**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


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## Key Indicators

**Corporación Nacional del Cobre de Chile**

| | 2003 | 2004 | 2005 |
|---|---|---|---|
| EBIT/INTEREST | 4.4x | 19.9x | 22.6x |
| EBIT MARGIN | 12.2% | 34.7% | 40.8% |
| CFO - DIVIDENDS / DEBT | 3.2% | 32.3% | 26.8% |
| FREE CASH FLOW / DEBT | -28% | 3% | -22% |
| DEBT / CAPITALIZATION | 43% | 43% | 49% |
| DEBT / EBITDA | 3.1x | 0.9x | 0.8x |

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

## Opinion

### Company 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 15% share of western world 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 21%. Operating through five divisions, CODELCO's operations include several world class mines from a reserve, production capacity and cost perspective, as well as smelting and refining capability.

### Rating Rationale

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

Baseline credit assessment (BCA) with a 5-7 range on a scale of 1 to 21

A1 local currency rating of the Chilean government

Medium dependence

High support

CODELCO's BCA range of 5-7 and the resultant foreign currency rating on its note issuances under Moody's piercing methodology recognizes the company's position as the world's largest copper producer (1.83 million metric tons in 2005 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 30 years at current production levels. The company'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 the ratings. This footprint contributes to robust operating performance in a strong copper market and acceptable performance during cyclical downturns

CODELCO's ownership by the Chilean State and the framework in which it operates are further considerations in the rating. As a state owned entity, CODELCO is required to pay 100% of its income to the Chilean Treasury and 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 consider the substantial capital expenditure program possible over the next several years and the continued incremental increases in debt to fund. However, the ratings also contemplate 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.

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 2005, CODELCO contributed US$4.4 billion to the Chilean treasury and accounted for roughly 23% of exports from Chile.

Key Rating Drivers

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 2005 performance) is illustrative of the company's operating strength and world-class operating mines.

Factor 1: Reserves - With proven and probable reserves of approximately 54 million tons of copper, CODELCO has about 30 years of productive capacity at current levels and maps to an A rating category. 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 under evaluation, CODELCO is expected to maintain and increase production going forward.

Factor 2: Cost Efficiency and Profitability - Of the three components in this factor, the EBIT margin is viewed as the most relevant for CODELCO as it indicates the strong operating profile of the company as well as its leverage to copper prices. In this measure CODELCO maps to an Aa rating. This measurement has fluctuated over the three year period reaching a high of 41% in 2005. The combined benefit of higher copper prices and lower costs (reflective of high moly prices and increased by-product credits) resulted in significant strengthening in the EBIT margin over the 3 year period. This is particularly evident in 2005 when cash costs were negative at $0.017/lb. Cash costs through June 2006 are trending more in the $0.33/lb range, reflective of higher input costs, particularly energy and lower moly prices. Moody's would expect costs in this range or slightly higher to be more the norm over the next twelve to fifteen months with ongoing pressure from energy and labor costs likely. Despite the expectation for softening in copper prices from the high levels seen in 2005, continued still favorable copper fundamentals are expected to translate into CODELCO continuing to map in the Aa category in this measure.

Factor 4: Financial Strength - In this category, CODELCO maps well in the earnings based coverage ratio of EBIT/Interest (mapping in the Aaa range) reflective again of the ongoing strengthening in copper prices over the last two years and the company's operating leverage to copper prices. Moody's expects CODELCO to continue to map well in this component but more likely in the Aa range as copper prices soften. In the cash flow based metrics the company maps poorly: in the Baa range for cash from operations minus dividends to debt and in the Caa range for the free cash flow to debt metric. This is reflective 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 and the acquisition of the Ventanas smelter in 2005. Using the sources of funds available to CODELCO ie depreciation and other non cash add backs as the numerator in these two metrics, the company would consistently map in the Caa range with minimal operating cash flow and negative free cash flow. 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 in mitigating the mapping in these two metrics.

**Rating Outlook**

The stable outlook reflects Moody's expectation that copper market fundamentals and prices will remain favorable over the next twelve to fifteen months although prices are anticipated to retreat from the high levels experienced in 2006. This will translate into continued strong earnings performance for CODELCO. 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 increasing debt position 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 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 9x 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.

## Rating Factors

**Corporación Nacional del Cobre de Chile**

| Mining Industry | Aaa | Aa | A | Baa | Ba | B | Caa |
|---|---|---|---|---|---|---|---|
| **Factor 1: Reserves** | | | | | | | |
| a) Reserves (Years) | | | 30 | | | | |
| **Factor 2: Cost Efficiency & Profitability** | | | | | | | |
| a) EBIT Margin | | 29% | | | | | |
| b) Return on Assets | 28% | | | | | | |
| c) Other Liabilities / Equity | | | | | | | |
| **Factor 3: Financial Policies** | | | | | | | |
| a) Debt / Capital | | | | 49% | | | |
| b) Debt / EBITDA | | 1.6x | | | | | |
| **Factor 4: Financial Strength** | | | | | | | |
| a) Interest Coverage | 15.6x | | | | | | |
| b) (CFO - Dividends) / Debt | | | | 21% | | | |
| c) Free Cash Flow / Debt | | | | | | | -16% |
| **Factor 5: Business Diversity & Size** | | | | | | | |
| a) Business Diversity Score | | | 5 | | | | |
| b) Size | | $10.5B | | | | | |