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Haitong Bank in a report from 13th December (08:00) upgrades KGHM from SELL to NEUTRAL with a FV of PLN 82.04 (was PLN 79.30) on the back of the metallurgical production rebound and possible 15% cut in the metal tax which may fuel 2019 results in spite of considerable electricity and gas prices increases.

Valuation Methodology

Our valuation approach for KGHM uses two methods: sum-of-the-parts method and peer valuation. We calculate the final FV as the weighted average of the two results with 80% and 20% weights for the DCF-based SOTP and relative valuation, respectively. We stress that the latter may not cover the full commodity cycle since it is based on 2019-2020 results which we believe bears the hallmarks of the-end-of-cycle. We also believe the peer group consists of not quite comparable stocks as the majority of those companies are global conglomerates with diversified portfolios exposed to diverse commodities such as coal, coking coal, zinc, iron ore, coal and many others. Moreover, KGHM is in most part an integrated copper producer with smelting and refining capacity. The processing business model differs from the production of primary metal.

Risks to Fair Value

Commodity price risk: KGHM is exposed to the risk of changes in the prices of the metals it sells: copper, silver, gold, lead, molybdenum, platinum and palladium.

Risk of changes in foreign exchange rates: Regarding the risk of changes in foreign exchange rates within the KGHM Polska Miedź S.A. Group, the following types of exposures were identified:

- transaction exposure related to the volatility of cash flows in the base currency;
- exposure related to the volatility of selected items of the statement of financial position in the base (functional) currency;
- the exposure to net investments in foreign operations concerning volatility of consolidated equity in the Group's base currency

Risk related to operations and technology: Operations are subject to a number of risks out of the Group's control including technological and geological problems, natural weather phenomena, failure of equipment and infrastructure, loss of key inputs and feedstock. Any unplanned disruption in the production process both in mining and smelting activity may entail losing production and sales as well as incurring unplanned expenditures. In particular, we see a risk related to operations regarding roasting installation ramping-up according to the schedule.

Risk related to resources and reserves: It's a risk related to insufficient knowledge of the parameters and characteristics of a deposit, both for exploration projects (estimated input data for orebody evaluation models), as well as for on-going mining operations. Resources and reserves are always estimates based on samples examination.

Risk related to community, labour relations and employees: In 2019 KGHM is going to renegotiate contracts with the union at Sierra Gorda, which may pose a risk of a strike.

Risk related to environmental compliance: Mining operations involve storage of large volumes of waste materials in tailings ponds which could result in spillages and cause damage to the environment.

Risk related to politics: The Group could be affected (to the upside and downside) by political decisions, especially the granting and renewal of permits as well as increasing or decreasing tax extraction rates. For instance, the company is currently struggling to obtain a permit for the Afton Ajax project. Moreover, during the political campaign in the run-up to previous parliamentary elections the winning party (PiS) pledged to decrease



the copper tax rate. The Group is controlled by the Polish State which may lead Management to participate in NPV-negative projects such as the Polish Nuclear Programme.

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