Freeport-McMoran Copper & Gold, Inc. (NYSE:FCX)

Analysts: Mike Zaccardi and Cory Black
December 7, 2009
Price Target: $94

**Company Profile**

Freeport-McMoran is a leading international mining company with headquarters in Phoenix, Arizona. FCX operates large, long-lived, geographically diverse assets with significant proven and probable reserves of copper, gold and molybdenum. FCX has a dynamic portfolio of operating, expansion and growth projects in the copper industry and is the world's largest producer of molybdenum. The company's portfolio of assets includes the Grasberg mining complex, the world's largest copper and gold mine in terms of recoverable reserves, significant mining operations in the Americas, including the large scale Morenci and Safford minerals districts in North America and the Cerro Verde and El Abra operations in South America, and the Tenke Fungurume minerals district in the Democratic Republic of Congo. As of December 31, 2008, its consolidated recoverable proven and probable reserves included 102.0 billion pounds of copper, 40.0 million...
ounces of gold, 2.48 billion pounds of molybdenum, 266.6 million ounces of silver, and 0.7 billion pounds of cobalt.

**Estimated vs. Actual Earnings**

![Chart](chart.png)

*Orange: Estimated
Green: Actual (non-GAAP)
Blue: Actual (GAAP)
*SmartMoney

**FCX Previous 4 Quarters Non-GAAP**

![Chart](chart2.png)

*FC Estimate
Actual

**Color on Quarter: Fourth Quarter 2008**

Freeport posted a loss of $13.9 billion, excluding special charges of about $14 billion related to the acquisition of Phelps Dodge, the company recorded a profit of $23 million. On March 19, 2007, FCX acquired Phelps Dodge, a fully integrated producer of copper and molybdenum, with mines in North and South America, processing capabilities for other by-product minerals and several development projects, including Tenke Fungurume in the Democratic Republic of Congo (DRC). The final write-down of Phelps-
Dodge in 2008 makes the company appear unduly unprofitable looking at GAAP financial metrics. In reality, FCX has remained the premier copper company in the world and continues to execute a strategy its strategy of being one of the most dominant industrial metal mining companies.

**Historical Quarterly Performance**

**Most Recent Quarter, ending 9/30/2009**

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<th>Third-Quarter 2009</th>
<th>Third-Quarter 2008</th>
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<tr>
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<td>Revenues</td>
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*FCX 10Q*

**Color on Quarter: Third Quarter 2009**

Strong commodities prices, increased volumes from Grasburg mines, and decreased cost structures allowed for a better than expected quarter from Freeport. Beginning in the third quarter of 2009, year-over-year comparables will show increased strength in the company as a violent downturn in profitability took place from the summer of 2008 through the early part of 2009. Though revenues as a whole were below that of 2008, we expect the fourth quarter to be very profitable for FCX and look markedly better than 2008. Slightly lower copper and lower molybdenum production, along with lower prices, were offset by stronger gold production and prices. Despite the lower revenue figure, operating income increased 84% year-on-year. The company has become leaner and has taken steps to reduce short-term debt. The Board is so confident that the company will continue to perform well; they reinstituted a cash dividend for the third quarter.
Currently, Freeport has $6.6 billion in total debt, however only $230 million is due through 2014. For the third quarter 2009 alone, the company repaid nearly 3 times that amount, $638 million in redemption of notes; this repayment saved the company $48 million in annual interest payments. The company will continue to repay debt early to save interest charges. The company does not issue earnings guidance for upcoming quarters.

**Operating Segments**

**North America**
The North American Segment includes five operating mines: Morenci, Sierrita, Bagdad, Safford, and Tyrone – Morenci is the reportable segment. Molybdenum is particularly prevalent in the North American mines.

**South America**
The South American Segment includes four operating mines: Cerro Verde in Peru, and Candelaria, Ojos de Salado and El Abra in Chile – Cerro Verde copper mine is the reportable segment. Candelaria and Ojos del Salado mines produce gold and silver as a by-product.

**Indonesia**
PT Freeport Indonesia’s Grasberg minerals district produces copper and significant amount of gold and silver. The DOZ underground mine is one the biggest mines for copper in the world. There are reserves at the surface to mine through the middle part of the next decade at which point further underground excavation will commence. The company had a net credit for unit cost per ounce of gold sold.

**Africa**
The Tenke Fungurume copper and cobalt mine is the reportable segment. Tenke produces copper cathode and cobalt hydroxide – newly commenced in 2009 and shows tremendous potential as a major mine for years to come. FCX expects full capacity by 2010.

**Molybdenum**
Henderson molybdenum mine in Colorado is the reportable segment. The mine includes conversion facilities which includes a sales company that purchases and sells molybdenum from the Henderson mine and copper mines that produce molybdenum as a by-product.

**Other Segments**
- Rod and Refining: copper conversion facilities located in North America including a refinery, 3 rod mills and a specialty copper products facility.
- Atlantic Copper Smelting & Refining: FCX’s wholly owned smelting unit in Spain. Smelts and refines copper concentrates and markets refined copper and precious metals in slimes.
Valuation
We have a 12 month price target for FCX of $94 per share which is a moderate estimate compared to consensus opinions. Scanning the estimates from analysts tracking the stock, prices range from $71/share to $125/share. Using a blended model of discounted cash flows, historical industry P/E ratios and estimated growth projections, we feel that our price target is optimistic about the mining sub industry over the next twelve months, but also in line with analyses currently available. We feel that 2010 EPS will average around $7/share and the stock will trade at least 13.4X earnings.

Freeport-McMoran vs. Competitors 1-year

*YahooFinance
Competitors: Rio Tinto, BHP Billiton, Newmont Mining, Southern Copper Corp
Freeport-McMoran has outperformed all of its competitors and the S&P 500 over the last year. The metals and mining industry has been one of the best performing industries in the market. The industry bottomed before the overall market and has been moving higher for the last year. The outperformance of Freeport does not mean it is the best company, some may argue that the stock has overextended itself, being up five fold in the last year. We believe that a continued improvement in the global economy and a continued trend of a weakening dollar will provide for higher raw materials prices, namely copper, and will benefit Freeport.
All Analyst Recommendations

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1 = Buy  5 = Sell

Total Number of Analysts: 20

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<td>Sell</td>
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Longer-term Performance

Growth of $10,000

- Stock: Freeport-McMoran Copper & Gold
- Industry: Copper
- Index: S&P 500

Freeport-McMoran had been performing in-line with the copper mining industry for the last several years up to the peak in mid-2008. Freeport was subsequently sold-off in a sharp fashion, even when compared to the industry. Since the bottom, FCX has sharply outperformed and we look for this trend to continue into next year. Though appreciation of the stock will likely be slower than that of the last year, we expect continued overall outperformance given the current economic environment and expected growth in global markets.

Technical Analysis
FCX still looks to be running pretty well. Look for support around the $80 level and long term resistance around $100. It is still trading above the 50-day which it has been riding for the last 6 months or so. Technically this one looks good but it is definitely a play on the dollar, copper and gold. Copper and gold technically continue to climb while the dollar is nearing its lows. Also FCX has outperformed the s&p over the last 1-year, 6-month, and 3- month periods. –Herman Klinger, OFG Technical Analyst

How FCX makes money
The company mines for copper, molybdenum, and gold and market the refined products. Freeport is focused on increasing production at its existing assets - that includes the development of more underground mining at Grasberg and the build-out of the Tenke Fungurume complex. FCX uses a unique ‘hourglass’ approach to conducting business. The hourglass approach requires the company and its suppliers to jointly examine the supply chain process from operational need identification to supplier material purchase and production to material and service delivery to payment settlement.

Copper, Molybdenum, and Gold
Copper is an industrial metal used in the production of cables, wire, and electrical products for both the electrical and building industries. The construction industry also accounts for copper’s second largest usage in areas such as plumbing, heating, and ventilating as well as building wire and sheet metal facings. Copper is often a gauge of expected industrial demand, as it is one of the most purely industrial metals. Copper is currently trading above $3/lb and has been on a steady climb since December of 2008 when it bottomed at $1.30/lb. The increase in copper prices is attributable to better economic data leading to increased demand for the industrial metal, namely a doubling of imports from China, concerns of supply due to strikes. There is concern, however, of how long China can continue to absorb so much supply. Also, when will investor optimism for increased demand in the copper market come to fruition in actual demand?
Molybdenum, or ‘moly’ as it is known in the industry, is an industrial metallic element found in copper mines. Industrial uses include providing increased hardness and corrosion resistance to metals such as steel, cast iron, chrome and other alloys. Heating molybdenum powder yields molybdic oxide, which is the form of molybdenum used most widely in alloying. Molybdenum is very versatile in enhancing alloy properties which ensures its use in today’s industrial technology; it has been proven to extend the life of other metals.

Gold is a precious metal that has both values in industrial use and as a store-of-value during times of economic uncertainty. As the price of gold increases, its demand from industrial use wanes and speculators believing inflation and economic troubles are on the precipice begin to move the price. In terms of industrial use, gold is used as a conductor of electricity, although often cheaper metals are used. Gold is also used in electronics, Japan being the leading consumer of gold, followed by the United States. The yellow metal is also used extensively in the dental industry, although new alloys are being created to mimic the properties of gold at much cheaper prices for dental use.

Management & Ownership

FCX is under the management of Richard Adkerson as CEO/President and Chairman of the Board James Moffet. Richard C. Adkerson has been with Freeport since December 2003. He has been President of the Company since January 2008 and from April 1997 to March 2007. He was Chief Financial Officer of the Company from October 2000 to December 2003, Director and Executive Vice President of PT Freeport Indonesia, Chairman of the Board of Directors of Atlantic Copper, and Co-Chairman of the Board of McMoran Exploration Co. (McMoran). He also served as President and Chief Executive Officer of McMoran from 1998 to 2004. James R. Moffett is Chairman of the Board of the Company, and President Commissioner of PT Freeport Indonesia. He was Chief Executive Officer of the Company until 2003. He was also Co-Chairman of the Board of McMoran. Moffett successfully guided Freeport through the entire Grasberg development phase. Management owns less than 1% of the total shares outstanding, and majority of shares are owned by institutional and mutual fund owners, 85% respectively.

3rd Quarter Earnings Call

The company reported 3rd quarter net income of $925MM or $2.07 earnings per share compared with $523MM or $1.31 per share for 3rd quarter 2008.
For the nine months ended 9/30/2009, they reported net income of $1.6B or $3.70/share.

Copper sales totaled 1 billion pounds, surpassing the July 2009 estimate of 910MM pounds due mostly to having access to high grade sections of their Grasberg Mine in Indonesia. The average copper price for the quarter was $2.75/pound, lower than 3rd quarter 2008 of $3.14/pound. The company iterated that they see a very strong underlying Chinese economy to continue to support copper prices.

Gold sales were up above July estimates of 550K ounces at 706K ounces due mostly to accelerated mining of a high grade section of the Grasberg Mine. The average gold price was $987/ounce for the 3rd quarter 2009 beating 3rd quarter 2008 prices of $869.

Molybdenum sales for the quarter were 16MM pounds, but lower than 3rd quarter 2008 sales of 19MM pounds, but better than the July 2009 estimate of 15MM pounds. Molybdenum averaged $13.95/pound which is 57% lower than the average price per pound for 3rd quarter 2008.

Net cash costs averaged $.50/pound for copper in the 3rd quarter of 2009 compared with $1.29/pound for 3rd quarter 2008.

They estimate 4th quarter 2009 copper, gold, molybdenum sales of 915 MM lbs, 425K oz, and 14MM lbs respectively. They estimate 2010 sales for copper, gold, molybdenum to reach 3.8B lbs, 1.9 MM oz, and 60MM lbs respectively.

The BOD reinstated a dividend of $.60/share, albeit much smaller than the $2.00 dividend of a year ago.

They have been successful with mine sequence optimization by mining high grade sections of their mines when stronger prices support those changes to their plans.

Grasberg open pits depleted by 2015.

Concerted effort to use free cash flow to pay down debt. Current debt levels around 6.6 Billion, with 2.3 Billion in cash. During the quarter paid off 638 million.

They continue to work with the Democratic Republic of the Congo related to contract revisions for operations at their Tenke Fungurume Mine.

The company was asked about its significant cash balance. They will focus on potential opportunities to reduce debt; they don’t have to do it, only if it makes sense.
The company was asked about China. They are encouraged by China’s spending on infrastructure, and said they don’t have particular insight in inventory levels. They are hearing more concerns about needs for copper rather than too much inventory.

The company was encouraged by reports out of the Congo that the government is taking steps to promote foreign investment.

**Green Copper & Gold**

Freeport-McMoRan Copper & Gold Inc.’s Environmental Policy commits them to minimize the impact of their operations on the environment using risk management strategies based on valid data and sound science. According to their website, they routinely undergo internal and external environmental audits to assess their environmental compliance, management systems and practices. Employees at each site take personal responsibility for environmental stewardship and develop action plans based on audit results. Their Safford, Arizona, operations were recommended for ISO 14001 certification in 2008 and subsequently received the certification in the first quarter of 2009. All of their operating locations are now certified to this international standard, which signifies that a facility or company has systems in place to monitor and minimize environmental impacts and to drive continuous improvement in protecting the environment. Their aggregate environmental expenditures including reclamation and remediation costs totaled $468 million in 2008.

**Fear**
- Political risk because of large concentration of investments in less stable and secure areas of the world
- Weakness in the overall economy going forward resulting in lower prices for copper, gold, and molybdenum
- EBITDA extremely levered to the price of commodities
- Problems with some of their debt ratios, P/E ratios relating to 4Q 2008
- Lower exploration and acquisition budgets to fill void after Grasberg Mine depletes
- Recent cautious comments from CEO Adkerson regarding US housing market, which represents a portion of the copper rod market.

**Greed**
- World’s second largest producer of Copper in the World, largest producer of molybdenum in the world
- Ability to optimize mine production to benefit from rising commodity prices
- Little near-term debt
- Proactive management
- Strong cash flow generation
- Rising prices for commodities and overall improvement in the world economy
- Significant reserve growth through better technologies
- Top performer in their sub industry

**Recommendation**

We recommend to buy one position in FCX and to remove an equal position from XLB.