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SECTOR IN-DEPTH
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Corporate Liquidity – Chile

Strong Credit Quality Overall Offsets Liquidity Risk

» **The liquidity risk of the Chilean non-financial companies that we rate slightly increased in 2015, but the corporate sector has strong credit quality overall.** Out of the nine companies in Chile rated B3 and higher, only three had enough cash and free cash flow at the end of 2015 to cover short-term debt and long-term maturities, operating expenses and regular capital spending through the end of 2017. Still, eight of the nine companies we studied have solid investment-grade credit profiles, with strong market positioning and access to debt capital markets and uncommitted bank funding.

» **Chile's economic dependence on commodity exports affects its growth outlook.** Chile's GDP will grow by 2% or less in 2016, compared to 5.3% from 2010-13, largely due to low copper prices and a sharp fall in capital investment in the mining sector. While slowing growth will strain profitability and demand for domestic companies that rely on consumption, weak commodity prices constrain the mining sector's profitability. Yet Chilean companies benefit from the country's track record of stability and solid fundamentals, strong institutions, and sustainable macroeconomic and fiscal policies.

» **Arauco, CMPC and SQM have the best liquidity among the rated Chilean companies.** Paper and pulp producers Arauco and CMPC have strong cash balances, positive free cash flow and diminishing capital spending through 2017. Both companies have recently concluded significant investment spending. Expansions into neighboring countries help diversify **ENAP, Cencosud, Entel Chile** and **LATAM,** exposing them to different economic dynamics. Weak commodity prices, particularly for copper, and falling ore grades will continue to strain cash flow in 2016 for mining companies, but **CODELCO's** importance to the federal government offers considerable credit protection, while **Escondida** shows consistent operating cash flows. Chemical producer SQM has strong liquidity today and cost advantages that will keep it profitable through the market cycle.

» **Despite their high liquidity risk overall, the Chilean companies' maturity profiles are manageable overall, with no significant refinancing peaks until 2020.** Most of the short-term debt is bank debt, which is relatively easy to refinance or amortize. Yet cross-border issuance has fallen considerably as capital needs have dropped and investor risk aversion to Latin America has grown. Currency risk is modest for Chilean companies today, despite the majority of debt denominated in US dollars, since a large part of these companies also draw most of their revenues and EBITDA in dollars or sell products indexed to the dollar.

About this report

This report summarizes the liquidity risk of nine non-financial, non-utility companies in Chile rated B3 and above. We define the degree of liquidity risk by looking at a company's cash needs over a 24-month period, from 1 January 2016 until 31 December 2017, against its available cash sources.

Cash needs include estimates of operating uses and short-term debt maturities. Maturities of interest-bearing debt are those reported as of 31 December 2015. We estimate available funds based on assumptions of each company's revenue growth, margins and cash flow generation after planned capital spending and dividend, in addition to committed bank facilities.

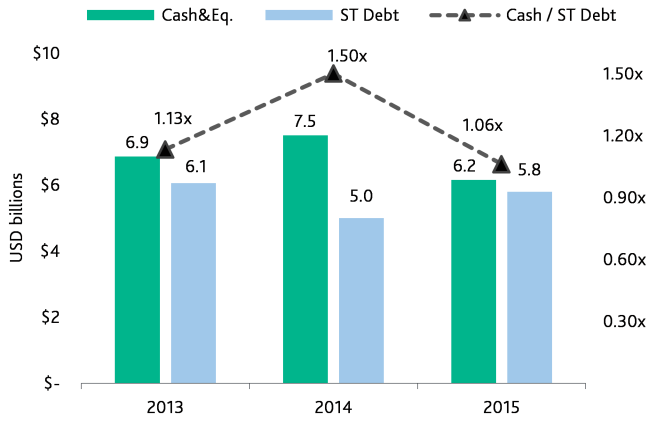
In our liquidity analysis we also take into consideration financial covenants and exposure to foreign-currency risk. The 2014 statistics reflect the historical data for the same pool of companies along with methodological refinements, so could differ from those cited in previous liquidity studies. Other reports in this series discuss corporate liquidity in Argentina, Brazil, Mexico and Peru.

Chilean Companies Face Slower Domestic Growth and Lower Commodity Prices

The liquidity risk of the Chilean non-financial companies that we rate slightly increased in 2015, and the corporate sector has high liquidity risk overall. Out of the nine rated companies in Chile rated B3 and higher, six have little liquidity cushion for addressing their upcoming cash needs, an increase compared to 2014 levels (see Exhibits 1 and 2). Only three of the companies had enough cash and free cash flow at the end of 2015 to cover short-term debt and long-term maturities, operating expenses and regular capital spending through 2017.

Exhibit 1

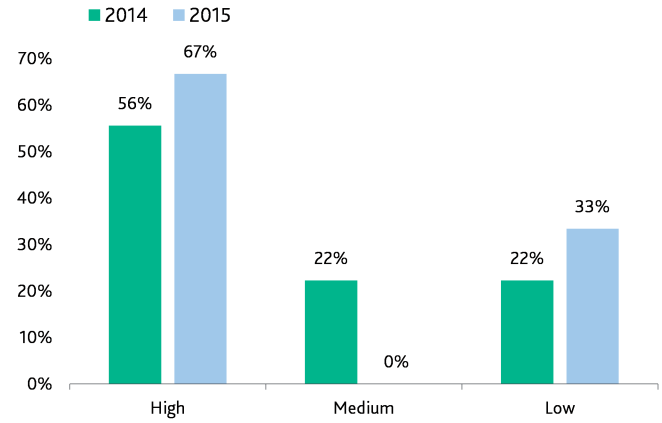
Cash, Short-Term Debt, Cash/Short-Term Debt



Source: Moody's Investors Service

Exhibit 2

Chilean Companies' Exposure to Funding Risk



Source: Moody's Investors Service

We typically define exposure to funding risk as low for Latin American companies with sufficient cash, free cash flow and committed credit facilities to cover more than 150% of debt maturities over the next 24 months; medium if liquidity sources are sufficient to cover more than 150% of maturing debt over the next 12 months, but not the next 24 months; and high if liquidity sources will cover less than 150% of debt maturities over the next 12 months. A few companies in this analysis have significant amounts of debt due in the short term, negative free cash flow generation, or limited cash to address upcoming maturities.

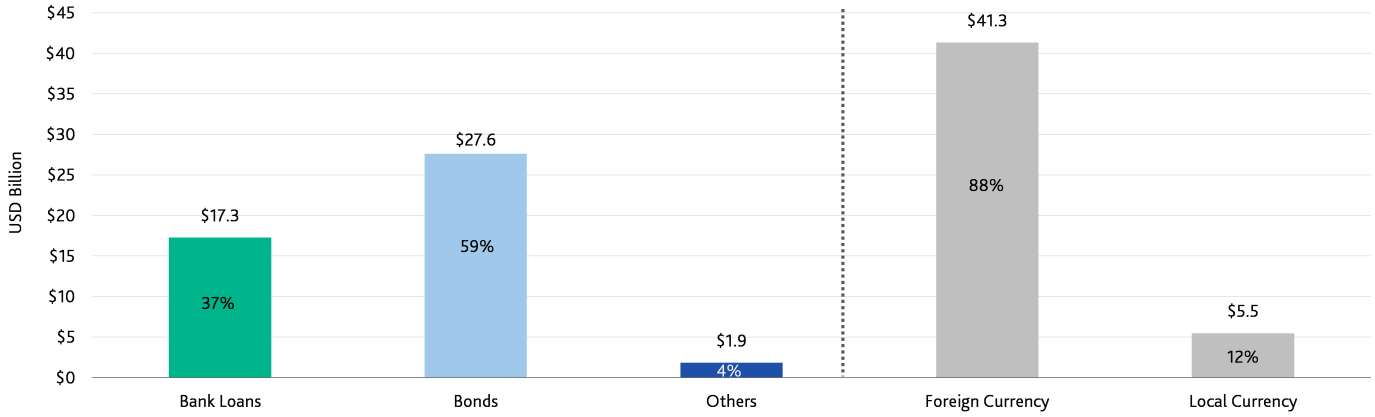
Even so, eight of the nine Chilean companies we studied have solid investment-grade credit profiles, with strong market positioning and access to capital markets and uncommitted bank funding. We would expect these companies to maintain strong cash balances or committed credit facilities for future debt service needs. The pulp/paper producer Celulosa Arauco y Constitucion (Baa3 stable), mining company Minera Escondida Limitada (Baa2 negative) and airline group LATAM Airlines (B1 stable) all have committed credit facilities. But, in the case of airlines, high cash balances do not fully mitigate their high business risk.

Since our previous annual liquidity study in May 2015, funding risk has decreased for Arauco and Empresas CMPC (Baa3 stable), both of which concluded large pulp capacity expansions and benefit from lower capital spending and improved product mix. Conversely, funding risk increased for Empresa Nacional de Telecomunicaciones S.A. (Entel Chile, Baa3 negative) and Empresa Nacional del Petroleo (ENAP, Baa3 stable) in 2015 from a year earlier. Yet Entel announced in March 2016 plans for an equity increase, which will help ease its liquidity and its ability to continue to finance its capital spending.

Chilean companies have long enjoyed better access to international capital markets than most of Latin America non-financial corporates. Today bonds represent most of total debt outstanding for the rated companies in this analysis (see Exhibit 3), but financial institutions remain a solid source of financing for Chile's companies. In fact, bank debt represents most of the companies' short-term debt, and we expect that companies will refinance, or that those with a comfortable liquidity position and positive free cash flow generation will amortize this debt.

Exhibit 3

Debt Structure by Instrument and Currency Denomination



Source: Moody's Investors Service

Reliance on Commodities Hinders Economy in Downturn Period

Chile's economic dependence on commodity exports affects its growth outlook. Real gross domestic product (GDP) grew by just 2% in 2015, and we expect growth of 2% or lower in 2016—the third consecutive year of weak economic growth as Chile adjusts to low copper prices. By contrast, Chile's GDP grew by an average 5.3% from 2010-13. A strong macroeconomic framework, strong federal balance sheet with relatively low debt indicators, and fiscal flexibility all help offset the lower economic development.

The main driver behind the economic deceleration has been the sharp fall in investment as companies reduced capital spending in the mining sector amid low copper prices. Investment in 2015 dropped by 3% as a percentage of 2014's GDP, staying flat year-on-year from January to September 2015. President Michelle Bachelet's reform agenda raised business uncertainties and tempered investments as well. Meanwhile, private domestic demand and weak exports are both subdued today, with half of Chile's exports coming from producers of commodities, primarily copper.

Slowing growth will also strain profitability and demand for domestic companies that rely on consumption, while weak commodity prices constrain the mining sector's profitability. The sharp decline in copper prices has significantly hurt economic growth. Copper represents around 8% of Chile's GDP in 2015, and accounts for around 40% of foreign direct investment, so Chile's real GDP growth

slows when copper prices drop. A permanent decline in commodity prices would place a long-term strain on Chile's GDP and capital stock.

Despite the current slowdown, Chilean companies benefit from the country's track record of stability and solid fundamentals, strong institutions, and sustainable macroeconomic and fiscal policies. Chile's economic activity is also well diversified, with mining contributing only 9% of total GDP in 2015, and Chile's many free trade agreements with various countries and economic blocs give it access to many markets.

Paper and Forestry Companies Enjoy Strong Export Advantages

Both Arauco and CMPC stand out for their adequate liquidity profiles, with strong cash balances, positive free cash flow and diminishing capital spending through the end of 2017. Both companies have recently concluded significant investment spending: Arauco completed its Uruguay pulp expansion in 2014, and CMPC finished its Guaiba II pulp expansion in 2015. Both companies benefited from their greater pulp capacity and favorable pulp prices in 2015.

While pulp capacity additions will likely outpace demand growth through mid-to-late 2017, currency depreciation in Chile will offset lower international prices, which are usually in US dollars—a benefit for Chilean exporters. Also, both CMPC and Arauco are large, competitive and diversified companies that can withstand weak pulp prices. CMPC is a large producer of paper and tissue products in Latin America, while Arauco has a strong presence in North America's panels and wood markets. Both companies enjoy structural cost advantages over North American and European producers of hardwood pulp, with fast-growing trees that give them almost full self-sufficiency in fiber.

International Opportunities Expand Limits of Domestic Market

Large Chilean companies are increasingly expanding into neighboring countries, exposing them to different economic dynamics. Cencosud has foreign retail operations in Argentina, Brazil, Peru and Colombia—all of which face economic challenges in 2015 from low commodity prices, currency depreciation and other specific factors.

For 2015, retailer Cencosud (Baa3 negative) 37.6% of its sales at home in Chile, along with 29.6% in Argentina, 15.3% in Brazil, 9% in Peru and the remaining 8.5% in Colombia. Macroeconomic factors have limited the spending power of its core middle-income customer base, weakening Cencosud's operating performance. Local currency devaluations also hit Cencosud's profitability, particularly at home in Chile, where 30% of sales in its department stores come from imported goods, and in Brazil, where the real depreciated 32% in 2015. But Argentina's new administration offers a chance for improved sales in the medium term.

As of December 2015, Cencosud had tight liquidity, with only enough cash and equivalents to cover about 75% of its short-term debt. But most of its short-term debt is composed by credit bank facilities that Cencosud expects to renew or amortize with its own cash generation.

Telecom operator Entel Chile has a resilient market presence, maintaining nearly 40% of subscriber market share since 2007. Entel Chile has a small presence in Peru's fixed-line and broadband segments as well, through its subsidiary Americatel, and offers mobile services in the extended region following its acquisition of Nextel Peru in 2013. Although Peru's mobile sector offers long-term growth opportunities that Chile's market does not, the expansion involves high execution risk and weighs on Entel Chile's consolidated results. In fact, Entel's credit profile has deteriorated since its expansion into Peru, and will remain constrained for at least the next 24 months through mid-2018.

Intense competition in both Chile and Peru will further delay Entel Chile's return to positive free cash flow generation. Entel Chile's liquidity position is tight today but it has no big maturities to pay through 2018, and it recently extended its existing $300 million bank facility into 2019 and 2020. Meanwhile, in March 2016 Entel Chile announced a $510 million equity increase that will help improve its liquidity cushion.

LATAM currently flies to 137 destinations in 25 countries and cargo service in Latin America, North America, Europe and the South Pacific, but its six home markets—Argentina, Brazil, Chile, Colombia, Ecuador and Peru—comprise about 90% of South America's regional air traffic. This concentration exposes LATAM to Latin America's slowing macroeconomic environment—particularly in Brazil,

which will likely continue to strain demand growth and yields through 2016, increasing pressure on airlines to reduce capacity to maintain profitability.

LATAM's liquidity is tight today, with only about $1.7 billion available under unrestricted cash and committed credit facilities—barely enough to cover its short-term debt, most of it bank debt—but it does benefit from a diversified capital structure, relatively low debt cost and a leading position in Latin America's airline market. To adjust for today's difficult operating environment, LATAM has announced an up to 10% passenger capacity reduction in Brazil in 2016 and an up to 2% reduction in consolidated cargo capacity, which will likely be accompanied by a consistent reduction in workforce supporting cost reduction. LATAM has also negotiated with suppliers a reduction of its fleet commitments by $2.8 billion to reduce its capital expenditures in 2016-18.

ENAP, the national oil company, is Chile's second-largest state-owned company, with 133 million barrels of oil equivalent in total proved reserves—43% of it concentrated in Chile, followed by Argentina (28%), Ecuador (21%) and Egypt (8%). ENAP's weak liquidity benefits from its ownership by the government of Chile (Aa3 stable).

At the end of 2015, ENAP had $117 million in cash, far less than its $453 million in debt maturing in 2016, most of it related to its imports of oil products and some crude for refining into fuel. While ENAP has historically successfully rolled maturities, it has also operated with high proportions of short-term debt related to trade in its capital structure. ENAP's constant need to access the debt capital markets is a credit weakness, but this strategy allows the company to adjust local prices quickly in reaction to volatile costs, thus protecting its profit margin.

Chemical Producer Sees Better Fundamentals Than Mining Companies

Weak commodity prices, particularly for copper, and falling ore grades will continue to strain cash flow in 2016 for mining companies Corporacion Nacional del Cobre de Chile (CODELCO, A3 negative), Chile's largest state-owned firm, and Minera Escondida. CODELCO's high dividend payout to the Chilean state treasury, and its high capital spending to fund strategic growth, limit its free cash flow generation. The company essentially pays 100% of its income to the Chilean treasury through income and export taxes and royalties. But CODELCO's importance to the Chilean economy, and a government budget that covers its interest and debt payments, ease the consequences of the company's heavy spending requirements.

CODELCO's reliance on the state means its credit quality depends largely on Chile's economic health. The government in the past has also consistently supported CODELCO with direct capital injections and by allowing the company to retain profits periodically, including $200 million in June 2014 and $225 million in June 2015. In October 2014, Congress approved a $4 billion capitalization bill for 2014-18, followed by a $600 million capital increase a year later, underlining CODELCO's importance to the state economy and the government's need to address CODELCO's significant capital investments and ease the pressure from weak copper prices. While CODELCO's federal support eases its financing needs and demonstrates the long-term importance of its project development and strategic growth, we still expect that CODELCO's debt will increase in coming years.

Meanwhile, Escondida has shown consistent operating cash flows, which it has invested in the business and in substantial dividend payments to its shareholders—historically, about 35% on average, though it has reduced dividends in times of higher capital spending or market distress. We now expect that Escondida's total capital spending will decline compared to recent years, and that the company will generate positive free cash flows. But lower copper prices have led to increased debt levels to $2.1 billion in December 2015 from $1.4 billion a year earlier, and to a greater reliance on short-term debt, including nearly $1.3 billion maturing soon that the company will likely refinance. The company's liquidity comes principally from its cash-generating capability and cash position—$196 million as of December 2015—as well as $345 million still available from its $1.1 billion in committed back-up credit facilities.

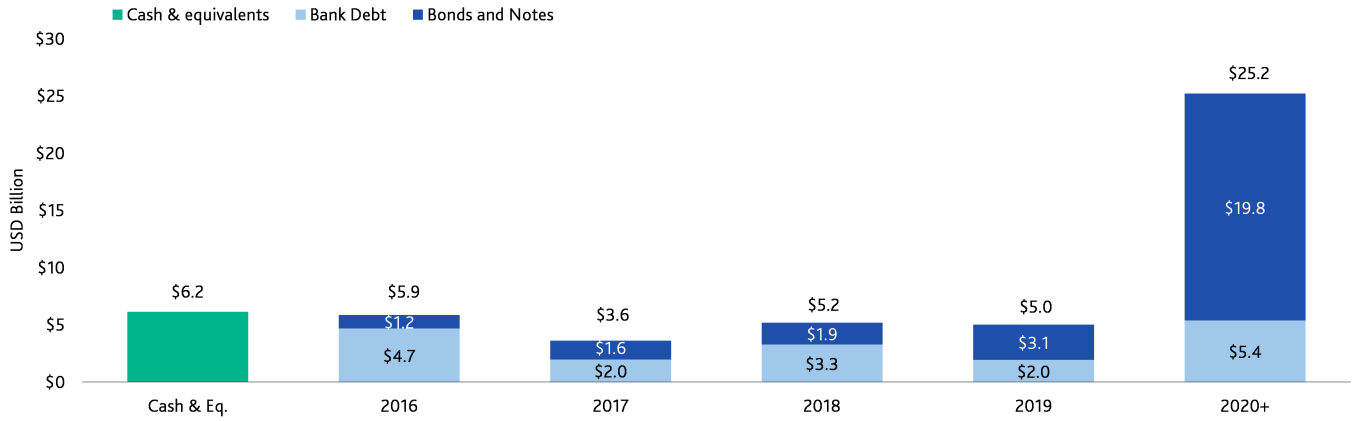
Sociedad Quimica y Minera de Chile S.A. (SQM, Baa1 negative), a large producer of fertilizer and chemicals producer, enjoys a sound market position and adequate liquidity, with $1,145 million in cash as of December 2015—enough to cover short-term debt by 2.9x. SQM has access to rich natural resources in northern Chile, which gives it cost advantages over its industry peers, and as one of the lowest-cost producers globally in each of its major product categories, SQM can stay profitable throughout the market cycle. Since 2014, SQM has carried high cash balances of around $1 billion to support its liquidity, but can comfortably operate with just $300 million of cash. SQM will likely generate positive free cash flow in 2016-17, benefiting from low projected capital spending, despite high

dividend payouts likely to continue at about 50% of earnings. The company's current arbitration process could temper its operation and liquidity if it revokes SQM's concession to operate in the Salar de Atacama.

Most Debt Obligations Are Long-Term and Issuance is Light Amid Lower Capital Spending

While six of the nine Chilean companies we reviewed had high liquidity risk at the end of 2015, their maturity profiles are manageable, with no significant refinancing peaks until 2020 (see Exhibit 4). About 80% of the debt due in 2016 and 55% due in 2017 is bank debt, and the strong credit profiles of these companies suggests they will have no difficulties refinancing or amortizing part of this debt.

Exhibit 4
Chilean Corporate Debt Maturity Profile, 2016-2020
in USD billions



Source: Moody's Investors Service

Yet cross-border debt capital markets issuance fell considerably in 2015 from 2014 levels, with three rated companies—Cencosud, LATAM and Codelco—together issuing $3.5 billion in notes, a 35% decline from $5.5 billion a year earlier (see Exhibit 5).

Exhibit 5
International Debt Issuance by Company (January 2015 - April 2016)
in USD millions

Issuer	Date of Issue	Amount	Maturity	Coupon
Cencosud	Jan-15	USD 350	Feb-45	6.63%
Cencosud	Jan-15	USD 650	Feb-25	5.15%
Latam Airlines Group	Jun-15	USD 500	Jun-20	7.25%
Codelco	Sep-15	USD 2,000	Sep-25	4.50%

Source: Moody's Investors Service

The lower level of issuance stems from the end of big investment cycles for Arauco and CMPC, the pulp and paper producers, as well as higher investor risk aversion to Latin America amid a global commodities downturn and soft economic growth. Still, Codelco was able to issue $2 billion for liability management and to fund a large capital spending program and structural projects that will help the mining company maintain its production profile over time.

Foreign Exchange Exposures Pose Little Hindrance to Most Chilean Issuers

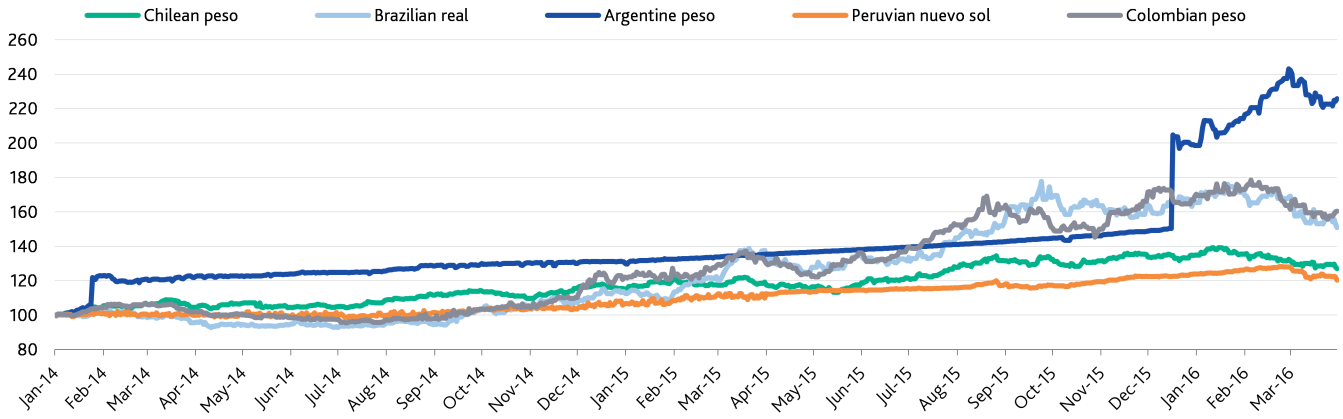
Currency risk is modest for Chilean companies today. The depreciation of the Chilean peso hurts Chilean companies' credit profile overall, since 88% of their total debt is denominated in US dollars. Yet the majority of these companies also draw most of their revenues and EBITDA in US dollars, either because they are exporters, such as the mining companies and pulp producers, or have products indexed to US dollars, such as SQM and ENAP.

The Chilean peso fell by 17% against the US dollar in 2015, on top of a 15% drop in 2014 (see Exhibit 6), weakening cash flow for importers and companies with significant dollar-denominated debt maturing in 2016. Cencosud has more exposure to foreign currency movements, with retail operations in Argentina, Brazil, Peru and Colombia, as well as about 70% of its debt is denominated in foreign currency, partially unhedged. For airlines such as LATAM, hedging strategies do not fully offset the strain of revenues and cash generation exposure to weak currencies in Latin America, particularly since much of its costs and capital spending are denominated in US dollars.

Exhibit 6

US Dollar Appreciation Against Latin American Currencies Since 2014

100 = 1 January 2014



Source: Banco Central (Brazil, Chile, Peru, Argentina, Colombia)

By contrast, a weak peso benefits the export-dependent producers of chemicals, metals, and paper and forest products. EBITDA is dollar-denominated for mining companies Codelco and Escondida, while ENAP, although mostly reliant on Chile's domestic market, gets protection from foreign currency fluctuations by indexing weekly all revenues from refined products to the US dollar through an import-parity-pricing mechanism. Arauco generates much of its EBITDA in US dollars through its large exposure to pulp, which it mostly exports at dollar-indexed prices, and from its US panel business. Its forest products peer CMPC by contrast has a far greater domestic exposure from its tissue and paper business, and therefore more foreign-exchange risk.

Appendix: Rated Chilean Companies, April 2016

Exhibit 7
Rated Chilean companies
as of April 2016

Company	Industry	Lead Analyst	Long-term Rating	Outlook
Celulosa Arauco y Constitucion S.A.	Paper and Forest Products	Barbara Mattos	Baa3	Stable
Cencosud S.A.	Retail and Consumer Goods	Veronica Amendola	Baa3	Negative
Corporacion Nacional del Cobre de Chile	Metals and Mining	Barbara Mattos	A3	Negative
Empresa Nacional de Telecomunicaciones S.A.	Media, Telecom, Cable and Comm Infrast.	Marcos Schmidt	Baa3	Negative
Empresa Nacional del Petroleo	Energy, Oil and Gas	Nymia Almeida	Baa3	Stable
Inversiones CMPC S.A.	Paper and Forest Products	Barbara Mattos	Baa3	Stable
Minera Escondida Limitada	Metals and Mining	Barbara Mattos	Baa2	Negative
LATAM Airlines Group S.A.	Transportation	Cristiane Spercel	B1	Stable
Sociedad Quimica y Minera de Chile S.A.	Chemical	Alonso Sanchez Rosario	Baa1	Negative

Source: Moody's Investors Service

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- Corporate Liquidity in Chile: Companies' Strong Overall Credit Quality Reduces Urgency of Liquidity, 13 May 2015
- Credit Quality in Chile: Banking, Corporate Sectors Poised to Withstand Slow Growth, Policy Shifts, 18 August 2015

Outlooks:

- Moody's Latin America 2016 Outlook (Presentation), 6 April 2016
- Non-Financial Corporates – Latin America: 2016 Outlook - Global and Regional Stresses Strain Credit Quality (Presentation), 3 December 2015
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