Corporacion Nacional del Cobre de Chile

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Rationale

The ratings on Chile's leading copper producer, Corporación Nacional del Cobre de Chile (Codelco), reflect the company's position as the world's largest copper mining company with ample high-grade ore reserves, a low cost structure, a well diversified client base, a moderate financial risk profile, and the direct ownership and strategic importance to its owner, the Republic of Chile. These factors are balanced by the inherent cyclicality of the industry, volatile metal prices, a lack of geographic diversification in the production side, and the high tax and dividend burden imposed by the Chilean government, which owns 100% of Codelco. The foreign currency corporate credit rating is the same as the sovereign rating of the Republic of Chile.

Codelco is the world's largest integrated copper producer, accounting for an approximately 16% share of Western market copper production, which is sold to a relatively well regionally diversified client base. The company's ample high-grade copper ore reserves account for approximately 20% of global proven, probable and possible reserves. Although copper accounts for approximately 87% of total sales, the company also benefits from its position as the world's largest producer of molybdenum. Codelco has made continued improvements to its cost structure, and with an average cash cost of 41.1 cents per pound of copper produced by the end of fiscal 2002, it ranks among the world's lowest-cost copper producers. The main drivers for this improvement are: increased copper production, improved and more flexible mining plans, the incorporation of low-cost solvent extraction electro-winning facilities, the reduction of the labor force, and the improvement in operating efficiencies.

With all of its mines located in Chile, Codelco has limited geographic diversification compared with other global metal producers. However, the mines are spread out among different regions in the country, which helps limit the impact of Chilean geological and environmental risks. In addition, separate labor union agreements, negotiated through each of the mining divisions, mitigate labor risks. Codelco's creditworthiness is supported by its strategic links to the government, including its position as Chile's largest nongovernmental employer and its importance for export generation. The company represented about 18% of Chile's exports, which compares favorably with the overall copper mining sector that comprised 40% of Chile's total exports. While Standard & Poor's views Codelco's strategic importance to the Chilean government --through export earnings and fiscal budget contributions— as a key element for expected support in the repayment of its local currency obligations if needed; those same reasons create incentives for potential sovereign intervention on the company's ability to serve its foreign currency-denominated liabilities. Therefore, while the local currency rating continues to bear additional enhancement due to the ownership by the Republic of Chile, the foreign currency rating is equalized with the sovereign's. Furthermore, in Standard & Poor's opinion, although Codelco may continue to develop new projects via joint ventures with the private sector such as recent agreements signed with major Latin American copper producers (such as Companhia Vale do Rio Doce and Southern Peru Copper Corp.), privatization is unlikely in the medium term. Thus, the company's close links with the government will continue to influence its credit quality.

Codelco is highly exposed to copper price fluctuations that in turn are largely correlated to global economic cycles, primarily industrial production. High levels of refined copper inventory due to soft global demand have helped to sustain weak copper pricing for most of 2001 and 2002. The combination of this unfavorable pricing environment with an expansion investment program, has increased Codelco's use of debt given the restricted access to cash generation as a result of government's high tax and dividends; and has resulted in a gradually more aggressive financial profile. For example, the average 72 cents/pound (c/lb) copper price of 2001 translated into relatively weaker cash flow protection measures, such as 9.9 times (x) EBITDA interest coverage and 33.1% FFO to debt by the end of fiscal 2001. Yet, and mostly because of the company's continued focus on cost reduction, operating margins at 28.9% compared well with global industry peers and over the cycle measures were still adequate for the rating category. In spite of the persistence of unfavorable prices, which as of December 2002 averaged 60 c/lb, Codelco's performance in 2002 presented some mild improvements against the previous year. In this respect, improvements in cash costs, when measured in U.S. dollars, allowed for some margin recovery to 29.8% against 27.7%. This margin recovery combined with meaningfully reduced financial expenses translated into a more solid 13.5 times (x) EBITDA interest coverage as of December 2002. The company's expansion plan and investments in efficiency improvements are expected to result in further improvements on profitability over the medium term, even under a relatively unfavorable pricing scenario (averaging a 40% EBITDA margin at 75c/lb). Standard & Poor's expects that the recent announcement to cut dispatches in 200.000 tons over 2003 as long as worldwide inventories remain high, is not expected to meaningfully affect Codelco's performance. The company had planned to increase copper production by 8% against 2002 levels; therefore, this cut in dispatches will represent at most a 5% decline in volumes sold.

The foreign currency of CODELCO is constrained by the foreign currency rating of the Chilean Republic as Standard & Poor's considers that there is a high likelihood of the government of Chile interfering with Codelco's ability to service its debt under a sovereign default scenario. In addition, and unlike other entities in Chile, the fact that CODELCO must surrender its export proceeds to the Central Bank of Chile, where it is also obligated to keep its foreign currency reserves, particularly exposes CODELCO to heightened interference risks.

Liquidity.

Although Codelco's capital structure at 42.1% is relatively high for the company's rating level, Standard & Poor's views Codelco's liquidity position as strong, given a well-structured debt profile into the longer term. The $165 million new bonds issued in November in the Chilean domestic capital market to refinance short-term, as well as the $435 million issued in the global market demonstrate the company's commitment to maintain this policy. Short-term debt now accounts for a more conservative 24.7%, which adequately matches cash flow generation measured as FFO even under price-stress periods. Furthermore, although as a minority shareholder in Electroandina, Codelco has an ownership right on the defaulted Empresa Electrica del Norte Grande S.A., no provision under Codelco's existing financings would trigger any debt acceleration or default.

Bank lines/Liquid assets:

Because of its top-tier position within the Chilean market and the copper industry, Codelco has very good access to the global and local capital and financial markets. Over its many years of operations, Codelco has developed strong relationships with more than 20 large international financial institutions, although as is the common practice in Latin America, it does not have access to any committed bank facility.

Codelco is in compliance with its traditional and non-financial covenants included in its financings, and its main MAC clause (change of control clause) contemplates the acceleration of most of its debt upon the loss of majority ownership by the Chilean Republic.

Alternative sources of liquidity could include:

-- The downward revision of its currently ambitious capital expenditures plans to levels close to its annual depreciations and amortizations, although such a reduction would likely affect future growth.

-- The proceeds that could be derived from the sale of its non-core electricity assets.

-- The reduction in dividends that would require authorization by its owner, the Chilean Republic, not to upstream 100% net earnings after taxes.

-- Inventories and receivables for approximately $457 million and $517 million respectively as of June 30, 2002, a portion of which could be sold.

Outlook

The stable local currency outlook reflects the expectation that Codelco will maintain its strong business position and prudent financial profile, even as it continues to analyze new national and international business development opportunities. The positive foreign currency outlook reflects the outlook on the ratings of the Republic of Chile.