local currency corporate credit rating reflects our expectation that the company's stand-alone financial risk profile is likely to deteriorate further in the next two to three years as a result of Codelco's aggressive business expansion strategy and high dividend distributions (100% payout), which in turn would result in a significant debt increase and weaker debt service coverage ratios. Specific government support actions, such as reducing the dividend payout ratio or moderating the expansion strategy, will likely be necessary to maintain the local currency corporate credit rating at current levels. We will lower our local currency rating on Codelco by one notch to 'A' if the company's adjusted cash generation-to-total debt ratio remains below 20% and leverage (total debt to total capitalization) exceeds 60%.

Business Description

With a total production of 1,83 million metric tons of copper in 2005 and copper reserves for about 189 million metric tons, Codelco is the world's largest copper producer, accounting for 11% of worldwide copper production and 20% of worldwide copper reserves. In addition, Codelco is one of the largest worldwide producers of molybdenum with a total production of 36,567 tons in 2005, which represented around 20% of worldwide production. The company owns and operates four mine complexes in Chile (Codelco Norte, El Teniente, Andina, and Salvador), and has a 49% participation in El Abra (a joint venture with U.S. mining company Phelps Dodge Corp.).

Created in 1976 by Decree Law 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.

Business Risk Profile

Codelco's strong business risk profile reflects the company's leading position in the worldwide copper sector, low production cost, ample ore reserves, relatively high vertical integration, and strategic links to the Chilean government. These strengths are partly offset by the company's exposure to the highly cyclical copper industry given by its product and geographical concentration.

Country Risk
Codelco's operations are geographically concentrated in the Republic of Chile. The ratings on Chile reflect its strong policy framework supported by rules-based fiscal and monetary policies and a political commitment to an open economy and a low and declining public debt burden. Public-sector gross debt is projected to fall below 25% of GDP in 2005 from nearly 40% three years earlier, thanks to rapid GDP growth and impressive fiscal surpluses. Nevertheless, the ratings are constrained by a relatively narrow economic base and resulting vulnerability to cyclical economic performance, due to the fluctuating price of copper and a high net external debt burden. Chile's total external debt, projected at 100% of current account earnings in 2005, is higher than that of most similarly rated sovereigns. The net external debt position of the Chilean nonbank private sector stands in contrast with the net creditor position of the private sector in most 'A' rated sovereigns.

Natural resources, led by the mining sector, comprise around 12% of Chile's GDP, compared with the 16% share held by manufacturing. While Chile has successfully used its natural resources to prosper, the comparatively small size of the more technologically advanced sectors of the economy gives it a weaker economic profile than some of its rating peers.

Codelco is the largest cash contributor to the Chilean government, mainly through income tax and dividend payments. Codelco's cash contributions to the Chilean government reached a very high $4.4 billion in 2005 compared with an already high $3.0 billion in 2004, mainly as a consequence of the higher copper prices. Codelco is subject to a special tax and dividend regime, which includes-on top of the regular 17% corporate tax applicable to private companies in Chile-a 10% tax on copper and related byproducts exports and a 40% special tax over its pretax earnings as a state-owned company. In addition, 100% of net income is commonly upstreamed to the Chilean government as dividends.

Codelco's Board of Directors is appointed by the President of the Republic of Chile, and most of the company's strategic decisions are approved by the President and the Ministries of Mining and Finance. We do not expect a change in ownership in the near term, which would have to be approved by Congress. A potential sale of a minority equity stake would trigger a revision of the level of parent support incorporated into the rating on Codelco.

Industry characteristics
As a typical commodity industry, the behavior of the copper industry is cyclical, reflecting the different growth nature of supply (new projects, mine reopenings, among others) and demand (related to the evolution of the worldwide economy).

Worldwide copper demand 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 consumers are China (about 22% of worldwide demand in 2005), the U.S. (14%), Japan (7%), Germany (6%), Korea (5%), and Italy (4%), which together represent almost 60% of worldwide copper demand. Supply is somewhat concentrated in Latin America in general, which represents about 45% of total worldwide production, and Chile in particular, which is the largest producer with about 35% of worldwide production (around 5.5 million metric tons per year). An additional 25% of worldwide production comes from copper mines located in North America, Asia, and Australia.

The combination of a further increase in worldwide copper demand of almost 3% in 2005 (over the almost 8% increase in 2004) within a context of very low inventory levels, resulted in copper prices reaching an average of $1.67 per pound in 2005 compared with $1.30 per pound in 2004. The higher demand continued to be fueled by strong demand in China and to a lesser extent by the good performance of the worldwide economy as a whole. In addition, copper supply was affected during 2005 by different issues like labor strikes and natural disasters, among other issues, and total increase in supply was lower than previously forecasted. A further reduction in inventory levels by the end of 2005 and the first five months of 2006, reaching less than one week of worldwide consumption, triggered copper prices to extraordinary high levels that exceeded $4.00 per pound during May 2006, being currently traded at still extraordinarily high levels of about $3.50 per pound in the London Metals Exchange. Going forward, we expect average copper prices to remain at high historical levels of more than $2.50 per pound in 2006 and more than $1.50 per pound in 2007, given the very low inventories, although they are below current extraordinary levels.

Competitive strengths and operations

The company's strong market position results from its standing as the world's largest copper producer and also from its large ore reserves, which result in low production costs. According to U.S. Geological Survey estimates, Codelco's proven, probable, and inferred reserves reach around 189 million metric tons and represent about 100 years of current production levels.

Codelco's operations are geographically concentrated in Chile, where the company currently operates four separate mining units: Codelco Norte in Northern Atacama Desert (provided 53% of Codelco's total copper production in 2005); El Teniente near the Santiago Metropolitan region (24% of copper production in 2005); Andina; and Salvador.

Codelco's cost structure is highly competitive on a worldwide basis with an average production cash cost of around 55 cents per pound in 2005 without considering any credit from byproducts. This cost level allows it to rank in the first lowest quartile in terms of copper production costs worldwide. Although the expected natural decline in ore grade (that reached 0.92% on average in 2005 compared with 1.02% in 2000, 0.97% in 2001, and 0.94% in 2004) could gradually increase Codelco's production costs during the next five years. We expect the company to continue with its cost reduction programs to partially offset the increasing costs and maintain its low-cost position on a global basis.

Differently from other copper producers in Chile like Escondida (BBB+/Stable/--), Codelco's operations are vertically integrated. Integrated smelting and refining facilities allow the company to operate with some autonomy from the concentrated base of independent smelters worldwide. In addition, with the acquisition of Enami's smelter Ventanas in May 2005, Codelco has refining and smelting capacity to process 100% of its own copper production (concentrates and cathodes). Ventanas is efficient in terms of cost per material processed but does not have the most efficient technology for smelting and refining methods like the solvent extraction electro-winning refining technology, which is available at Codelco Norte's division.

We do not expect the higher cost of power in Chile and the higher risk of power supply shortages (resulting from restrictions imposed by the Argentine government to natural gas exports) to significantly affect Codelco's operations, at least in 2006 and 2007, because it provides a low probability to a total interruption of natural gas imports from Argentina. Nevertheless, we will monitor power supply risk closely to assess any potential impact on Codelco's operations.

Finally, Codelco does not benefit from significant business diversification but presents a well-diversified client base, as its 10 largest customers account for about 30% of total sales. Although more than 90% of the company's clients are supplied under annual contracts, the majority of these clients have longer than 30-year relationships with Codelco. In addition, from a geographical standpoint, Codelco's revenues were adequately distributed in 2005, with Asia as the largest market accounting for about 40% of total physical shipments, followed by Europe (33%), North America (17%), and South America (10%).

Profitability

Codelco's operating margin compares very well with those of global industry peers as a result of its large copper reserves with high ore grade, which results in its low cost position. With the exception of Minera Escondida S.A. (Chilean unintegrated copper producer), Codelco's operating margins per metric ton produced and EBITDA margins per total sales are higher than those of peers. In addition, the company has been able to maintain an operating margin during the cycle. From 1997-2005 (average price of $0.95 per pound), EBITDA generation averaged 38%, reached a floor of 28% in 2001 when the average of copper reached $0.72 per pound, and peaked at almost 58% in 2005 when the average of copper reached $1.67 per pound. Even under a more conservative price environment of $0.95 per pound, the EBITDA margin should remain at about 40%, benefiting from the increasing production levels and cost reductions derived from the ongoing investment program.

Financial Risk Profile

Codelco's aggressive financial profile has deteriorated on a stand-alone basis as a result of the debt financing of its aggressive capital expenditures while maintaining a 100% dividend payout ratio. Within this context, Codelco's debt increased 147% in the past four years, to $3.7 billion in December 2005 from $1.5 billion in December 2001. In view of the current favorable copper industry environment and Codelco's large ore reserves, Codelco is expected to continue expanding its copper production capacity. Within this context, if the company's dividend policy is maintained, we expect Codelco's credit metrics to continue deteriorating in the next years. In spite of this, Codelco is expected to benefit from a smooth debt maturity profile and good financial flexibility.

Cash flow adequacy

Although Codelco's profitability and cash flow are volatile because of the important fluctuations in copper prices, the company's low cost position allows it to generate adequate levels of cash even under a weak pricing scenario like in the period from 1998 to 2003. During 2004 and 2005, Codelco posted an extraordinarily high $4.1 billion and $6.1 billion EBITDA (compared with a range of between $800 million and $1.3 billion in 1998-2003), which represented almost 58% of total sales and 163% of total debt as of December 2005. The high profitability and cash-flow generation in 2004 and 2005 mainly derived from the extraordinary high copper prices that reached $1.30 per pound in 2004 and $1.67 per pound in 2005 compared with levels of between $0.70 and $0.80 per pound from 1998 to 2003. Nevertheless, payments to the government for about $3.0 billion and $4.4 billion in fiscals 2004 and 2005, respectively, and capital expenditures for about $900 million and $1.8 billion, resulted in negative free cash-flow generation after dividends, and in a $100 million and $800 million increase in financial debt, respectively.

Given Codelco's relatively rigid 100% dividend payout, we adjusted the company's cash generation by deducting dividend payments from the company's FFO to compare 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 ratio decreased to a relatively weak 21.2% and 19.7% in fiscal 2004 and 2005, respectively, from 32.0% in 2002, mainly as a result of the 86% debt increase from December 2002 to December 2005. In addition, adjusted FFO interest coverage decreased to 4.9x in 2005 from 9.3x in 2002.

Codelco has defined a very aggressive preliminary capital expenditure plan of about $8 billion for the five-year period 2005-2009, of which $1.8 billion has been carried out in 2005 including the acquisition of Enami's smelter Ventanas. Nevertheless, the plan could be lower if the market environment for copper changes. In addition, if the Chilean government decides to significantly reduce dividend payments or carries a downward revision of investments, Codelco's adjusted debt service coverage ratios could significantly improve.

Capital structure/Asset protection

Codelco's aggressive financial strategy resulted in increasing leverage in recent years. The total debt-to-capitalization ratio reached 60.7% as of March 31, 2006 (compared to 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 (debt maturities do not exceed $600 million in one year). 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%. We expect the company to continue with this low exposure.

As a result of the company's very aggressive capital expenditure plan and high dividend payments, Codelco's capital structure may deteriorate further in the next years. To partly offset that, Codelco has recently signed a long-term commercial agreement with China's state-owned Minmetals Nonferrous Metals Co. Ltd. through which Codelco will sell 55,750 tons per year for 15 years to a joint venture (50% owned by each of the companies). Codelco collected a $550 million advance payment from the joint venture, which is part of the sale price of the 55.750 tons of copper that will be deliver every year during the next 15 years. We view this payment similar to a long-term financial debt that will gradually decrease every year as copper is delivered. Nevertheless, this transaction involves only a minor portion of Codelco's production and does not significantly affect its cash flows or credit quality. The agreement also includes an option for Minmetals to participate in the equity of the Gaby project if it takes place.

In the past, Codelco has entered into a joint venture with an international partner in the El Abra project (total annual copper production of about 210.000 metric tons) to reduce project risk and investment requirements for mine development.

Financial Statistics

	--Fiscal year ended Dec. 31--				
(Mil. $)	**2005**	**2004**	**2003**	**2002**	**2001**
Sales	10,490.6	8,203.7	3,781.8	3,489.9	3,564.0
Net income from cont. oper.	1,779.6	1,134.2	89.2	48.5	25.6
Funds from operations (FFO)	2,443.9	1,702.0	650.9	636.2	630.4
Capital expenditures	1,844.7	893.1	895.0	844.0	585.8
Dividends declared	1,714.3	1,084.6	50.0	0.0	102.4
Total debt	3,705.8	2,917.0	2,819.2	1,989.0	1,498.0
Equity	2,941.0	2,871.9	2,821.4	2,733.1	2,699.9
Ratios					
EBITDA margin (%)	57.7	49.6	33.5	29.8	27.7
EBITDA interest coverage (x)	32.0	28.5	12.0	13.5	9.9
Return on equity (%)	60.5	39.5	3.2	1.8	0.9
FFO/total debt (%)	65.9	58.3	23.1	32.0	42.1
Total debt/EBITDA (x)	0.6	0.7	2.2	1.9	1.5
Total debt/capital (%)	55.7	50.4	50.0	42.1	35.6