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Research Update:

Codelco Rating Outlook Revised To Negative On Lower Copper Prices, 'AA-' Rating Affirmed

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Research Update:

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Overview

- Lower copper prices are pressuring Codelco's credit quality.
- We are revising our rating outlook on Codelco to negative and affirming the ratings at 'AA-'.
- We could lower the ratings within the next 12 months if the company is not able to reduce costs or investments to offset rising leverage levels, and/or if the Chilean government postpones capital injections.

Rating Action

On Sept. 1, 2015, Standard & Poor's Ratings Services affirmed its ratings on Corporación Nacional del Cobre de Chile (Codelco) at 'AA-' and revised the outlook to negative from stable.

Rationale

Our ratings on Codelco continue to reflect the company's close relationship and high importance to its 100% owner, the Chilean government, which has had an active role in defining long-term strategic goals and financing decisions. The company contributes significant cash flows to the central government in the form of dividends and ad-hoc taxes.

The outlook revision reflects the weakening price of copper and the impact we expect it to have on Codelco's debt levels. The action incorporates the higher likelihood of a one notch downgrade if copper prices remain at $2.4 per pound or below, absent meaningful counteracting measures. Under our base-case scenario, prices remain at $2.40 per pound through 2017, making leverage levels rise steadily, as operating cash flows are not sufficient to finance the investment program the company is embarked on to sustain production levels. We now assess Codelco's stand-alone credit profile (SACP) as 'bb+' instead of 'bbb-'. We now assess its financial risk profile as "aggressive".

We are closely monitoring the government's actions to mitigate Codelco's balance sheet deterioration, as our support assessment may be challenged by an scenario of lack of action and/or late or too-soft countercyclical measures. Our forecasts incorporate a total cash injection of the $3 billion confirmed under the Capitalization Law in October 2014, but the payment schedule has not been announced yet and payment could be delayed until 2018, where the Law sets the time limit for the contribution.

Our base-case scenario also incorporates the positive effects of the Chilean currency depreciation on costs and capital expenditures (capex), and updated estimates on the impact of the company's cost reduction initiatives. Main assumptions include:

- Average Chilean peso of 650 per dollar in 2015, 680 in 2016, and 720 in 2017;
- Inflation rates ranging between 2.0% and 3.5% through 2017;
- Flat copper prices at $2.40 per pound through 2017;
- Copper output of about 1.7 million tons through 2017;
- Molybdenum production of 28,000 tons in 2015, dropping to 24,000 tons in 2017 with prices at $6 per pound;
- Declining cash costs of $1.38 per pound in 2015, $1.34 in 2016, and $1.33 in 2017, due mainly to the weaker Chilean peso;
- A tax rate on exports remaining at 10%, according to Law 13.196 (Ley Reservada);
- A 40% additional tax rate on Codelco's earnings before taxes, according to Decree Law 2.398;
- Capex of $3.4 billion in 2015, $3.6 billion in 2016, and $4.5 billion in 2017; and
- Annual capital injections of $700 million in 2015 and 2016, and $800 million in 2017 and 2018.

Based on those assumptions, we arrive at the following credit measures:

- Adjusted EBITDA of $4.0 billion in 2015, $3.6 billion in 2016, and $3.7 billion in 2017 (including dividends from equity investments in Anglo American and El Abra of $170 million per year and operating lease adjustments of about $850 million);
- Debt-to-EBITDA ratios of 3.8x in 2015, 4.4x in 2016, and 4.7x in 2017; and
- Funds from operations (FFO)-to-debt ratios of 20% in 2015, 18% in 2016 and 16% in 2017.

All else being equal, if copper prices were to stabilize at $2.3 per pound the resulting credit metrics would be as follows:

- Debt-to-EBITDA of 3.8x in 2015, 4.8x in 2016, and 5.3x in 2017; and
- FFO-to-debt ratios of 20% in 2015, 16% in 2016, and 14% in 2017.

Liquidity

We continue to assess Codelco's liquidity as "adequate" because we expect cash sources to exceed uses by at least 20% in the next 12 months and the company will continue to generate free cash surpluses even if EBITDA were to decline by 15%, compared to our base case.

We also believe the company has strong financial flexibility and open access to credit markets thanks to its government ownership, which is reflected in the low spreads in its bonds compared with other frequent corporate debt issuers. These factors offset the risks associated with the company's significant capex in the next 12 months and its lack of committed credit lines.

Sources of liquidity:

- Cash position of above $824 million by March 31, 2015;
- FFO of $2.3 billion;
- Estimated working capital cash inflows of $200 million; and
- Capital injections of $700 million.

Uses of liquidity:
- Short-term debt maturities of $788 million as of March 31, 2015;
- Minimum capex levels of $2 billion; and
- Dividends of $200 million.

Outlook

The negative outlook reflects the increased likelihood of a one notch downgrade in the next 12 months due to the impact of lower copper prices on Codelco's credit protection measures.

We could also lower the ratings if we revise downward our local currency ratings (LCR) on Chile, or if we believe the Chilean government's capacity or willingness to provide timely support has diminished.

Upside scenario

Although very unlikely at this moment, we could raise the rating on Codelco to 'AA' if we raised the foreign and local currency ratings on Chile to 'AA+'.

Rating Score Snapshot

Foreign currency corporate credit rating: AA-/Negative/--
Business risk: Satisfactory
- Country risk: Low
- Industry risk: Moderately high
- Competitive position: Satisfactory

Financial risk: Aggressive
- Cash flow/Leverage: Aggressive

Anchor: bb
Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: bb+
Sovereign foreign currency rating: AA-
Likelihood of government support: Extremely high

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Metals And Mining Upstream Industry, Dec. 20, 2013
- Corporate Methodology, Nov. 19, 2013
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Corporacion Nacional del Cobre de Chile		
Corporate Credit Rating		
Foreign Currency	AA-/Negative/--	AA-/Stable/--

Ratings Affirmed

Corporacion Nacional del Cobre de Chile	
Senior Unsecured	AA-

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