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Diversified Metals & Mining (GICS) | Metals & Mining (Citi)  
CEEMEA | South Africa

# Anglo American (AGLJ.J)

## Cheap for two Reasons – Maintain Neutral

- **Cheap on deep value metrics** — Anglo is now trading at price to book of only 1x a 47% discount to its long-term average of 1.9x, and just about the lowest it's been since 1965. On a cyclically adjusted PE multiple basis (price divided by 10-year earnings), it is trading on a multiple of 10x, a 29% discount to its historic average of 14x.
- **Rump seems cheap, but not at spot prices** — Anglo's rump excluding Kumba and Angloplat is trading on a relatively attractive FY13 PE of only 8.6x. However, using spot commodity prices to calculate rump earnings results in a demanding FY13 rump PE of 16x (Figure 5), which is significantly more expensive than mining peers' spot PE of 12.9x, and in line with Anglo's own spot PE of 16.2x.
- **Cheap for two reasons** — Anglo's return on equity fell to 8.3% in 1H12, its worst return since the great depression. We believe Anglo's low ROE is only partly explained by depressed commodity prices, and relates mostly to significant value destruction through **poor capital allocation** and **operational disappointments**.
- **Capital allocation possibly overstates book** — We calculate that Anglo destroyed around \$17bn or 40% of current market cap through poor capital allocation since 2006. We believe Minas Rio's book value of around \$10bn has little economic value. We value future cash flows from Minas Rio at only \$463m (operating cash flows less remaining capex). We therefore believe Anglo American's reported equity value (or book value) of \$41bn is overstated by 32%, which partly explains the "cheap" price to book, in our view.
- **Operational disappointments** — Continued disappointments at Minas Rio (commissioning now pushed out to 2014 and capex remain open ended), falling copper volumes at Collahuasi, ramp up difficulties at Los Bronces copper, cost pressure at met coal operations and Anglo Platinum's margin pressure seems to be eroding group profitability and weigh on shareholder confidence.
- **Neutral maintained** — Anglo's target price of R280 is at a 10% discount to DCF fair value. Given Anglo's track record we cannot rule out further value destruction.

### Anglo American (USD)

Year to 31 Dec	2010A	2011A	2012E	2013E	2014E
Sales (\$M)	27,960.0	30,580.0	27,266.5	37,813.9	40,050.9
Profit Before Tax (\$M)	10,928.0	10,782.0	5,615.3	8,268.0	9,053.7
Diluted EPS (\$)	3.96	4.85	2.21	2.87	3.27
Diluted EPS (Old) (\$)	3.96	4.85	2.21	2.87	3.27
PE (x)	7.6	6.2	13.6	10.5	9.2
EV/EBITDA (x)	4.6	3.7	5.7	4.4	4.0
DPS (\$)	0.65	0.74	0.82	0.95	1.10
Net Div Yield (%)	2.2	2.5	2.7	3.2	3.7

### Company Update

<b>Neutral</b>	<b>2</b>
Price (23 Oct 12)	R260.00
Target price	R280.00
Expected share price return	7.7%
Expected dividend yield	2.7%
<b>Expected total return</b>	<b>10.4%</b>
Market Cap	R361,601M
	US\$41,849M

### Price Performance (RIC: AGLJ.J, BB: AGL SJ)



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

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AGLJ.J: Fiscal year end 31-Dec						Price: R260.00; TP: R280.00; Market Cap: R361,601m; Recomm: Neutral					
Profit & Loss (US\$m)	2010	2011	2012E	2013E	2014E	Valuation ratios	2010	2011	2012E	2013E	2014E
Sales revenue	27,960	30,580	27,267	37,814	40,051	PE (x)	7.6	6.2	13.6	10.5	9.2
Cost of sales	-19,452	-20,912	-21,517	-29,322	-30,851	PB (x)	1.1	0.9	0.9	0.9	0.8
Gross profit	8,508	9,668	5,750	8,492	9,200	EV/EBITDA (x)	4.6	3.7	5.7	4.4	4.0
Gross Margin (%)	30.4	31.6	21.1	22.5	23.0	FCF yield (%)	15.5	10.0	2.6	8.8	15.4
EBITDA (Adj)	10,450	11,655	7,935	11,427	12,275	Dividend yield (%)	2.2	2.5	2.7	3.2	3.7
EBITDA Margin (Adj) (%)	37.4	38.1	29.1	30.2	30.6	Payout ratio (%)	16	15	37	33	34
Depreciation	-1,942	-1,987	-2,185	-2,935	-3,075	ROE (%)	21.7	16.8	5.8	8.6	9.2
Amortisation	0	0	0	0	0	Cashflow (US\$m)	2010	2011	2012E	2013E	2014E
EBIT (Adj)	8,508	9,668	5,750	8,492	9,200	EBITDA	10,450	11,655	7,935	11,427	12,275
EBIT Margin (Adj) (%)	30.4	31.6	21.1	22.5	23.0	Working capital	-98	102	-1,490	-525	583
Net interest	-139	183	-96	-300	-215	Other	44	-2,532	-570	-2,380	-2,890
Associates	822	977	413	76	69	Operating cashflow	10,396	9,225	5,874	8,523	9,968
Non-op/Except	1,737	-46	-452	0	0	Capex	-5,092	-5,859	-5,491	-5,658	-4,619
Pre-tax profit	10,928	10,782	5,615	8,268	9,054	Net acq/disposals	0	0	-7,448	0	0
Tax	-2,809	-2,860	-1,820	-2,621	-2,875	Other	-193	1,090	33	196	337
Extraord./Min.Int./Pref.div.	-1,575	-1,753	-1,447	-1,989	-2,001	Investing cashflow	-5,285	-4,770	-12,906	-5,462	-4,282
Reported net profit	6,544	6,169	2,349	3,658	4,177	Dividends paid	-302	-818	-968	-1,114	-1,293
Net Margin (%)	23.4	20.2	8.6	9.7	10.4	Financing cashflow	-1,979	876	-1,861	1,800	-8,609
Core NPAT	4,976	6,120	2,794	3,658	4,177	Net change in cash	3,132	5,331	-8,893	4,861	-2,923
Per share data	2010	2011	2012E	2013E	2014E	FCF ex acquisns & explorn	5,304	3,365	-7,065	2,865	5,349
Reported EPS (\$)	5.18	4.89	1.87	2.87	3.27	Segmental Revenue (US\$m)	2010	2011	2012E	2013E	2014E
Core EPS (\$)	3.96	4.85	2.21	2.87	3.27	Platinum	6,602	7,359	5,303	7,030	7,967
DPS (\$)	0.65	0.74	0.82	0.95	1.10	Diamonds	2,644	3,320	3,204	8,021	8,279
CFPS (\$)	8.19	7.28	4.62	6.66	7.79	Copper (prev. base metals)	4,877	5,144	5,050	6,041	6,258
FCFPS (\$)	4.65	3.00	0.77	2.64	4.63	Nickel	426	488	593	856	991
BVPS (\$)	28.37	32.31	32.28	34.27	36.52	Iron ore and manganese	6,612	8,124	6,965	7,403	7,358
Wtd avg ord shares (m)	1,206	1,210	1,255	1,280	1,280	Metallurgical Coal (Australia)	3,522	4,347	3,820	3,859	4,110
Wtd avg diluted shares (m)	1,281	1,282	1,283	1,282	1,282	Thermal Coal (South Africa)	2,866	3,722	3,382	3,292	3,657
Growth rates	2010	2011	2012E	2013E	2014E	Other mining and industrial	2,999	1,692	1,600	736	764
Sales revenue (%)	34.0	9.4	-10.8	38.7	5.9	Industrial minerals	2,376	2,347	2,562	2,829	2,961
EBIT (Adj) (%)	94.2	13.6	-40.5	47.7	8.3	Corporate activities	5	5	3	0	0
Core NPAT (%)	93.7	23.0	-54.4	30.9	14.2	Less: Equity accounted	-4,969	-5,968	-5,214	-2,252	-2,293
Core EPS (%)	88.7	22.6	-54.4	29.5	14.1	Sales - total segments	27,960	30,580	27,267	37,814	40,051
Balance Sheet (US\$m)	2010	2011	2012E	2013E	2014E	Segmental EBIT (US\$m)	2010	2011	2012E	2013E	2014E
Cash & cash equiv.	6,778	11,904	2,839	7,700	4,776	Platinum	837	890	-51	674	1,182
Accounts receivables	4,052	4,111	4,467	6,397	6,716	Diamonds	495	659	510	1,127	1,065
Inventory	3,604	3,517	4,095	4,447	3,906	Copper	2,817	2,461	1,942	2,588	2,520
Net fixed & other tangibles	41,086	41,577	51,184	53,633	54,888	Nickel	96	57	146	286	385
Goodwill & intangibles	2,316	2,322	2,282	2,327	2,374	FM&I	3,681	4,520	3,125	3,174	2,871
Financial & other assets	8,820	9,011	8,567	8,736	8,909	Metallurgical Coal	780	1,189	181	217	437
Total assets	66,656	72,442	73,435	83,240	81,569	Thermal Coal	710	1,230	716	723	949
Accounts payable	4,950	5,098	4,915	6,670	7,031	Other mining & industrial	616	230	188	163	155
Short-term debt	1,535	1,018	3,000	3,000	3,000	Industrial minerals	48	-35	17	189	261
Long-term debt	11,904	11,855	8,291	13,415	8,201	Exploration	-136	-121	-142	-140	-140
Provisions & other liab	10,296	11,282	10,480	10,908	11,140	Corporate	-181	15	-195	-140	-140
Total liabilities	28,685	29,253	26,685	33,993	29,373	Less: Equity accounted	-1,255	-1,427	-687	-369	-345
Shareholders' equity	34,239	39,092	41,322	43,866	46,750	EBIT - total segments	8,508	9,668	5,750	8,492	9,200
Minority interests	3,732	4,097	5,429	5,381	5,446						
Total equity	37,971	43,189	46,750	49,247	52,197						
Net debt	6,661	969	8,451	8,715	6,424						
Net debt to equity (%)	17.5	2.2	18.1	17.7	12.3						

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

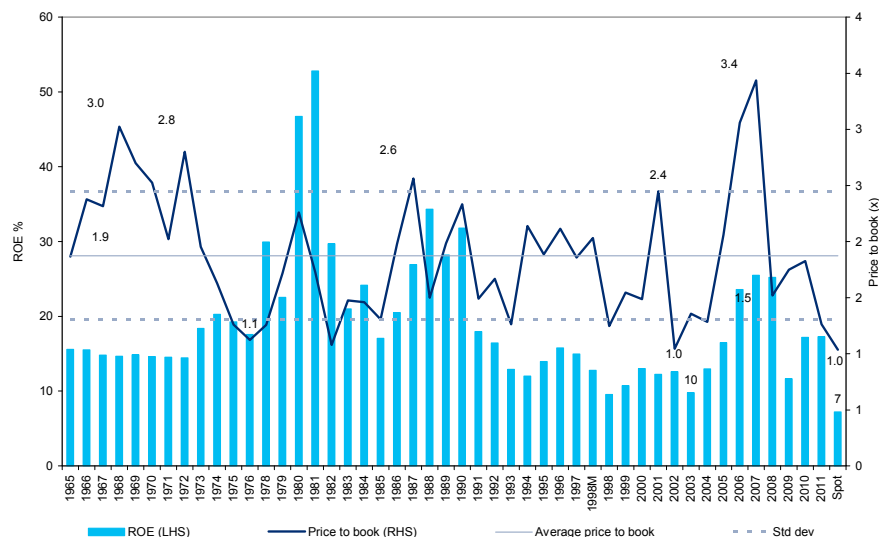
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## Cheap on deep value metrics

Anglo is now trading at price to book of only 1x, a 47% discount to its long-term average of 1.9x.

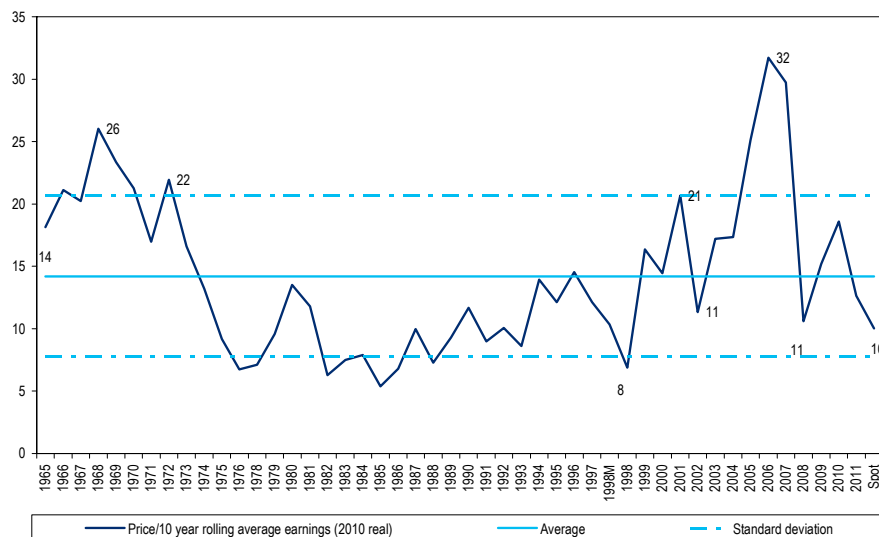
Figure 1. Anglo American's price to book and ROE history



Source: Company Reports and Citi Research Estimates

On a cyclically adjusted PE multiple basis (price divided by 10-year earnings), it is trading on a multiple of 10x, a 29% discount to its historic average of 14 (Figure 2).

Figure 2. Anglo's cyclically adjusted PE multiple over time\*



\* Price dividend by average 10 year real earnings

Source: Company Reports and Citi Research Estimates

## Anglo's rump seems fairly cheap

Anglo American's interest in listed South African companies is worth around US\$30.5bn, which is roughly 57% of its market capitalisation. If we use market values for Anglo's interests in listed subsidiaries (without applying any discount), rather than our significantly lower DCF values for Angloplat and Kumba Iron Ore, we calculate Anglo's fair value per share at R383 or £27, which implies 47% upside to the ruling share price (see table below).

Figure 3. Anglo American's sum-of-the-parts valuation using market values for listed assets

	Market cap (ZARm)	Exch. rate	Market cap (US\$m)	AGL's holding	Market value of AGL's shares (US\$m)
<b>Market value of listed entities</b>					
Anglo Platinum	107,530	8.75	12,289	80.0%	9,831
Kumba Iron Ore	165,831	8.75	18,952	69.7%	13,210
Exxaro	61,072	8.75	6,980	10.0%	698
<b>Market value of Anglo's interest in listed companies</b>					<b>23,739</b>
<b>DCF enterprise value of unlisted divisions</b>					
De Beers (net of acquisition price)					2,182
Metallurgical coal					5,591
Thermal coal					7,989
Copper					10,570
Nickel					1,797
Tarmac					2,000
Samancor Manganese					1,241
Anglo Ferrous Brazil					466
Other mining and industrial (mainly Copebras, Scaw Metals and Catalao)					1,523
Exploration					-1,346
Corporate Activities					-2,041
<b>DCF enterprise value of unlisted entities</b>					<b>29,971</b>
Net debt as at 31 December 2011					-1,708
Share (buy-backs) issues during 2012F					1,700
Investments as at 31 December 2011 (excluding Exxaro)					2,286
<b>Equity value as at 23-10-2012</b>					<b>55,989</b>
Number of shares (one-year out)					1,280
<b>Fair value per share (US\$)</b>					<b>44</b>
<b>Fair value per share (GBP)</b>					<b>27</b>
<b>Fair value per share (ZAR)</b>					<b>383</b>

Source: Bloomberg, Company Reports, Citi Research

However, we believe both Kumba and Angloplat are significantly overvalued and maintain Sell recommendations on both stocks. (AMSJ.J; R398.93; 3)

## Rump PE multiples relatively attractive....

Anglo's rump excluding Kumba and Angloplat is trading on a relatively attractive FY13 PE of only 8.6x (Figure 4).

Figure 4. Anglo's rump PE multiples using Citi commodity prices and currency forecasts

	2012F	2013F
Anglo American earnings excl Anglo Platinum and Kumba (US\$m)	1,769	2,138
Diluted weighted ave. no. of shares (millions)	1,283	1,282
<b>Diluted underlying EPS (US\$) - excl AMS, KIO</b>	<b>1.38</b>	<b>1.67</b>
Share price excluding AMS and KIO market value (US\$/share)	14	14
<b>PE multiple excluding AMS, KIO at market value</b>	<b>10.4x</b>	<b>8.6x</b>

Source: Bloomberg, Citi Research

## ...but not attractive at spot commodity prices

However, using spot commodity prices to calculate Anglo's rump earnings result in a demanding FY13 rump PE of 16x (Figure 5).

Figure 5. Anglo's rump PE multiples using spot commodity prices and currencies

	2012F	2013F
Anglo American earnings excl Anglo Platinum and Kumba (US\$m)	1,070	1,143
Diluted weighted ave. no. of shares (millions)	1,283	1,282
<b>Diluted underlying EPS (US\$) - excl AMS, KIO</b>	<b>0.83</b>	<b>0.89</b>
Share price excluding AMS and KIO market value (US\$/share)	14	14
<b>PE multiple excluding AMS, KIO at market value</b>	<b>17.1x</b>	<b>16.0x</b>

Source: Citi Research

At spot commodity prices, Anglo's rump is looking significantly more expensive than mining peers' spot FY13 PE of 12.9x, and in line with Anglo's own spot PE of 16.2x.

Figure 6. Miners' PE multiples – base case input assumptions vs. spot and consensus

PE Multiples				Citi Base Case		Spot Fx/Prices		IBES Consensus	
	RIC	Rating	Price	2012E	2013E	2012E	2013E	2012E	2013E
Anglo American	AGLJ.J	Neutral	R 264	13.8	10.7	14.0	16.2	12.9	10.0
BHP Billiton PLC	BLT.L	Buy	£ 20	13.3	11.6	13.4	13.8	11.0	10.9
African Rainbow *	ARIJ.J	Neutral	R 173	13.5	12.2	13.0	17.0	9.5	8.5
Assore	ASRJ.J	Sell	R 347	13.7	14.4	13.0	15.2	10.5	10.4
Exxaro	EXXJ.J	Neutral	R 174	9.1	9.1	8.9	10.7	8.4	7.4
Kumba Iron Ore Ltd	KIOJ.J	Sell	R 520	12.7	10.9	12.1	11.9	11.9	10.9
ENRC	ENRC.L	Neutral	£ 3.46	9.8	8.1	10.1	10.4	8.7	7.6
Rio Tinto PLC	RIO.L	Neutral	£ 32	10.4	8.3	10.0	10.3	9.6	8.4
Vale	VALE.N	Buy	\$ 18	9.4	9.4	9.0	13.2	7.9	7.2
<b>Weighted Average</b>				<b>11.6</b>	<b>10.1</b>	<b>11.4</b>	<b>12.9</b>	<b>10.2</b>	<b>9.2</b>

Source: dataCentral, Citi Research

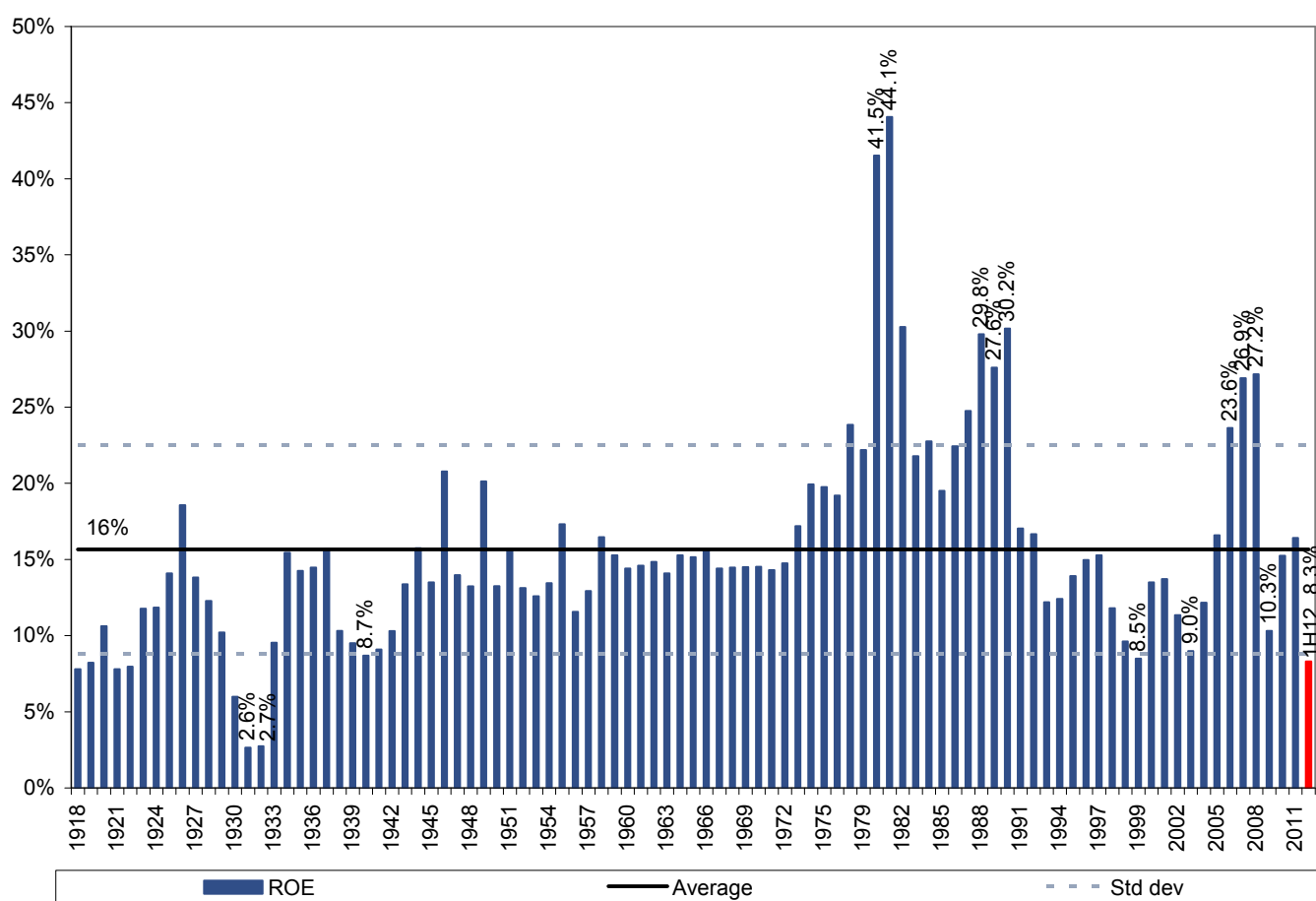
## But Cheap for a Reason

We highlight two major reasons for this:

- Poor capital allocation
- Disappointing operational performance

The combination of poor capital allocation, disappointing operational performance and low commodity prices resulted in Anglo's 1H12 return on equity falling to the lowest level since the Great Depression.

Figure 7. Anglo American's return on equity (1918-2012)



Source: Company Reports and Citi Research Estimates

## 1. Poor capital allocation

We calculate that Anglo destroyed around \$17bn or 40% of current market cap through poor capital allocation since 2006. Figure 8 shows Anglo's capital destruction since 2006 in detail.

**Figure 8. Total value destroyed since 24 October 2006 through poor capital allocation**

	US\$m
Anglo American Platinum acquisitions above spot	1,206
Share buy backs above spot	2,387
Acquisitions delivering no EBIT to date (Including Minas Rio)	8,058
Project budget overruns (including Minas Rio)	5,050
Convertible bond dilution as per 24 May 2012 release	302
<b>Total value destroyed</b>	<b>17,004</b>
% of market cap	41%

Source: Company Reports and Citi Research Estimates

Figure 9 shows more detail on Anglo's acquisitions since 2006, which have not generated profit to date.

**Figure 9. Anglo American Acquisitions since 2006, which has not delivered EBIT to date**

Date	Project/company	Acquisition price (US\$m)
<b>Minas Rio</b>		
23-Apr-07	Acquisition of 49% of MMX Minas Rio	1,150
15-May-07	Minas Rio contract signed	
17-Jan-08	Acquiring control of MMX Minas Rio	5,500
31-Mar-08	Acquiring control of MMX Minas Rio	
	<b>Total acquisition price (Minas Rio)</b>	<b>6,650</b>
30-Apr-07	Michiquillay Copper project	403
01-Aug-07	Pebble Copper-Gold-Molybdenum project	450
24-Jul-12	Revuboe	555
	<b>Total acquisitions delivering no EBIT</b>	<b>8,058</b>

Source: Company Reports and Citi Research Estimates

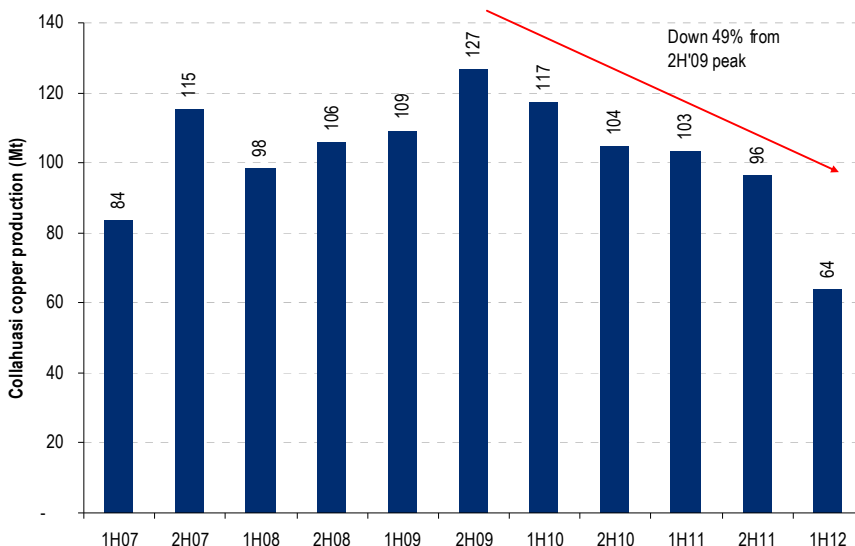
## 2. Disappointing operational performance

Other than depressed commodity prices, and poor capital allocation we believe five key operational disappointments are responsible for Anglo American's share price underperformance:

- Collahuasi's declining copper production (Figure 10).
- Difficulties with Los Bronces copper's ramp up, which is unlikely to reach 400ktpa within the next two years as previously promised.
- The significant rise in Anglo's metallurgical coal division cash costs (Figure 11).
- Significant budget overruns and delays to Minas Rio's commissioning (by at least another year to second half 2014).
- Anglo Platinum's uncompetitive position on industry margin curve due to its high cost Rustenburg operations.

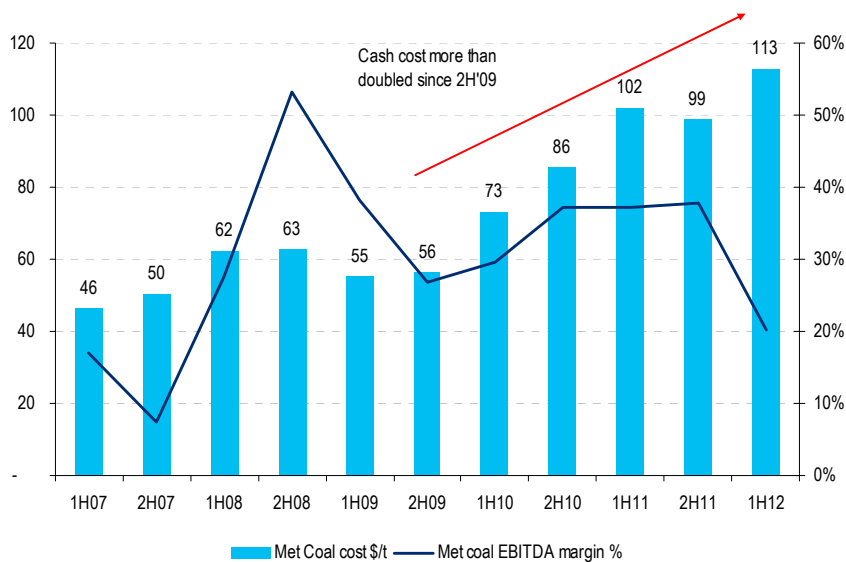


Figure 10. Collahuasi half yearly attributable production performance over past five years



Source: Company reports, Citi Research

Figure 11. Metallurgical Coal cash cost and EBITDA margin



Source: Company reports, Citi Research

## Anglo American

### Company description

Anglo American is a diversified mining company, with key operations in base metals, coal, iron ore and PGMs. While its head office is in the UK, its operations are spread across the globe, with exposure to South Africa, Australia and South America. Its biggest differentiator vs. its peer group is its globally dominant position in platinum and diamond production. The group has a larger proportion of assets in Africa (40%) than its peers, which could be perceived as higher risk given political uncertainty and electricity shortages.

### Investment strategy

We have a Neutral recommendation on Anglo American. We forecast reasonable volume growth over the next four years. We believe Anglo could offset the negative impact of falling commodity prices on its margins over the next five years to some extent through a defensive commodity basket and high-margin iron ore copper and coal growth. However, we currently believe it is fairly valued.

### Valuation

Our R280 target price for Anglo is based on a 50/50 weighting of our DCF derived fair value and a P/E-derived value, whereby we apply a 11x PE multiple to 2013E earnings (Anglo's long-term average was 10.3x). We derive our DCF valuation based on: 1) a weighted average cost of capital (WACC) of 9.52%; 2) long-term (2013-23E) nominal revenue growth of 5% per annum; 3) long-term EBITDA margins of 31%; 4) a long-term capex/EBITDA ratio of 46%; 5) long-term ROCE of 14%; and 6) a terminal growth rate (after 2023E) of 3.5%.

### Risks

The biggest risks to our earnings forecasts and valuation relate to our commodity price and currency forecasts.

Industry-specific risks include government actions, such as controls on imports, exports and prices, new forms or rates of taxation and royalties, and increased government regulation. South African miners started paying mining royalties in March 2010, in line with global best practice and market expectations.

Higher-than-forecast inflation in the mining sector could lead to near-term margin compression, but should support higher commodity prices in the long term.

Skills, electricity and water shortages in South Africa may affect production and mining inflation more than we anticipate. As around 40% of Anglo's assets are in South Africa, this could erode Anglo's global competitiveness.

Over-estimation of mineral reserves could weaken our investment case. We assume long-term reserve replacement at a fixed capital cost to EBITDA. Failure to discover new reserves or expand existing reserves could therefore impact on Anglo's valuation.

Conversely, if any of these factors proves to have less of an effect than we anticipate, the stock could materially outperform our target.

## Appendix A-1

### Analyst Certification

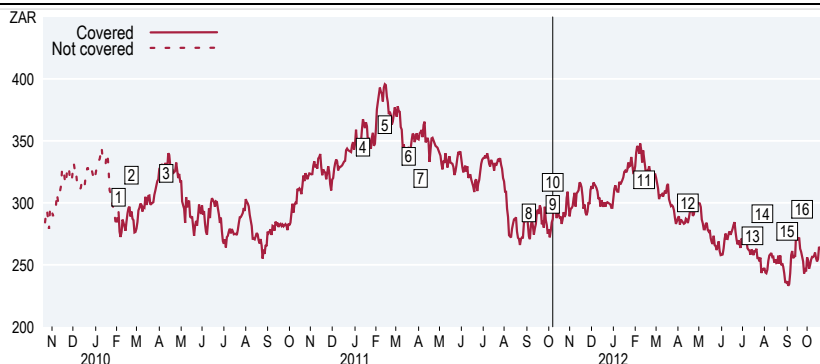
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### IMPORTANT DISCLOSURES

#### Anglo American (AGLJ.J)

##### Ratings and Target Price History Fundamental Research

Analyst: Johann Pretorius  
Covered since February 4 2010



	Date	Rating	Target Price	Closing Price
1	3-Feb-10	*1M	*340.00	292.50
2	22-Feb-10	1M	*360.00	293.00
3	12-Apr-10	1M	*420.00	328.50
4	13-Jan-11	1M	*430.00	367.50
5	14-Feb-11	*2M	*450.00	395.70
6	18-Mar-11	*1M	450.00	344.42

\* Indicates change

	Date	Rating	Target Price	Closing Price
7	5-Apr-11	1M	*460.00	357.10
8	5-Sep-11	1M	*420.00	273.00
9	7-Oct-11	Stock rating system changed		
10	7-Oct-11	*1	420.00	286.93
11	14-Feb-12	*2	*380.00	335.60
12	16-Apr-12	*1	*360.00	283.68

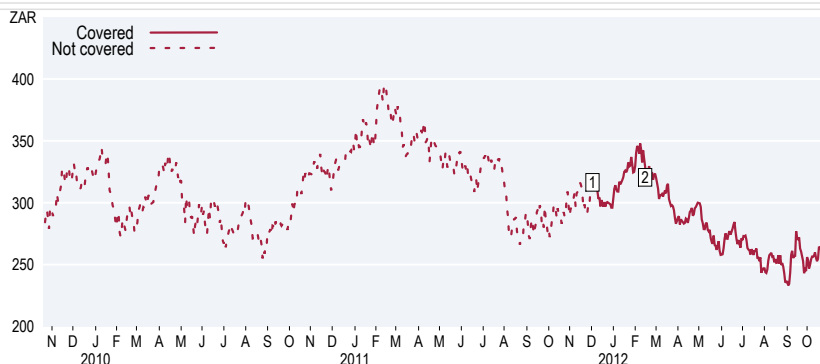
	Date	Rating	Target Price	Closing Price
13	16-Jul-12	1	*330.00	261.20
14	30-Jul-12	1	*290.00	246.54
15	3-Sep-12	1	*280.00	236.63
16	24-Sep-12	*2	280.00	260.50

Rating/target price changes above reflect Eastern Standard Time

#### Anglo American (AGLJ.J)

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

Analyst: Johann Pretorius  
Covered since February 4 2010



	Date	Rating	Target Price	Closing Price
1	2-Dec-11	*ADD MP	-	311.28

\* Indicates change

	Date	Rating	Target Price	Closing Price
2	15-Feb-12	*REM MP	-	329.21

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