Global Equity Research
Company Note
Earnings Update

METALS AND MINING RESEARCH

December 7, 2017

Freeport-McMoRan

We Remain Extreme Copper Bulls – Further Upside Likely

KEY TAKEAWAYS

FCX reported 3Q earnings from operations of $0.34 per share, beating consensus by 3 cents.

While FCX management says it is encouraged, we simply do not know what the outcome of the negotiations in Indonesia is likely to be. And, we are very skeptical of those who claim they do. As has been the case for the 23 years we have covered this stock, Indonesia risks are real. But, as we outline in this report, we are so bullish on copper that we are buyers of the stock at $15 even if a worst case Indonesia scenario materializes. And, we'd continue to be aggressive buyers of any weakness that Indonesia news flow creates. As we have said many times, Indonesia is not alone in raising the political risks facing long-term investments in copper projects – quite bullish for copper prices. We believe the market overestimates the relative importance of Grasberg within FCX's portfolio. And, we believe the market is overlooking that FCX has a $10B NOL in the United States.

Given the weaker dollar and continued improvement in copper's fundamentals, we are comfortable raising our above-consensus forecasts again. We now forecast $3.25 in 2018 from $3. For 2019, we leave unchanged at $3.50. And, we are comfortable raising 2020 to $4 per pound from $3.75. In 2020, we estimate FCX would generate $3.50 in free cash flow per share from its current operations. If FCX had no ownership in Grasberg in 2020, we estimate the company would still generate $2.40 in FCF per share at $4 copper. And, in that scenario, we'd likely be even more bullish on copper prices. It's difficult for us to believe that a state-owned Indonesian aluminum company would not encounter substantial production difficulties as the mine transitions underground. We raise our 1-year target to $22.

FCX: Quarterly and Annual EPS (USD)

FY Dec	2016E	2017			2018		
		Old	New	Cons	Old	New	Cons
Q1	(0.16)A	-	0.15A	0.36E	NC	N/A	N/A
Q2	(0.02)A	-	0.17A	0.34E	NC	N/A	N/A
Q3	0.12A	0.30	0.34A	0.30E	NC	N/A	N/A
Q4	0.25A	0.32	0.40E	0.28E	NC	N/A	N/A
Year	0.21A	0.94	1.07E	1.28E	1.65	2.05E	0.95E
P/E	72.5x	15.3x	14.2x		8.7x	7.4x	

Source: Renaissance Macro Research
Consensus Estimates are from FactSet

Refer to page 6 for important disclosures and Analyst Certification. RenMac and its affiliated companies do not seek to do business with the companies covered in this report. RenMac does not make a market in the security.
The analyst owns shares in the security.

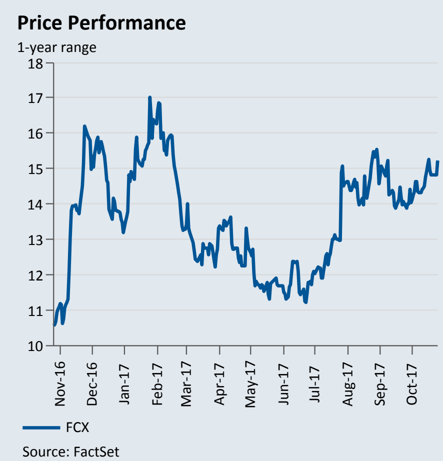
Ratings

Stock Rating:	Overweight
Industry View:	Neutral
Target Price:	$22.00

Financial Data

Symbol:	FCX (NYSE)
Rating/Target Price:	OW / $22.00
Price (10/24/2017):	$15.23
52-Week Price Range:	$10.33 - $17.06
Diluted Shares Outstanding (mm):	1,448
Market Cap (mm):	$22,227
Average Daily Vol (mm):	16.8
Book Value/Share:	$4.82
Dividend/Yield:	0.0%
Net Debt (mm):	$9,825

Price Performance



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We Are Raging Copper Bulls – Raising Forecasts, Upside Risk Remains

Recent press reports indicate that many copper bears are baffled by the recent strong move in the commodity price. The confusion often stems from myopically focusing on an economic outlook that has not remarkably changed while the copper price has. From our perspective, focusing so much on demand misses the larger part of the bull case for copper. We have never been believers in the "Dr. Copper" theory that the copper price is merely a reflection of the global economy. Our very bullish thesis is based upon mine supply actually starting to fall. Meanwhile, we'd argue the demand curve for copper is highly inelastic. After many yeas of high prices last decade, easy substitution opportunities have already been exploited. We believe a very high rationing price ($5+ per pound) may be necessary for a decade – even in an environment of weak economic growth. In our opinion, Dr. Copper can retire as a reliable economic indicator.

Last month, we attended the Denver Gold Show and visited with companies that had pitched potential smaller new copper/gold projects in recent years. Almost without exception, the projects were being cancelled, deferred, scaled down and, in some cases, being reconfigured as potential underground mines to appease environmental concerns. We remain very confident that a supply wave in response to modestly higher copper prices is not on the horizon. In our opinion, copper prices still need to sustainably trade much higher before major producers will be incentivized to take on the substantial risks of new copper mine development. We'd argue that political and environmental permitting risks are as high as they have been in decades. Boards are likely to use very high discount rates when evaluating potential new projects. Furthermore, we believe the time lag involved in bringing new projects is substantially underappreciated. Developing new copper mines is nothing like building a new aluminum smelter or steel furnace. Safford took 20 years to permit and develop. Oyu Tolgoi in Mongolia took 14 years. Rio Tinto has been working on Resolution in Arizona for over 9 years. We estimate it will be at least another 9 years before production comes online – <u>if ever</u>. Increasingly, there is evidence that underground block-caving that would be used at Resolution is not as simple as once advertised. FCX had its own issues with "mining induced seismic activity" at its block-cave operation in Indonesia last quarter.

Meanwhile, the ability of existing mines to simply maintain output is deteriorating faster than even we had expected. For evidence, one needs to look no further than the recent 3Q production reports from the global majors. Anglo American lowered the midpoint of its 2017 production guidance from 585K tonnes to 575K tonnes. Rio Tinto lowered its 2017 guidance from 525K tonnes to 470K tonnes. Escondida has been ramping back up slower than expected. Oyu Tolgoi produced just 37K tonnes in 3Q – way below what this very expensive mine was once anticipated to produce. Bingham Canyon in Utah produced just 26K tonnes. Bingham Canyon has been producing since the 1880's and was producing 300K tonnes per year as recently as 2009. As we have said many times, simply maintaining output is going to be a huge challenge for the global mining industry over the next decade. Mines are old. Grades are falling. Pits are deeper. Political risks are rising. Permitting risks are rising. Fresh water shortages are worsening. And, the industry's production will increasingly move underground – a far more challenging method of extraction. The list of challenges is a long one indeed.

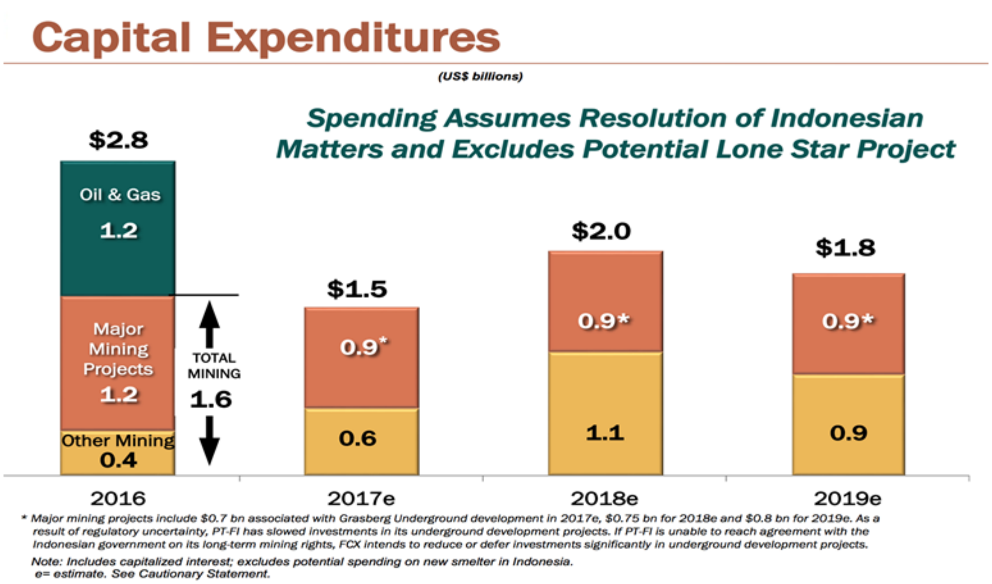
For BHP, copper production declined sequentially at Spence, Olympic Dam, Antamina and Cerro Colorado. Combined with the aforementioned disappointment at Escondida, that is BHP's entire copper portfolio. Olympic Dam has been a disappointment for over a decade. BHP guided that this copper/uranium mine in Australia will see a further production decline in 2018 due to smelter maintenance. Finally, FCX itself produced 44K tonnes less in 3Q y/y.

In short, we are not in the camp that "the copper price is way ahead of itself." Fundamentals are unfolding in line with our expectations. Likely incremental demand for copper in the grid to support renewables and much higher intensity of use in electric vehicles are likely to be icing on the cake for an already bullish fundamental story. To us, these will be yet more sources of price inelastic demand at a time when mine supply is unlikely to be there to meet it. We remain very confident this is just the beginning of what is likely to be a strong and sustainable bull market in copper.

Over the next decade, we expect sustainable new highs for copper.

Source: Bloomberg

Without the burden of Oil & Gas, a lean capex budget will enable substantial FCF generation and deleveraging in the next few years. We estimate FCX will have no net debt in just over 3 years.



Freeport-McMoRan

Stock Price		$15.35
Rating		Overweight
Price Target		$22.00
Shares (mm)	3Q17	1,448
Market capitalization ($ mm)		$22,227
Financial Summary (US$ mm)		
Cash	3Q17	4,957
Total Debt	3Q17	14,782
Common Equity	3Q17	6,973
Total Debt / Capital	3Q17	68%
Net Debt / Capital	3Q17	58%
Net EV/EBITDA	2017E	7.2x
P/E	2017E	14.4x
Annual Dividend	Current	$0.00
Dividend Yield	Current	0.0%

Operational Data	**2014**	**2015**	**2016**	**2017E**	**2018E**	**2019E**	**2020E**	**2021E**
Copper Price ($ per lb)	$3.09	$2.48	$2.25	$2.82	$3.25	$3.50	$4.00	$4.00
Gold Price ($ per oz)	$1,234	$1,134	$1,247	$1,273	$1,300	$1,300	$1,300	$1,300
Molybdenum Price ($ per lb)	$13	$9	$8	$9	$9	$10	$10	$10
Copper Production (mm lbs)	3,904	4,017	4,597	3,702	3,930	3,566	4,273	4,423
Gold production (k ozs)	1,214	1,257	1,082	1,549	2,099	1,234	1,188	1,379
Molybdenum Production (mm lbs)	95	92	80	93	79	81	81	66
Copper Cash Cost ($ per lb)	$1.49	$1.46	$1.25	$1.19	$1.08	$1.18	$1.41	$1.38
Financial Data								
EPS	$1.99	-$0.08	$0.21	$1.07	$2.05	$2.00	$2.85	$3.03
P/E	7.7x	N/A	74.7x	14.4x	7.5x	7.7x	5.4x	5.1x
Attributable EBITDA ($ mm)	7,441	3,056	3,245	4,313	6,515	6,191	8,508	8,892
Net EV/ Attributable EBITDA	4.6x	12.0x	9.9x	7.2x	4.4x	4.3x	2.8x	2.4x
Free Cash Flow per Share	-$1.93	-$3.01	$0.18	$1.89	$2.33	$2.33	$3.38	$3.24
Free Cash Flow Yield	-12.6%	-19.6%	1.1%	12.3%	15.2%	15.2%	22.0%	21.1%
Dividends per Share	$1.25	$0.41	$0.00	$0.00	$0.40	$1.00	$1.25	$1.50
Dividend Yield	8.1%	2.7%	0.0%	0.0%	2.6%	6.5%	8.1%	9.8%
Net Debt/Cap	50.3%	72.1%	66.1%	54.3%	37.8%	26.4%	7.6%	N/A

Valuation

Given our expectations for improving copper prices, we believe FCX shares are attractively valued. Our $22 target assumes a net EV 5.4 times our 2019 attributable EBITDA forecast in a year. Given likely robust FCF in 2018-2028, we believe this is a reasonable multiple.

Growth Prospects

Similar to other copper producers, FCX will do well simply to maintain its current level of output. Earnings growth will come largely from the improvement in copper prices we foresee. A 10 cent change in the copper price changes annual EPS by about $0.17.

Balance Sheet

Following two disastrous oil & gas acquisitions, FCX's balance sheet was overleveraged. However, following 2016 asset sales, improving copper prices should lead to further rapid deleveraging, an attractive dividend and a higher stock price.

Investment Summary

Indonesian political risks are real and likely to persist. Nonetheless, we believe these are reasonably discounted in the current stock price. Rising copper prices will be the key catalyst to drive FCX higher from its current level.

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Primary Stock:
Freeport-McMoRan (FCX, 10/24/2017, US $15.23). Overweight

Price target and Valuation Methodology: Each Analyst has a single price target in all of the stocks that they cover. The price target represents that Analyst's expectation of where the stock will trade in the next twelve months.

We use an enterprise value multiple of estimated future EBITDA to arrive at our price targets.

Risk Disclosure(s):

Change in commodity prices is the key risk for Metals and Mining. In addition, the companies face political, geological and financing risks.

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Neutral – Industry coverage universe has neutral fundamentals and valuations.

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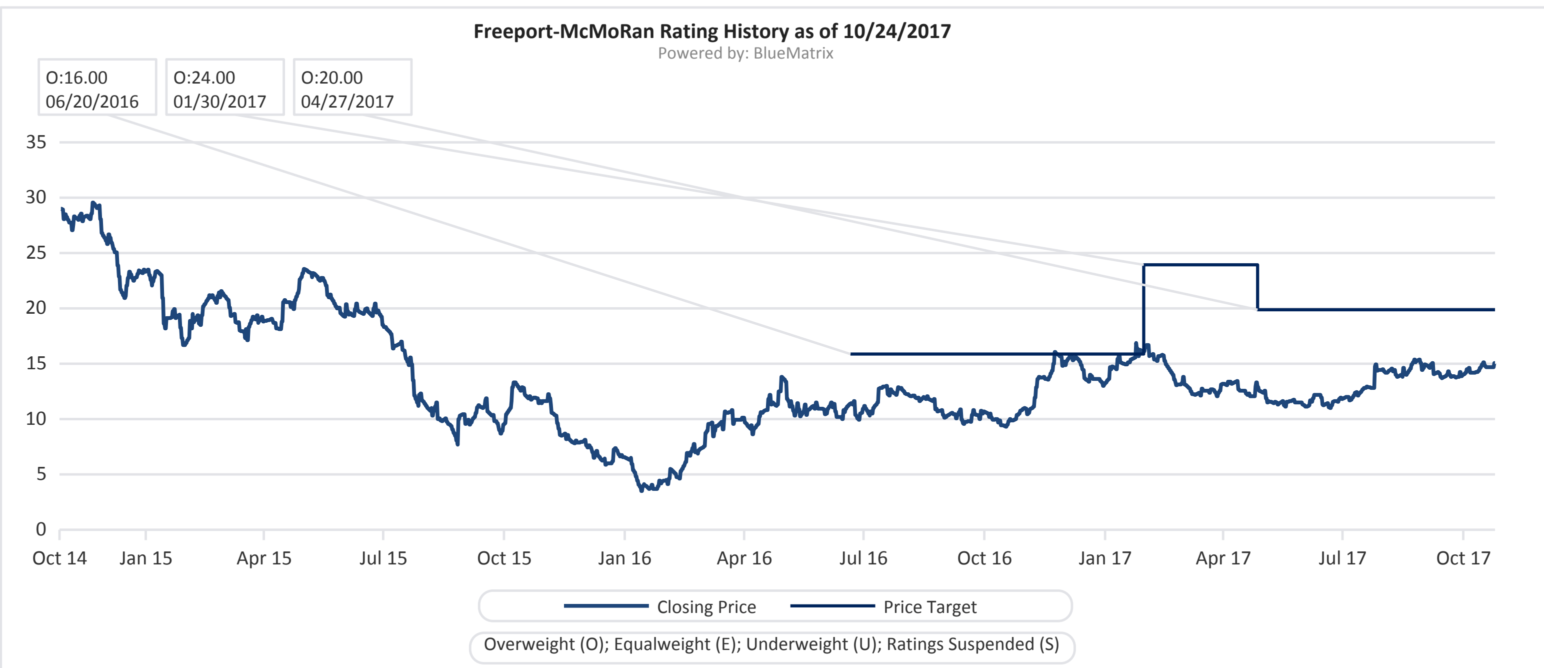

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