

15 July 2013 | 22 pages

Diversified Metals & Mining (GICS) | Metals & Mining (Citi)
Western Europe | United Kingdom

First Quantum Minerals Ltd (FQM.L)

Concept Cracking & Financial Risk Climbing, Maintain Sell

■ Estimate Change
■ Target Price Change

- **Concept under pressure** — Despite the 30% share price drop YTD, we continue to see downside risk to FQM. We argued in our recent note, [Concept Cracking](#), that rising incremental capital intensity is likely to drive a structural dilution of group ROIC, calling into question the stock's premium valuation. On the back of Citi's updated commodity price forecasts, we reduce our TP to £8.40 and maintain our Sell recommendation.
- **Earnings downgrades** — While we have reduced our copper price expectations for 2014 by c4%, FQM's price basket is down close to 8%, driven by its increasing exposure to nickel (21% of revenue by 2015E). As a result, our 2013-15 EBITDA estimates fall by c.15% on average. Our 2013-14 EPS forecasts are 15% and 28%, respectively, below consensus forecasts (which imply a \$9,900/t copper-equivalent price in 2H13).
- **Leveraged with refi risk** — The levered acquisition of Inmet has introduced a dimension of balance sheet risk that has historically been absent from the stock. With significant capex commitments driving persistent negative FCF from an already geared base, FQM screens as one of the most financially high risk companies in our space. To drive net gearing below 50% by 2015E would require copper prices 30% above our forecasts. We see further risk for investors from the need to refinance a large portion of the group's \$2.5bn RCF by March 14 in an environment of rising yields and increasing risk aversion towards EM exposed equities.
- **Struggle for CP to clear market hurdle rate** — The group does have levers to pull, including cost reduction at Cobre Panama (not our base case). However, we doubt that returns will measure up to market expectations. Our analysis suggests at least a 17% IRR is required to drive a rerating of the shares from the current c30% discount to NPV, implying both \$1bn of cost savings *and* a LT copper price of \$7,500/t (Citi \$6,200).
- **Valuation** — FQM trades on c17x 2013E/2014E P/E, but closer to 30x on spot compared with the diversified miners on 8x and 10x, respectively. We expect that, with the stock no longer offering investors alpha, some of this premium will reverse.

Sell	3
Price (12 Jul 13)	£10.27
Target price	£8.40
	from £9.80
Expected share price return	-18.2%
Expected dividend yield	1.9%
Expected total return	-16.3%
Market Cap	£5,946M
	US\$9,029M

Price Performance (RIC: FQM.L, BB: FQM LN)



First Quantum Minerals Ltd (USD)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales (\$M)	2,583.5	2,950.4	3,666.0	4,090.9	5,804.7
Net Income (\$M)	577.3	537.1	509.0	546.1	1,039.3
Diluted EPS (\$)	1.28	1.13	0.91	0.92	1.75
Diluted EPS (Old) (\$)	1.28	1.13	0.96	0.84	1.61
PE (x)	12.1	13.8	17.2	16.9	8.9
EV/EBITDA (x)	7.3	8.4	9.6	11.3	7.5
DPS (\$)	0.19	0.17	0.20	0.09	0.18
Net Div Yield (%)	1.2	1.1	1.3	0.6	1.1

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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FQM.L: Fiscal year end 31-Dec						Price: £10.27; TP: £8.40; Market Cap: £5,946m; Recomm: Sell					
Profit & Loss (US\$m)	2011	2012	2013E	2014E	2015E	Valuation ratios	2011	2012	2013E	2014E	2015E
Sales revenue	2,584	2,950	3,666	4,091	5,805	PE (x)	12.1	13.8	17.2	16.9	8.9
Cost of sales	-1,276	-1,849	-2,516	-2,834	-3,586	PB (x)	1.9	1.4	1.1	1.1	0.9
Gross profit	1,308	1,101	1,150	1,257	2,219	EV/EBITDA (x)	7.3	8.4	9.6	11.3	7.5
Gross Margin (%)	50.6	37.3	31.4	30.7	38.2	FCF yield (%)	-9.1	-13.4	-29.9	-30.3	-10.6
EBITDA (Adj)	1,281	1,143	1,289	1,453	2,437	Dividend yield (%)	1.2	1.1	1.3	0.6	1.1
EBITDA Margin (Adj) (%)	49.6	38.8	35.2	35.5	42.0	Payout ratio (%)	15	16	22	10	10
Depreciation	-112	-172	-322	-359	-431	ROE (%)	16.5	39.0	6.9	6.5	11.0
Amortisation	0	0	0	0	0	Cashflow (US\$m)	2011	2012	2013E	2014E	2015E
EBIT (Adj)	1,169	971	968	1,094	2,006	EBITDA	1,281	1,143	1,289	1,453	2,437
EBIT Margin (Adj) (%)	45.2	32.9	26.4	26.7	34.6	Working capital	-413	-364	167	-233	-518
Net interest	-5	8	-36	-60	-71	Other	-455	-455	-464	-649	-1,014
Associates	0	0	0	0	0	Operating cashflow	412	325	993	572	905
Non-op/Except	-48	1,218	0	0	0	Capex	-1,050	-1,317	-3,607	-3,377	-1,887
Pre-tax profit	1,116	2,197	932	1,034	1,935	Net acq/disposals	-49	635	-1,016	-47	-47
Tax	-461	-346	-390	-406	-779	Other	0	0	0	0	0
Extraord./Min.Int./Pref.div.	-126	-97	-73	-82	-116	Investing cashflow	-1,099	-681	-4,623	-3,424	-1,934
Reported net profit	529	1,755	468	546	1,039	Dividends paid	-90	-130	-69	-72	-78
Net Margin (%)	20.5	59.5	12.8	13.3	17.9	Financing cashflow	482	193	4,111	2,183	542
Core NPAT	577	537	509	546	1,039	Net change in cash	-205	-164	481	-670	-486
Per share data	2011	2012	2013E	2014E	2015E	FCF ex acquisns & explorn	-687	-357	-3,630	-2,852	-1,029
Reported EPS (\$)	1.18	3.68	0.83	0.92	1.75						
Core EPS (\$)	1.28	1.13	0.91	0.92	1.75						
DPS (\$)	0.19	0.17	0.20	0.09	0.18						
CFPS (\$)	0.92	0.68	1.77	0.96	1.53						
FCFPS (\$)	-1.42	-2.08	-4.66	-4.73	-1.65						
BVPS (\$)	8.22	11.25	14.71	14.74	17.24						
Wtd avg ord shares (m)	447	474	559	591	591						
Wtd avg diluted shares (m)	449	476	561	593	593						
Growth rates	2011	2012	2013E	2014E	2015E						
Sales revenue (%)	8.6	14.2	24.3	11.6	41.9						
EBIT (Adj) (%)	3.8	-16.9	-0.4	13.0	83.4						
Core NPAT (%)	-32.6	-7.0	-5.2	7.3	90.3						
Core EPS (%)	-29.1	-12.2	-19.6	1.5	90.3						
Balance Sheet (US\$m)	2011	2012	2013E	2014E	2015E						
Cash & cash equiv.	452	309	835	348	26						
Accounts receivables	238	390	507	635	910						
Inventory	650	903	1,008	1,262	1,808						
Net fixed & other tangibles	3,906	5,648	14,117	17,364	19,031						
Goodwill & intangibles	0	0	444	444	444						
Financial & other assets	52	286	166	166	166						
Total assets	5,298	7,536	17,077	20,219	22,384						
Accounts payable	273	356	870	1,018	1,322						
Short-term debt	48	49	2,249	2,249	2,249						
Long-term debt	15	348	2,209	4,209	4,209						
Provisions & other liab	793	903	1,779	1,779	1,779						
Total liabilities	1,130	1,655	7,106	9,255	9,559						
Shareholders' equity	3,676	5,331	8,215	8,705	10,181						
Minority interests	493	550	1,756	2,260	2,645						
Total equity	4,169	5,881	9,971	10,964	12,826						
Net debt	-389	88	3,623	6,110	6,432						
Net debt to equity (%)	-9.3	1.5	36.3	55.7	50.1						

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For definitions of the items in this table, please click [here](#).

Concept cracking, financial risks climbing

Despite the 30% share price drop YTD we continue to see downside risk to FQM. As detailed in our recent [Concept Cracking](#) note, the group's incremental capital intensity is rising as new capital is deployed at the top of the incentive curve, driving a structural dilution of ROIC. As a result, we believe the stock's premium valuation is becoming increasingly hard to justify.

Alongside the risk of valuation compression, investors also face a deteriorating earnings outlook driven by the group's sizeable exposure to nickel (c17% of revenue over 2013-15E). On the back of changes to our commodity price assumptions, we have taken down our EBITDA estimates for 2013-2015 by 15% on average. We are now 15% below consensus EPS in 2013 and 28% below in 2014. On our numbers, consensus expectations are pricing in copper at \$9,900/t in 2H 13.

Further to this the levered acquisition of Inmet has introduced a dimension of balance sheet risk that has historically been absent from the stock. With significant capex commitments from a base of already elevated gearing, the stock screens as one of the most financially high risk companies within our space.

The company does have some levers to pull, including the upcoming review of Cobre Panama. However, in our view, returns are unlikely to measure up to market expectations. Our analysis suggests at least a 17% IRR is required to drive a rerating of the shares from the current 30% discount to NPV. In turn, this would imply capex savings of at least \$1bn and a LT price of \$7,500/t.

On the back of changes to our commodity price forecasts, we have reduced our target price to £8.40 from £9.80.

Commodity prices drive 15% downgrades

We reduce our EBITDA estimates by c15% over the next 3 years

We are 23% below consensus EPS on average

The impact of our revised commodity price assumptions is summarised in Figure 1. On average we have reduced our EBITDA estimates by c15% over the next 3 years. At the EPS level, this effect has been offset, particularly in 2014 and 2015, by the change in our interest expense assumptions, whereby we now expect the group to capitalise the interest costs from capex-related debt. Even so we remain significantly below consensus, by 17% on average, despite market expectations coming down c10% over the past few weeks.

Figure 1. Summary of estimate changes and consensus (US\$/sh)

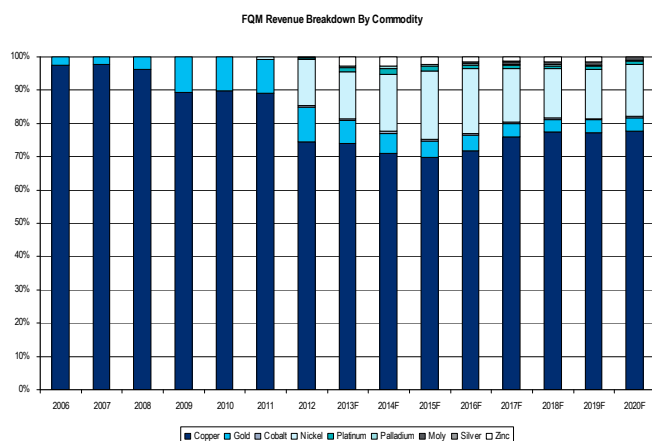
	2013	2014	2015
Citi EBITDA prior	1,557	1,836	2,681
Citi EBITDA new	1,289	1,453	2,437
% change	-17%	-21%	-9%
Citi EPS prior	0.96	0.84	1.62
Citi EPS new	0.91	0.92	1.75
% change	-5%	9%	9%
Consensus	1.07	1.28	1.90
Citi vs cons	-15%	-28%	-7%

Source: Citi Research

With the acquisition of Ravensthorpe and Kevista the group's revenue exposure to copper is set to reduce from 90% in 2011 to 70% in 2015. This trend is only likely to reverse with the ramping up of Cobre Panama eventually taking FQM to c80% copper exposure by 2020E (Figure 2).

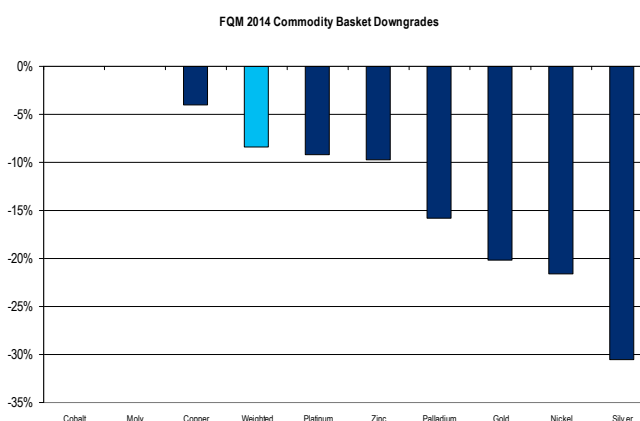
While we only marginally trim our copper outlook, the key earnings delta to our forecasts comes from the scaling back of our above-consensus bullish call on nickel. As detailed in our [latest commodity outlook](#), we have cut our nickel forecasts by 18% over the next 3 years.

Figure 2. Copper is set to fall to 70% of revenue by 2015E



Source: Company data, Citi Research estimates

Figure 3. Price basket as a result falls by 2x the change in copper alone

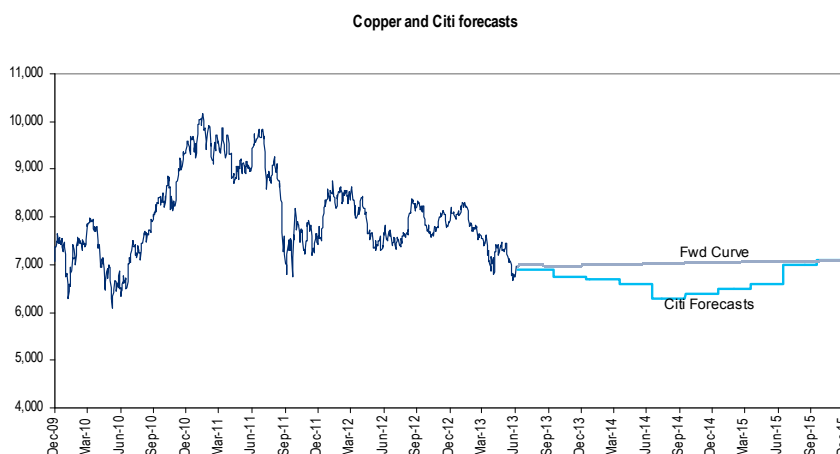


Source: Citi Research estimates

The main driver of our below-consensus numbers remains our bearish view on copper

The main driver of our below-consensus FQM estimates, particularly in 2014, remains our cautious outlook for copper, which we now expect to trough at \$6,300/t (from \$6,500/t) in Sep quarter 14. This compares with the forward curve which remains in a mild contango, implying the price will stay broadly around \$7,000/t out to 2015.

Figure 4. Copper continues to remain in a mild contango



Source: Bloomberg, Citi Research

We also appear more cautious on volumes, which makes up the rest of the top line delta to consensus.

Figure 5. Citi vs. consensus copper price forecasts

		2013	2014	2015
Copper price	Citi	7,205	6,500	6,800
	Cons	7,284	7,007	7,073
	% diff	-1%	-7%	-4%
Implied cu eq	Citi	509	629	854
	Cons	536	665	878
	% diff	-5%	-5%	-3%

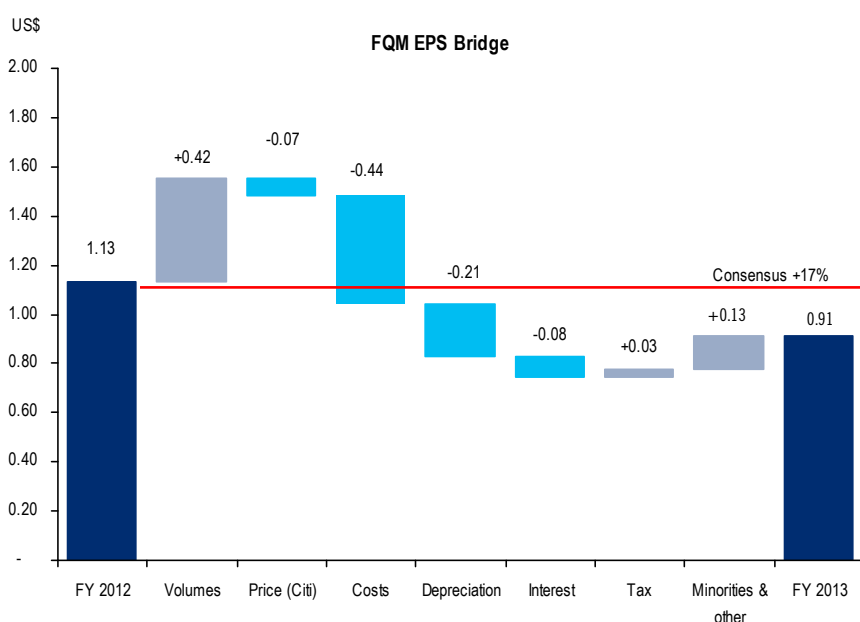
Source: Bloomberg, Citi Research

Consensus EPS imply a copper-equivalent price of \$9,900/t in 2H13

We have broken out the EPS bridge for our 2013 estimates in Figure 6. On a per share basis, adjusting for the 18% acquisition issuance dilution, we expect the increase in the total cost base to essentially offset the group's volume growth.

Consensus estimates suggest that not all these impacts may be factored in. As a result, on our calculations consensus EPS are implying a copper-equivalent price of \$8,740/t average for 2013 or an implied \$9,900/t in 2H13.

Figure 6. Consensus implies a copper-equivalent price of \$9,900/t for 2H13



Source: Company data, Bloomberg, Citi Research estimates

Balance sheet vulnerable in troubled markets

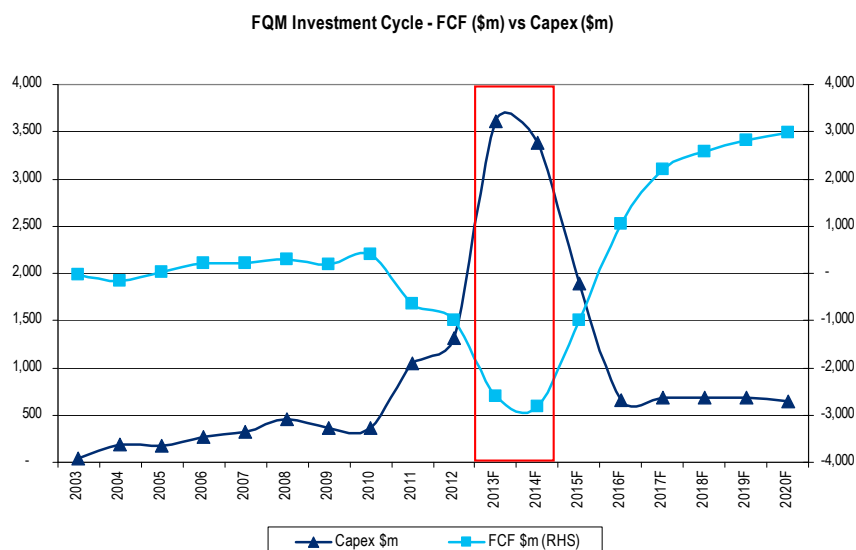
In acquiring Inmet FQM in effect committed c\$9bn of capital (\$5bn acquisition plus 80% of remaining capex post Silver Wheaton deal), or 90% of the pre deal market cap, at a time when commodity markets appear to be weakening.

The group faces cumulative capex over the next 3 years of \$6.8bn or 80% of market cap

On top of this the group is also in a crucial build-out phase of its Zambian capacity including the flagship Sentinel project and Kansanshi smelter. In total, this adds up to a cumulative capex spend of c\$6.8bn over the next 3 years or 80% of current market cap.

As a result investors in FQM are exposing themselves to the peak in the capex vs. FCF cycle, bearing all the risks of project execution but none of the cash flow upside.

Figure 7. Investors are exposed to the peak in the capex vs FCF cycle

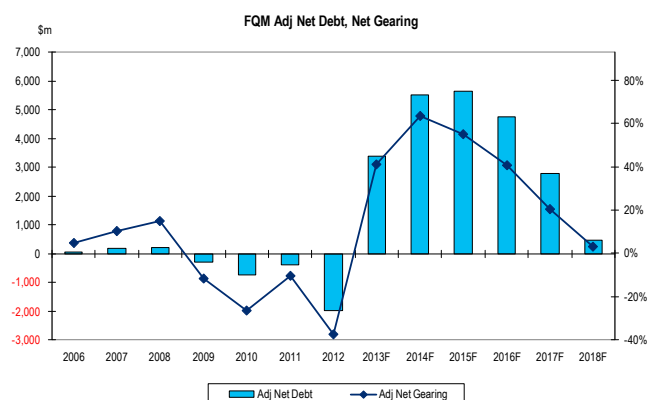


Source: Company data, Citi Research estimates

Being highly levered into a downturn in copper is a vulnerable position

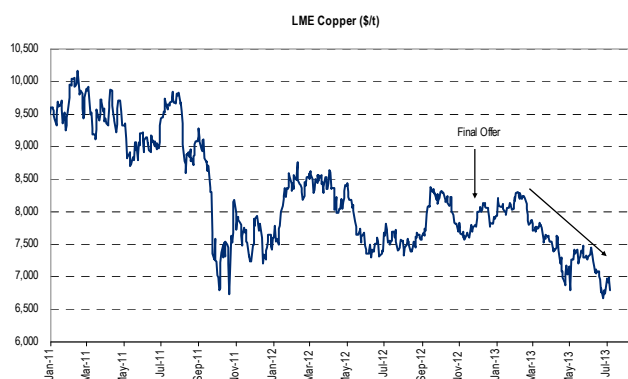
Regardless of whether or not savings are made at Cobre Panama (not our base case), this appears to us to be a vulnerable position given the increasing volatility in the copper market.

Figure 8. FQM's leverage jumped and is set to peak in 2014E at c75%...



Source: Company data, Citi Research estimates

Figure 9. ...to finance an acquisition as the copper cycle rolls over

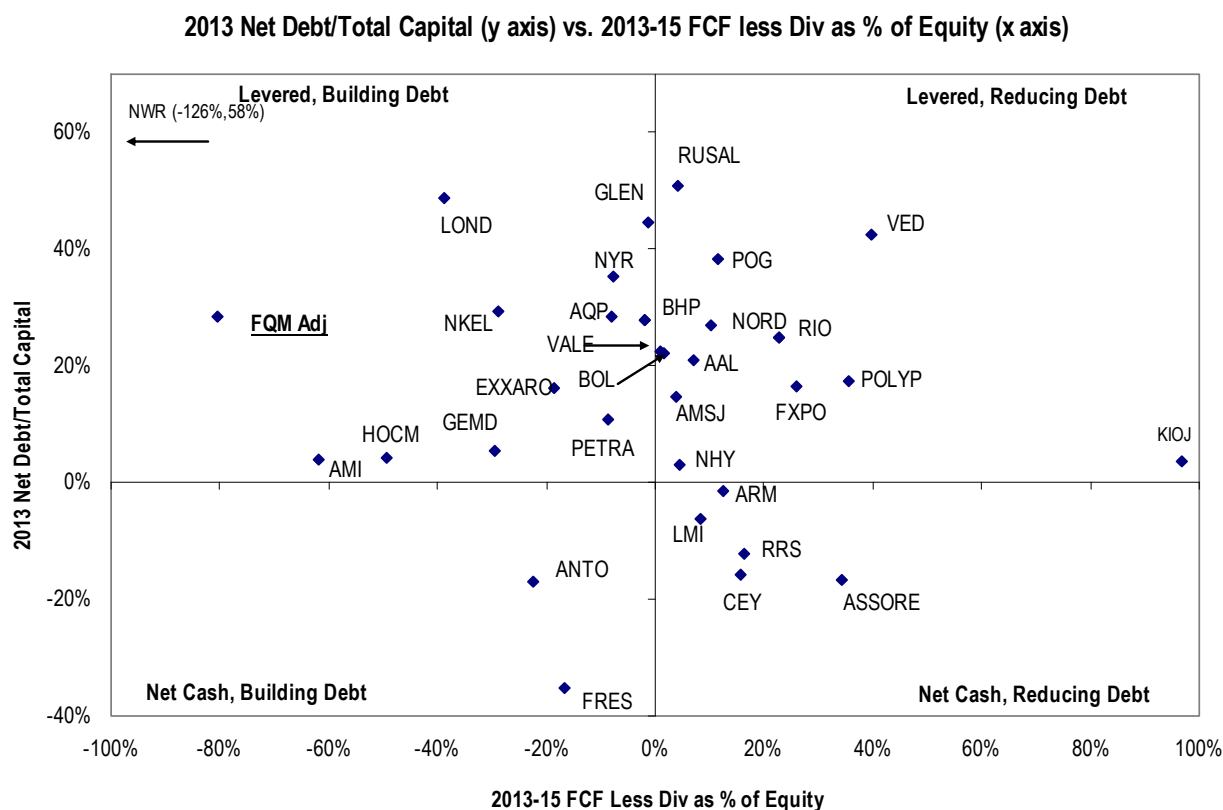


Source: Citi Research, Datastream

FQM is one of the most financially high risk companies in our space

Indeed, as Figure 10 highlights, the stock screens as one of the most financially high risk companies within our European coverage. We see significant negative FCF over the next 3 years from a starting point of elevated gearing.

Figure 10. FQM is constrained from reducing leverage by the build-out of key growth projects



Source: Citi Research estimates

To drive net gearing below 50% by 2015E would need copper prices 30% above our forecasts across the curve or savings of \$2bn at Cobre Panama.

Figure 11. Sensitivity of 2015 adj net gearing to % deviations in the copper price vs. Citi base case and capex savings on Cobre Panama

	70%	75%	80%	85%	90%	95%	100%	105%	110%	115%	120%	125%	130%
\$0m	84%	80%	76%	73%	69%	66%	63%	60%	57%	55%	52%	50%	47%
\$500m	79%	76%	72%	69%	65%	62%	59%	56%	54%	51%	48%	46%	44%
\$1,000m	75%	71%	68%	64%	61%	58%	55%	52%	50%	47%	45%	42%	40%
\$1,500m	70%	67%	63%	60%	57%	54%	51%	48%	46%	43%	41%	39%	37%
\$2,000m	65%	62%	59%	56%	53%	50%	47%	45%	42%	40%	37%	35%	33%

Source: Citi Research estimates

\$2.5bn refinancing needed by March 2014

The reversal of sentiment towards EM equities could make refinancing more expensive/difficult

While the premise of leveraging up to acquire Inmet may have appeared sensible within the context of increasing risk appetite and historically low yields at the beginning of the year, market conditions have since deteriorated. Prompted by the realisation of imminent Fed tapering and the 'cash crunch' in China sentiment has turned, both within credit and generally towards EM-exposed equities. In our view, this could potentially make the required refinancing of FQM's acquisition debt more problematic/costly.

The \$2.5bn bridging facility, taken out with Standard Bank to fund the cash portion of the Inmet acquisition, was repaid on June 4th through the sell-down of the pool of

c\$2bn of government bonds on Inmet's balance sheet. However, it has been replaced by an RCF, again for \$2.5bn with Standard Bank, which currently remains undrawn, pending the current review of Cobre Panama.

Figure 12. FQM debt facility and balance sheet values at 1Q13

		Facility	Q1 13 BS Value
Drawn			
FQM (Akubra) 2020 8.75%	\$m	1,500	1,663
FQM Akubra 2021 7.5%	\$m	500	541
FQM 2019 7.25%	\$m	350	340
FQM (Akubra) Acq Facility 2014	\$m	2,500	2,117
Inventory financing	\$m	110	26
Other	\$m		18
Total Drawn Debt	\$m	4,960	4,705
Undrawn			
	\$m		
Kevitsa facility	\$m	250	
Kansanshi	\$m	1,000	
Total Undrawn Debt	\$m	1,250	
Cash	\$m	1,778	1,778
Headline net debt	\$m		2,927
Treasuries and gov bonds	\$m	2,053	2,053
Cash and Eq	\$m	3,831	3,831
Adj Net Debt	\$m		874

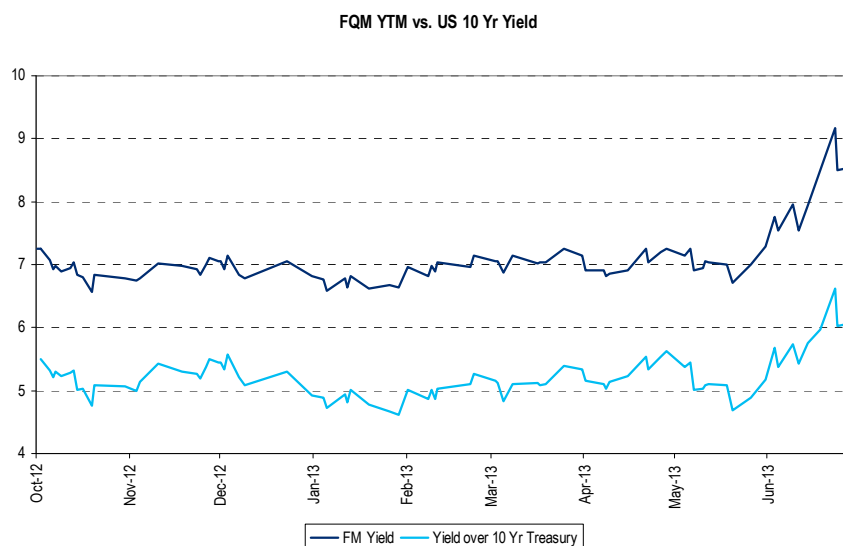
Source: Company data, Citi Research

Of the \$2.5bn RCF, a minimum of \$1bn or 50% is due for repayment by end-2013

The terms of the RCF remain similar to the bridging facility; a minimum of 50% of the balance or \$1bn is due by end-2013 with the remainder by March 2014. As we would expect the facility to be fully drawn by the end of the year to finance the company's capex program, FQM is likely to need to refinance a large portion of the \$2.5bn in the markets in the next 6 months, in our view, to avoid approaching too close to the expiry of the facility.

With yields on FQM's outstanding \$350m bond up 1-2% since the beginning of June, 1% over the increase in Treasuries, the cost of this refinancing appears to be rising. A 1% rise in the cost of borrowing would reduce our EPS estimates by c0.8%.

Figure 13. Yields on the outstanding \$350m bond have spiked ahead



Source: Bloomberg, Citi Research

Citi downgraded China's GDP growth to 7.1% in 2014E

The longer the refinancing is left, the greater the risk that the outlook for EM deteriorates further, making any new issuance more difficult. On July 8th, for example, our China economists downgraded 2014E GDP growth to 7.1% with the expectation that the economy will trough at 6.8% YoY in 1Q14 ([Link to Note](#))

Agency downgrade potential

Given the financial position of the group there is an increasing risk, in our view, that we may see downgrades by the ratings agencies. As the below table highlights, two of the three agencies have the group on negative watch, while S&P recently downgraded the financial risk to 'aggressive'.

Figure 14. Rating agency FQM summary

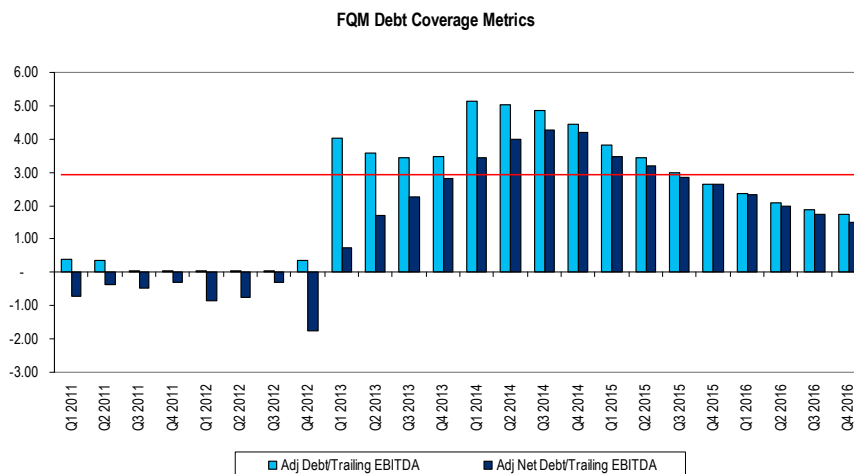
Agency	Rating	Outlook	Comments
Fitch	BB	Rating watch negative	Placed on RWN following the Inmet acquisition and concerns "about the refinancing of the acquisition debt...and timing and amount of capex".
Moody's	Ba3	Negative	The negative rating outlook reflects a combination of higher leverage and weaker liquidity for the combined company while it remains exposed to volatile commodity prices and uncertainties in the global economy.
S&P	B+	Stable, financial risk Aggressive	The stable outlook reflects the expectation that FQM will convert its RCF into new long-term funding while the financial risk profile has weakened due to the 50% debt funded acquisition and higher negative FOCF over the next 3 years

Source: Citi Research

EBITDA coverage ratios do not appear adequate to prevent an agency downgrade

While Moody's believes the liquidity profile of the group is "adequate to cover the large cash outflows expected over the next 18-24 months" the rating on the stock could be downgraded if there is a deterioration in credit metrics including "debt/EBITDA in excess of 3x on a sustained basis". As the below chart highlights, we see even net debt/EBITDA over 3x for a period of at least a year.

Figure 15. FQM appears likely to breach coverage ratios for a sustained period



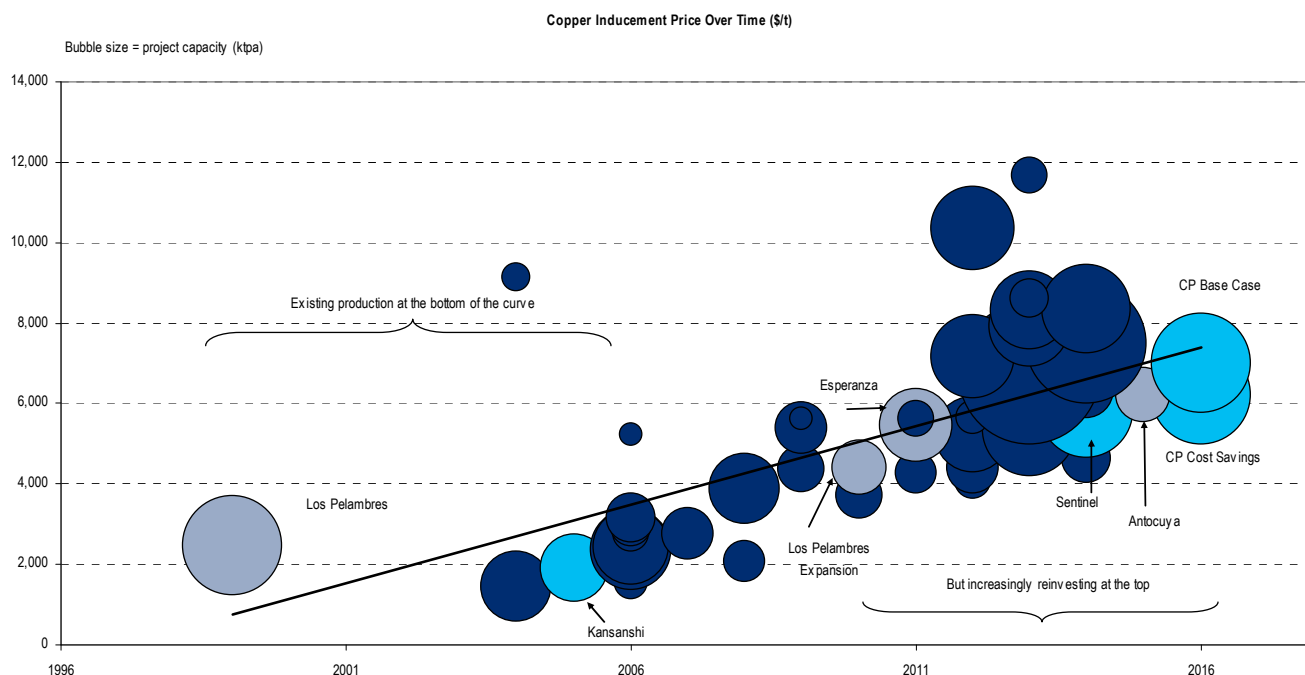
Source: Company reports, Citi Research estimates (from 2Q13 onwards)

While there may be not be any immediate financial impact, any downgrade is likely to make refinancing more costly. As a result, the potential for divestments to boost the cash profile of the group is now a real possibility, in our view.

Required returns at Cobre Panama 17%+ implying \$1bn savings plus \$7,500/t LT copper

As highlighted in our note from 27th June, [Copper Equities: concept cracking](#), one of the key challenges facing copper producers and particularly FQM and ANTO is the fact that new capital is being deployed much higher up the incentive price curve than the existing assets.

Figure 16. Whereas FQM's legacy assets are at the bottom of the incentive price curve, new growth is much higher implying lower returns



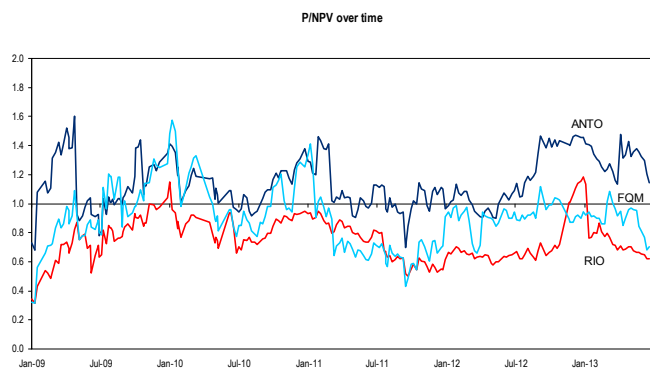
Source: Wood Mackenzie, Citi Research

The copper price required to generate a 15% IRR on Cobre Panama is 3x higher than that for Kansanshi. Given our view that prices are set to remain capped this suggests that returns may be structurally in decline.

A 17% IRR at Cobre Panama is needed to drive a rerating. Citi Base Case 12.6%.

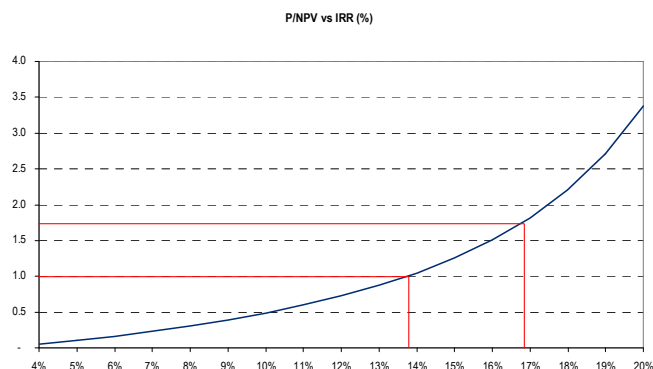
However, 15% is arguably not a high enough hurdle rate for value generation at Cobre Panama. With FQM currently trading at a c30% discount to NPV (Figure 17), on our estimates, the market appears to be running a 14% WACC rather than the 12% used by Citi (Figure 18). As a result, to generate 3% EVA, the average over the cycle for the sector, suggests FQM needs at least a 17% IRR on the project to drive a rerating of the stock.

Figure 17. FQM trades at c30% discount to NPV



Source: Citi Research estimates

Figure 18. Implying a market WACC of 14% and 17% for a rerating



Source: Citi Research estimates

As highlighted in the table below a 17% IRR requires some stretched assumptions, in our view, on capex and/or the long-term copper price.

Using Citi's real long-term copper price of \$6,200/t and headline capex we get an IRR of 12.6%. Note we assume a debt weighting of 60% for the project in this model and that c50% of the acquisition cost of Inmet is attributable to Cobre Panama as a form of pre-commitment capex.

Arguably, 17% is too low, given the additional risks associated with developing Cobre Panama

Arguably, if the WACC for the existing assets is 17% Cobre Panama should require an even higher hurdle rate, given the challenges of greenfield development in a location with little history of mining.

Figure 19. Cobre Panama IRR scenarios (Row = Real copper price \$/t, Col = Capex \$m)

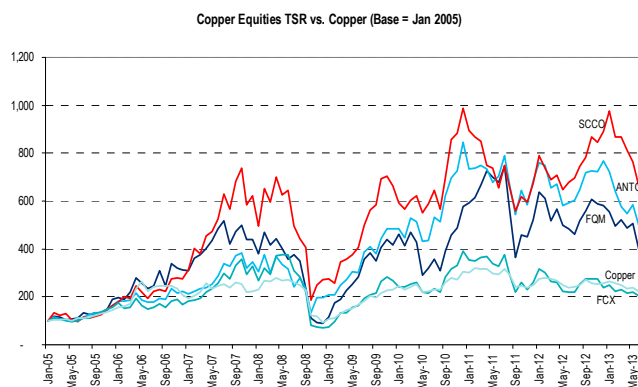
	\$5,500	\$6,000	\$6,200	\$6,500	\$7,000	\$7,500
\$4,000m	15.1%	16.7%	17.2%	18.1%	19.5%	20.7%
\$4,500m	13.9%	15.4%	16.0%	16.8%	18.1%	19.4%
\$5,000m	12.8%	14.3%	14.9%	15.7%	17.0%	18.2%
\$5,500m	11.9%	13.3%	13.9%	14.7%	15.9%	17.1%
\$6,000m	11.0%	12.4%	13.0%	13.8%	15.0%	16.1%
\$6,200m	10.7%	12.1%	12.6%	13.4%	14.6%	15.8%

Source: Citi Research estimates

Cracking concepts

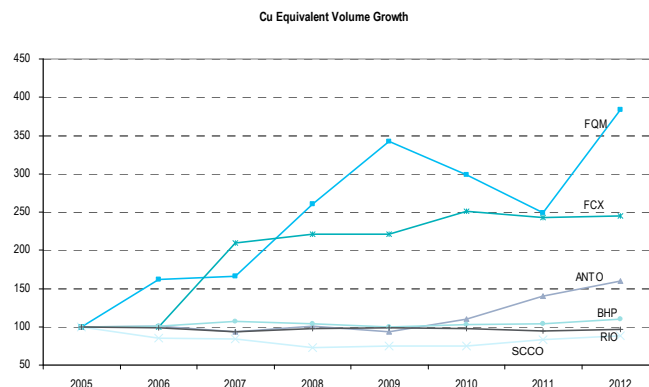
In addition to Figure 16, below is a selection of key charts from our recent [Copper Equities: concept cracking](#) note.

Figure 20. FQM and other names significantly outperformed copper during the super cycle



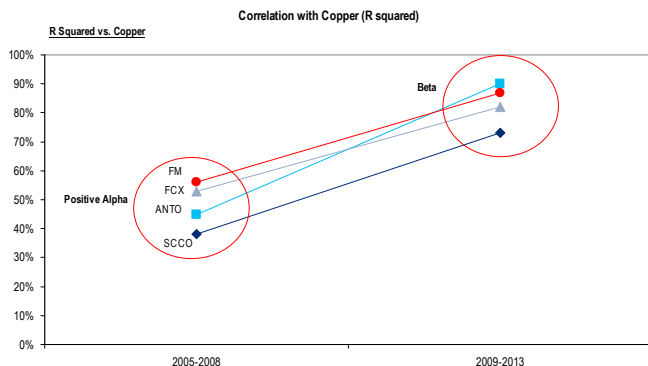
Source: Datastream, Citi Research

Figure 21. Driven by a combination of cost curve positioning and, in the case of FQM, aggressive volume growth



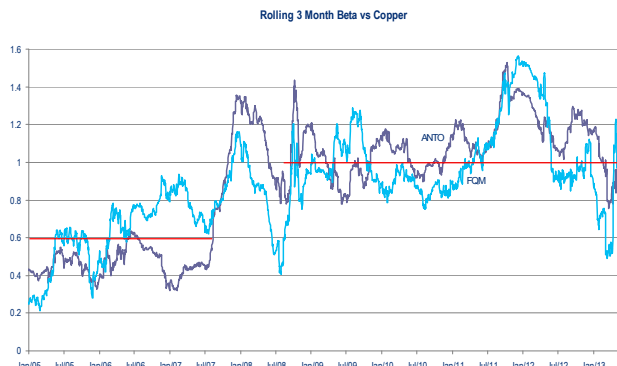
Source: Company Research, Wood Mackenzie, Citi Research

Figure 22. However, since 2009 outperformance has given way to increasing correlation with copper with R² on average up to 83%



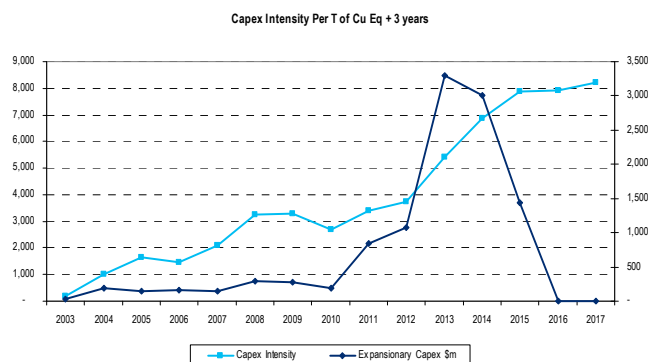
Source: Datastream, Citi Research

Figure 23. While the rolling beta has also moved towards 1 from c0.6 pre crisis



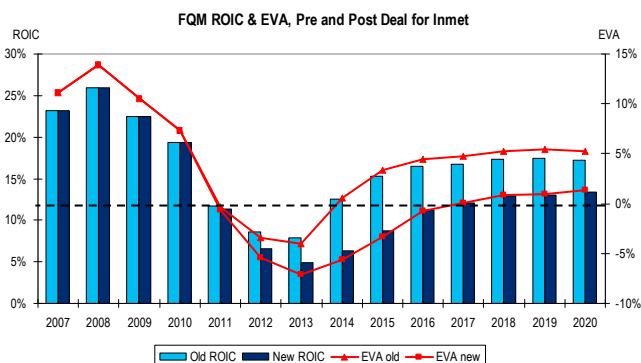
Source: Bloomberg, Citi Research

Figure 24. Alpha is unlikely to return: FQM's concept of low cost growth is cracking as capex intensity rises...



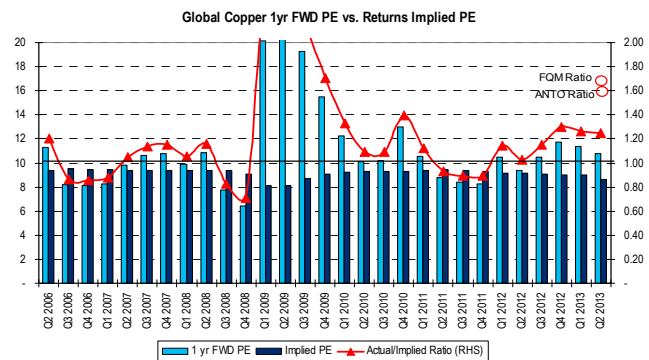
Source: Company Reports, Citi Research estimates (from 2013)

Figure 25. Driving a 4pps drop in forecast ROIC and a negative EVA out to 2017E



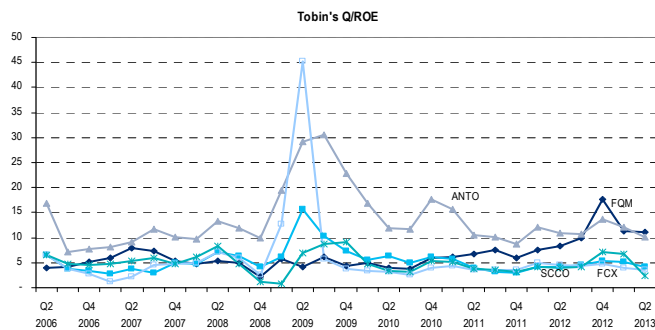
Source: Company Reports, Citi Research estimates (from 2013)

Figure 26. Despite declining return expectations valuations remain stretched with FQM at a 70% premium to its implied PE



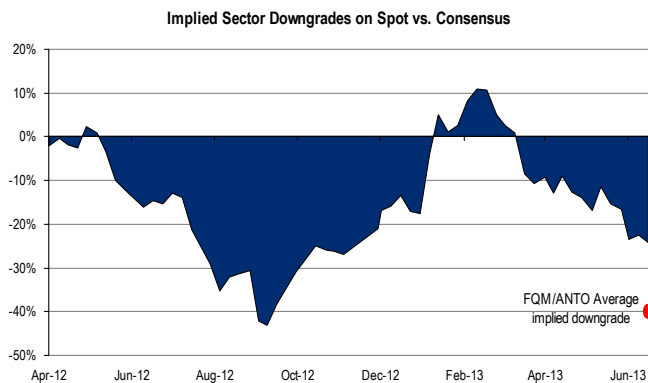
Source: Datastream, Citi Research

Figure 27. While the stock trades on 2x its historical value of replacement cost relative to returns



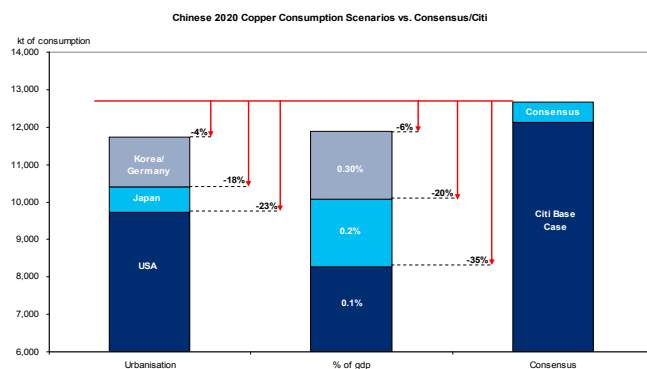
Source: Wood Mackenzie, Citi Research

Figure 28. Substantial downgrades remain suggesting investors are not yet buying trough earnings



Source: Bloomberg, Citi Research

Figure 29. Our top down analysis on China suggests demand could be 4-35% below consensus in 2020 with 18-20% the most likely shortfall



Source: Citi Research

Prices/ratings for stocks mentioned: United Company Rusal (0486.HK; HK\$3.00; 3); Anglo American PLC (AAL.L; £13.37; 2); African Minerals Ltd (AMlq.L; £1.99; 1H); Anglo American Platinum Ltd (AMSJ.J; R285.00; 1); Antofagasta (ANTO.L; £8.54; 3); Aquarius Platinum Ltd (AQPL; £0.42; 1); African Rainbow Minerals (ARIJ.J; R151.35; 1); Assore Limited (ASRJ.J; R340.99; 3); BHP Billiton PLC (BLT.L; £18.00; 2); Boliden AB (BOL.ST; SKr87.65; 3); Centamin Egypt Limited (CEY.L; £0.38; 2); Exxaro Resources Limited (EXXJ.J; R148.02; 2); Freeport-McMoRan Copper & Gold Inc. (FCX.N; US\$28.53; 3); Fresnillo Plc (FRES.L; £10.18; 2); Ferrexpo PLC (FXPO.L; £1.57; 1); Gem Diamonds (GEMD.L; £1.30; 1); Glencore Xstrata PLC (GLEN.L; £2.66; 1); Hochschild Mining Plc (HOCM.L; £1.55; 3); Kumba Iron Ore Ltd (KIOJ.J; R460.00; 2); Lonmin PLC (LMI.L; £2.88; 1); London Mining (LOND.L; £0.93; 1); Norsk Hydro ASA (NHY.OL; NKr25.31; 3); Norilsk Nickel (NKElyq.L; US\$14.34; 2); Nordgold (NORDNq.L; US\$1.80; 3); New World Resources (NWRR.L; £0.71; 3H); Nyrstar NV (NYR.BR; €3.40; 3); Petra Diamonds (PDL.L; £1.19; 1); Petropavlovsk PLC (POGL; £0.77; 3); Polymetal (POLYP.L; £5.19; 2); Rio Tinto PLC (RIO.L; £28.34; 1); Randgold Resources Ltd (RRS.L; £44.02; 2); Southern Copper Company (SCCO.N; US\$27.81; 2); Vale (VALE.N; US\$13.56; 1); Vedanta Resources Plc (VED.L; £11.06; 2)

First Quantum Minerals Ltd

Company description

First Quantum (FQM.L) is listed on the Canadian and London exchanges, and is a copper, nickel and gold producer. FQM produces ~300ktpa of copper and 200koz of gold, making it one of the world's top 20 producers.

We expect FQM to nearly treble its copper equivalent production by 2014 as the company commissions nearly one project every year from 2012.

Investment strategy

We rate FQM Sell. The company offers the best copper equivalent volume growth in our UK mining coverage, on our estimates. However, it is moving into a project execution phase, and a recent change in the government in Zambia creates policy uncertainty.

Furthermore, we expect the acquisition of Inmet to result in ROIC falling 4pps, loss of the stock's material M&A premium (given it is now less likely to be a target) and higher risks for investors from a new capex cycle.

Valuation

We value FQM using DCF, free cash flow and multiples. Our DCF inputs for FQM are a risk-free rate of 4%, a risk premium of 4.0% and a terminal growth rate of 3%. Our multiples-based valuation uses a 6x EBITDA multiple for GM, Kevitsa, Kansanshi and Sentinel. We set our price target of £8.4 as a blend of the three methods.

Risks

Key risks for the company include an uncertain tax regime in Zambia where it operates one large copper mine and has its biggest project, and also its ability to successfully execute the Sentinel, Ravensthorpe and Enterprise projects. With the acquisition of Inmet it will be constructing a project in Panama, which has little history of mining and where the company has never before operated. If the impact of these risk factors is greater/less than we currently anticipate, then the share price could miss/exceed our target price.

Appendix A-1

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First Quantum Minerals Ltd (FQM.L)

Ratings and Target Price History Fundamental Research

Analyst: Michael E Flitton

Covered since May 23 2012



Date	Rating	Target Price	Closing Price
1 8-Dec-10	*1M	*16.00	13.16
2 31-Jan-11	1M	*18.20	14.54
3 17-Mar-11	1M	*20.00	15.12
4 12-Aug-11	1M	*19.00	14.65
5 5-Sep-11	*2M	*17.00	14.00
6 28-Sep-11	*1H	*14.00	10.09
7 7-Oct-11	Stock rating system changed		

* Indicates change

Date	Rating	Target Price	Closing Price
8 7-Oct-11	*1	14.00	10.49
9 10-Nov-11	*2	*13.00	11.36
10 9-Jan-12	2	*14.40	13.74
11 30-Jan-12	2	*14.00	13.80
12 13-Mar-12	2	*13.60	13.60
13 16-Apr-12	2	*13.70	12.91
14 4-May-12	2	*13.50	11.74

Date	Rating	Target Price	Closing Price
15 16-Jul-12	2	*12.50	11.39
16 5-Aug-12	2	*12.80	12.25
17 9-Jan-13	*3	*11.00	13.24
18 15-Apr-13	3	*10.00	10.48
19 9-May-13	3	*9.20	11.88
20 30-May-13	3	*9.80	12.13

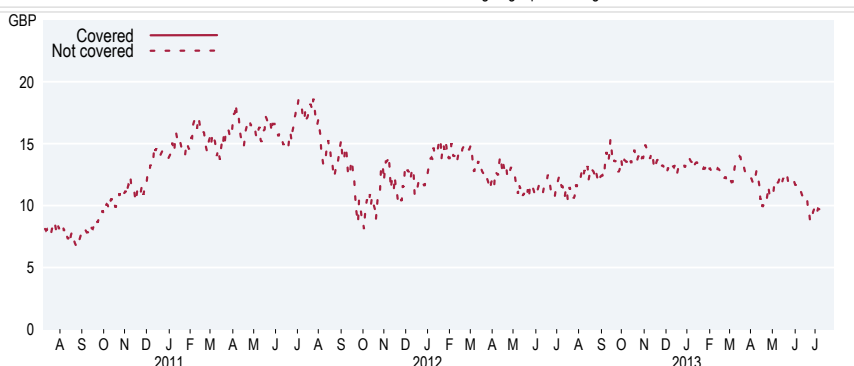
Rating/target price changes above reflect Eastern Standard Time

First Quantum Minerals Ltd (FQM.L)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Michael E Flitton

Covered since May 23 2012



* Indicates change

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