

Monday, October 14, 2019 | update

KGHM: accumulate (upgraded)

KGH PW; KGH.WA | Metals, Poland

Copper Outlook Improves As Trade Tensions Ease

The US and China reached a preliminary trade deal on Friday, 11 October – a positive turn of events which could convince investors to reduce bearish bets in commodities, resulting in an upward shift in prices of industrial metals, including copper. This after an extended period of downside trade tensions which led to a build-up of short positions by speculative investors. As of this writing the short position held by copper speculators totals -48,000 contracts, the fourth-highest weekly print this year and a level just short of an all-time high. A delayed threat of a tariff increase might restore the faith of investors in a recovery in global copper demand, especially when set against weaker production numbers for this year (-1.4% y/y in H1 2019), underpinned by disruptions in the past month at mines in Chile and Peru that account for a combined 570,000t, or 2%-3%, of annual world supply. We decided to raise our 2020-2021 copper price forecasts to \$6,450 and \$6,700, respectively, per tonne, as well as upgrading the outlook for gold (to \$1,350/oz) and silver (to \$16.5/oz). At KGHM, the zloty's depreciation versus the US dollar observed since the beginning of October is a source of additional upside. With all this in mind, we upgrade KGH from hold to accumulate, and we raise our target price from PLN 77.51 to PLN 90.12 per share based on the adjusted earnings outlook and updated peer ratios.

Investors bearish on metals

The total speculative position in metals is currently 560,000 – the lowest level since 2015. Net short exposure to copper is at its most bearish level in history after an increase in contracts to over 50,000 in late August. Today there are -48,000 open copper positions after continuing activity last week as investors increased bets in anticipation of failed US-China talks.

Mine disruptions in Latin America

Three South American mines have experienced production stoppages in the last three weeks: at Peru's Las Bambas, with annual capacity for 120kt, production has had to be halted due to anti-mining protests, while Atacofasta's operations in Chile (Los Pelambres, 370.5kt, and Antucoya, 72.2kt) are in the midst of tough labor disputes. Between them, these three mines account for 2-3% of global copper supply. On top of that, in the first half of the year, production in Chile was down 2.5% y/y in the wake of the labor disputes combined with unfavorable weather events.

A weaker zloty supports Polish copper mine profits

KGHM benefits whenever the zloty weakens vis-à-vis the US dollar; any decrease of 10 groszy in the PLNUSD exchange rate provides a potential topline boost of PLN 550m, and has the potential to add PLN 420-430m to EBITDA.

(PLN m)	2017	2018	2019E	2020E	2021E
Revenue	20,275.0	20,526.0	22,706.6	22,477.4	23,087.8
EBITDA	5,753.0	4,972.0	5,335.1	4,732.7	4,997.4
EBITDA margin	28.4%	24.2%	23.5%	21.1%	21.6%
EBIT	4,144.0	3,176.0	3,481.9	2,800.4	3,013.5
Net profit	1,792.0	1,887.9	2,423.9	1,887.9	2,047.0
P/E	8.9	8.5	6.6	8.5	7.8
P/CE	5.2	4.6	3.7	4.2	4.0
P/BV	0.9	0.8	0.7	0.7	0.6
EV/EBITDA	3.9	4.6	3.8	4.1	3.7
DPS	1.00	0.00	0.00	1.50	2.83
DYield	1.3%	0.0%	0.0%	1.9%	3.5%

Current Price	PLN 79.92
Target Price	PLN 90.12
Market Cap	PLN 15.9bn
Free Float	PLN 8.5bn
ADTV (3M)	PLN 104.7m

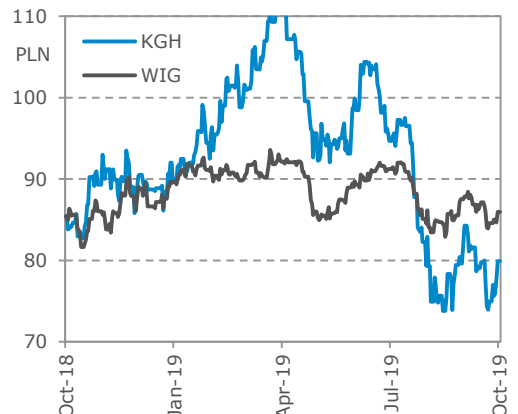
Ownership

State Treasury	31.79%
OFE NN	7.37%
OFE Aviva	5.25%
Others	55.59%

Business Profile

KGHM is the eighth-largest copper producer in the world, and it ranks as #1 in the production of silver. As a copper producer, it is in the third quartile on the global cost curve. The Company extracts and refines copper in facilities based in Poland, Chile (Sierra Gorda), the US (Robinson & Carlot mines), and Canada (Ajax, Sudbury, Victoria).

KGHM vs. WIG



Company	Target Price		Rating	
	new	old	new	old
KGHM	90.12	77.51	accumulate	hold

Company	Current Price	Target Price	Upside
KGHM	79.92	90.12	+12.8%

Forecast Update	2019E	2020E	2021E
EBITDA (adj.)	+2.9%	+7.9%	+3.5%
Net Profit (adj.)	+5.2%	+16.6%	+6.9%
Copper price (\$/t)	0.0%	+2.4%	+0.8%
Silver price (\$/oz)	+3.1%	+3.1%	+3.1%
Molybdenum price (\$/t)	+11.1%	+4.8%	+4.8%
Copper output (kt)	0.0%	0.0%	0.0%
Silver output (tonnes)	0.0%	0.0%	0.0%
Molybdenum (Mlb)	0.0%	0.0%	0.0%

Analyst:

Jakub Szkopek
+48 22 438 24 03
jakub.szkopek@mbank.pl

List of abbreviations and ratios contained in the report:

EV – net debt + market value
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

OVERWEIGHT (OW) – a rating which indicates that we expect a stock to outperform the broad market
NEUTRAL (N) – a rating which indicates that we expect the stock to perform in line with the broad market
UNDERWEIGHT (UW) – a rating which indicates that we expect the stock to underperform the broad market

Recommendations of Dom Maklerski mBanku:

A recommendation is valid for a period of 9 months, unless a subsequent recommendation is issued within this period. Expected returns from individual recommendations are as follows:

BUY – we expect that the rate of return from an investment will be at least 15%
ACCUMULATE – we expect that the rate of return from an investment will range from 5% to 15%
HOLD – we expect that the rate of return from an investment will range from -5% to +5%
REDUCE – we expect that the rate of return from an investment will range from -5% to -15%
SELL – we expect that an investment will bear a loss greater than 15%
 Recommendations are updated at least once every nine months.

mBank S.A. with its registered office in Warsaw at Senatorska 18 renders brokerage services in the form of derived organisational unit – Brokerage Office which uses name Dom Maklerski mBanku.

mBank S.A. as part of the Exchange's Analytical Coverage Support Programme ("Programme", <https://www.gpw.pl/eacsp>) prepares analytical reports for the following companies: Cognor Holding, Comarch, VRG. These documents are prepared at the request of Giełda Papierów Wartościowych w Warszawie S.A. ("WSE"), which is entitled to copyrights to these materials. mBank S.A. receives remuneration from the WSE for the preparation of the reports. All documents prepared for the Programme are available at: https://www.mdm.pl/ui-pub/site/market_and_analysis/analysis_and_recommendations/analytical_coverage_support_programme

This document has been created and published by Dom Maklerski mBanku. The present report expresses the knowledge as well as opinions of the authors on day the report was prepared. The opinions and estimates contained herein constitute our best judgment at this date and time, and are subject to change without notice. The present report was prepared with due care and attention, observing principles of methodological correctness and objectivity, on the basis of sources available to the public, which Dom Maklerski mBanku considers reliable, including information published by issuers, shares of which are subject to recommendations. However, Dom Maklerski mBanku, in no case, guarantees the accuracy and completeness of the report, in particular should sources on the basis of which the report was prepared prove to be inaccurate, incomplete or not fully consistent with the facts. mBank S.A. bears no responsibility for investment decisions taken on the basis of the present report or for any damages incurred as a result of investment decisions taken on the basis of the present report.

This document does not constitute an offer or invitation to subscribe for or purchase any financial instruments and neither this document nor anything contained herein shall form the basis of any contract or commitment whatsoever. It is being furnished to you solely for your information and may not be reproduced or redistributed to any other person. This document does not constitute investment, legal, accounting or other advice, and mBank is not liable for damages resulting from or related to the use of data provided in the documents. This document may not be copied, duplicated and/or be directly or indirectly distributed in the United States, Canada, Australia or Japan, nor transferred to citizens or residents of a state where its distribution may be legally restricted, which does not limit the possibility of publishing materials prepared for the Programme on Cognor Holding, Comarch, VRG, mBank or WSE websites. Persons who disseminate this document should be aware of the need to comply with such restrictions.

Recommendations are based on essential data from the entire history of a company being the subject of a recommendation, with particular emphasis on the period since the previous recommendation.

Investing in shares is connected with a number of risks including, but not limited to, the macroeconomic situation of the country, changes in legal regulations as well as changes on commodity markets. Full elimination of these risks is virtually impossible.

It is possible that mBank S.A. in its brokerage activity renders, will render or in the past has rendered services for companies and other entities mentioned in the present report.

mBank S.A. does not rule out offering brokerage services to an issuer of securities being the subject of a recommendation. Information concerning a conflict of interest arising in connection with issuing a recommendation (should such a conflict exist) is located below.

The present report was not transferred to the issuer prior to its publication.

The production of this recommendation was completed on October 14, 2019, 8:35 AM.
 This recommendation was first disseminated on October 14, 2019, 8:35 AM.

This document is an extract from a recommendation produced by Dom Maklerski mBanku.

mBank S.A., its shareholders and employees may hold long or short positions in the issuer's shares or other financial instruments related to the issuer's shares.

Copying or publishing the present report, in full or in part, or disseminating in any way information contained in the present report requires the prior written consent of mBank S.A.

Recommendations are addressed to all Clients of Dom Maklerski mBanku.

All investment recommendations and strategies issued by mBank S.A. over the last 12 months are available at:
http://www.mdm.pl/ui-pub/site/market_and_analysis/analysis_and_recommendations/fundamental_analysis/recommendations?recent_filter_active=true&lang=en

The activity of mBank S.A. is subject to the supervision of the Polish Financial Supervision Commission.

Individuals who did not participate in the preparation of recommendations, but had or could have had access to recommendations prior to their publication, are employees of Dom Maklerski mBanku authorised to access the premises in which recommendations are prepared and/or individuals having to access to recommendations based on their corporate roles, other than the analysts mentioned as the authors of the present recommendations.

This publication constitutes investment research within the meaning of Art. 36.1 of Commission Delegated Regulation (EU) 2017/565.

The compensation of the research analysts responsible for preparing investment research is determined independently of and without regard to the compensation of or revenue generated by any other employee of the Bank, including but not limited to any employee whose business interests may reasonably be considered to conflict with the interests of the persons to whom the investment research prepared by the Research Department of Dom Maklerski mBanku is disseminated. With that being said, since one of the factors taken into consideration when determining the compensation of research analysts is the degree of fulfillment of annual financial targets by customer service functions, there is a risk that the adequacy of compensation offered to persons preparing investment research will be questioned by a competent oversight body.

For U.S. persons only: This research report is a product of mBank SA which is the employer of the research analyst(s) who has prepared the research report. The research analyst(s) preparing the research report is/are resident outside the United States (U.S.) and are not associated persons of any U.S. regulated broker-dealer and therefore the analyst(s) is/are not subject to supervision by a U.S. broker-dealer, and is/are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with U.S. rules or regulations regarding, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account.

This report is intended for distribution by mBank SA only to "Major Institutional Investors" as defined by Rule 15a-6(b)(4) of the U.S. Securities and Exchange Act, 1934 (the Exchange Act) and interpretations thereof by U.S. Securities and Exchange Commission (SEC) in reliance on Rule 15a-6(a)(2). If the recipient of this report is not a Major Institutional Investor as specified above, then it should not act upon this report and return the same to the sender. Further, this report may not be copied, duplicated and/or transmitted onward to any U.S. person, which is not the Major Institutional Investor.

In reliance on the exemption from registration provided by Rule 15a-6 of the Exchange Act and interpretations thereof by the SEC in order to conduct certain business with Major Institutional Investors, mBank SA has entered into an agreement with a U.S. registered broker-dealer, Cabrera Capital Markets. ("Cabrera"). Transactions in securities discussed in this research report should be effected through Cabrera or another U.S. registered broker dealer.

Strong and weak points of valuation methods used in recommendations:

DCF – acknowledged as the most methodologically correct method of valuation; it consists in discounting financial flows generated by a company; its weak point is the significant susceptibility to a change of forecast assumptions in the model.

Relative – based on a comparison of valuation multipliers of companies from a given sector; simple in construction, reflects the current state of the market better than DCF; weak points include substantial variability (fluctuations together with market indices) as well as difficulty in the selection of the group of comparable companies.

Economic profits – discounting of future economic profits; the weak point is high sensitivity to changes in the assumptions made in the valuation model.

Discounted Dividends (DDM) – discounting of future dividends; the weak point is high sensitivity to changes in the assumptions as to future dividends made in the valuation model.

NAV – valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/profits of a company.

mBank issued the following investment recommendations for Company in the 12 months prior to this publication

Rating	hold	reduce	hold	hold	hold	hold	hold	hold
Rating date	2019-08-22	2019-08-05	2019-07-03	2019-06-03	2019-04-02	2019-02-04	2018-12-05	2018-10-15
Target price (PLN)	77.51	80.38	98.35	91.71	105.57	92.41	84.56	87.99
Price on rating day	74.90	87.78	101.70	95.00	109.40	94.16	92.60	85.40

Dom Maklerski mBanku

Senatorska 18
00-082 Warszawa
<http://www.mbank.pl/>

Research Department

Kamil Kliszc

director
+48 22 438 24 02
kamil.kliscz@mbank.pl
energy, power generation

Jakub Szkopek

+48 22 438 24 03
jakub.szkopek@mbank.pl
industrials, chemicals, metals

Aleksandra Szklarczyk

+48 22 438 24 04
aleksandra.szklarczyk@mbank.pl
construction, real-estate development

Michał Marczak

+48 22 438 24 01
michal.marczak@mbank.pl
strategy

Paweł Szpigel

+48 22 438 24 06
pawel.szpigel@mbank.pl
media, IT, telco

Piotr Poniąkowski

+48 22 438 24 09
piotr.poniakowski@mbank.pl
industrials

Michał Konarski

+48 22 438 24 05
michal.konarski@mbank.pl
banks, financials

Piotr Bogusz

+48 22 438 24 08
piotr.bogusz@mbank.pl
retail, gaming

Mikołaj Lemańczyk

+48 22 438 24 07
mikolaj.lemanczyk@mbank.pl
banks, financials

Sales and Trading

Traders

Piotr Gawron

director
+48 22 697 48 95
piotr.gawron@mbank.pl

Jędrzej Łukomski

+48 22 697 49 85
jedrzej.lukomski@mbank.pl

Magdalena Bernacik

+48 22 697 47 35
magdalena.bernacik@mbank.pl

Krzysztof Bodek

+48 22 697 48 89
krzysztof.bodek@mbank.pl

Adam Prokop

+48 22 697 47 90
adam.prokop@mbank.pl

Andrzej Sychowski

+48 22 697 48 46
andrzej.sychowski@mbank.pl

Tomasz Jakubiec

+48 22 697 47 31
tomasz.jakubiec@mbank.pl

Bartosz Orzechowski

+48 22 697 48 47
bartosz.orzechowski@mbank.pl

Sales, Foreign Markets

Joanna Łukasik

+48 22 697 48 82
joanna.lukasik@mbank.pl

Private Client Sales

Kamil Szymański

director
+48 22 697 47 06
kamil.szymanski@mbank.pl

Jarosław Banasiak

deputy director
+48 22 697 48 70
jaroslaw.banasiak@mbank.pl