STANDARD &POOR'S

## My Credit Profile

Table of Contents



# Summary: Corporacion Nacional del Cobre de Chile


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## 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 government; and the company's aggressive financial policy.

Standard & Poor's rates Codelco according to its 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 11% 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 with about 14% of global production. Codelco's ample high-grade copper ore reserves account for about 10% of proven reserves worldwide, and have enabled the company to achieve large economies of scale and to be a low-cost copper producer. Although Codelco's cash production costs increased significantly to 63 cents per pound in the first nine months of 2008 compared with 40 cents per pound in fiscal 2007, we expect that the company's cost profile will still remain highly competitive on a global basis.

During 2007 and the first nine months ended on Sept. 30 2008, Codelco reported very high profitability and cash flow generation due to the very favorable pricing environment for copper ($3.23 per pound in 2007 and $3.61 per pound in the nine-month period of 2008). However, Codelco's EBITDA margin declined to a still historically high 55.2% in fiscal 2007 and 46.7% in the first nine months ended on Sept. 30 2008, compared with 60.1% in 2006 and 57.7% in 2005. This was mainly due to higher operating costs: lower ore grade and higher cost of energy, steel and chemical products, as well as higher labor costs due to the revaluation of the Chilean peso, etc. In addition, debt continued to increase to about $5.1 billion, including commercial debt with China's state-owned Minmetals Nonferrous Metals Co. Ltd. as of Sept. 30 2008, mainly driven by high capital expenditures ($1.5 billion in the first nine months of fiscal 2008) and dividend payments ($3.0 billion in the first nine months of fiscal 2008).

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 cash flow generation remained at extraordinary high levels in 2007 as a result of higher copper prices, adjusted cash generation (FFO less dividends) to total debt deteriorated to 15% in 2007 from 26% in 2006 due to the higher debts levels and dividend payout. 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. In addition, about $200 million of Codelco's 2007 earnings were retained. Although these measures are a credit positive for Codelco, they provide only minor relief for the company's high cash needs. If 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 good financial flexibility in the current financial environment. This flexibility is supported by its strong business risk profile and 100% ownership by, and strategic importance to, the Republic of Chile. However, the company routinely has significant negative free cash flow due to its 100% dividend payout to the government and partly debt-financed capital expenditures. Nevertheless, Codelco has an adequate debt structure, with sizable but manageable debt maturities of $600 million in 2009, and no debt maturities in 2010 and 2011. 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 stable outlook incorporates our expectations that the Chilean government, if necessary, will support Codelco, given the company's strategic importance to the national 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 its financial profile, and/or a perception that the company's importance to the Chilean government is diminishing, or a potential privatization.