

Metals & Mining

MARKET COMMENTARY/STRATEGY

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Is copper about to spike?

- As the global recession appears to unfold, copper prices have rallied significantly this week. This may be explained by the ongoing supply shortages in the industry and limited stockpiles held by consumers who appear to be operating hand to mouth. We think copper prices now have the potential to hit our \$12,000 per tonne target that we wrote about in *Brave New World II*, 1st of November 2006.
- The scene is certainly set for a spike. Consumer restocking in the US and Europe appears only 4 weeks old and buyers are about to return from Chinese New Year. Supply misses are now back on the agenda given water and power issues in Chile.
- Looking through the current US recession, if the central banks can stimulate the economies, 2009 could see global copper demand re-accelerate to +5-6%. With supply growth of only 3.3% this could set the scene for a significant spike in prices. If this is true, then Antofagasta and Kazakhmys net of cash and investments could be trading on less than 4X and 3X price earnings respectively in 2009. Time will tell when the market begins to consider this potential price spike, but the longer prices stay firm in this current slowdown the higher the spike could be.
- In this report we re-examine our supply models and find that producers are continuing to slip on their targets. Since our last report *Brave New World III 'Copper supply: Too much or too little'* (14th September 2007) we have further revised down our near term supply targets. We estimate that at least 700,000 tonnes of copper supply will slip between 2008-12. We are downgrading our 2008 supply estimate from 2.3% to 1.9% and our 2009 estimate from 3.6% to 3.3%.
- This is hardly the environment for significant copper price weakness unless we see a major economic recession. If this turns out to be true, then we believe our copper shares are trading at the wrong price and deserve a significant re-rating.

Looking through the recession

If this is the worst that the US recession can do to copper prices, then imagine where copper could go if growth re-accelerates later in the year. We are convinced copper will hit our \$12,000 per tonne target that we set in *Brave New World II* on 1st November 2006. This is up from our earlier prediction of \$8,000 per tonne that we forecast on the 21st November, 2005 in our report *Copper-the new precious metal*. The scene certainly appears set for a spike. Investors appear bearish, US and Europe consumers have destocked, China remains strong and supply is likely to significantly disappoint in 2008. So far, copper demand this year has been stronger than expected as US and European consumers have returned to the market and begun a restocking cycle. How long this will last is difficult to predict. The last global synchronised restocking cycle from the US, Europe and China occurred between October 2005 and March 2006. During this period copper prices almost doubled. Is this likely again today? Well, one thing is for certain, the markets are certainly not positioned for a rally. The net short position has continued to grow helped by increasing macro economic concerns.

Figure 1: Chinese copper inventories (2006 to date) – continue to fall
in tonnes, unless otherwise stated



Source: Bloomberg

The longer the copper price can stay strong and actually rally in the current US recession, the more likely prices are going to spike higher when growth re-accelerates. We have visited over 100 investors in the last four weeks and their biggest surprise appears to be the ongoing strength in commodity prices amidst the doom and gloom in the equity markets. Are the commodity markets telegraphing a completely different story on global growth that has yet to be reconciled by the equity markets? We think so, and believe commodity markets are a better indicator of global growth than equity markets. This is especially true for the bulk commodities that are not influenced by speculators. So far this year, coal prices are up over 40%, spot ferrochrome is up 20% and iron ore price expectations have doubled in two months. Recession, what recession?

Figure 2: Copper demand growth scenarios for 2008

	Worst case (ROW at -1% and BRIC at 5%)	Mild recession case (ROW at 0% and BRIC at 5%)	Soft landing (ROW at 1% and BRIC at 7%)
BRIC demand (kt)	6,138	6,138	6,255
ROW demand (kt)	12,480	12,606	12,732
Global demand (kt)	18,618	18,744	18,987
Yoy	0.9%	1.6%	2.9%
Global supply (kt)	18,803	18,803	18,803
yoy	1.9%	1.9%	1.9%
Surplus / (Deficit) (kt)	185	59	(184)
Copper price (USc)	260	300	400
Upside / (downside) to spot	-26%	-14%	+14%

Source: Credit Suisse estimates

If we are entering a recession, then let's take a look at the worst case outcome for copper prices as illustrated in Figure 2. Our worst case scenario assumes that copper demand from BRIC countries grows by only 5% in 2008 compared to 9% in 2007, whilst ROW demand falls to a negative 1% compared to estimated 1.8% growth in 2007. Under this scenario, our revised global supply growth of 1.9% would be more than global demand of 0.9%. In this scenario the market is likely to move into a surplus by some 185,000 tonnes which may push copper prices to a low of \$2.60 per pound. We think prices won't fall much further than this due to the limited inventories held at both the exchanges and amongst consumers in the US, Europe and China. If \$2.60 per pound is a worst case scenario in a global recession then we will take that anytime. On this basis, Antofagasta (Neutral, price target £6.00 per share) and Kazakhmys (Outperform, price target £20 per share) would be trading on a PE net of their cash and investments of only 9.7X and 7.5X respectively. Hardly the stuff to get too worried about.

In a mild recessionary environment where demand from ROW slows to 0% and BRIC growth slows to 5%, then we would still likely enjoy global demand of 1.6% in 2008, which is almost the same as our supply forecast of 1.9%. This would create a small surplus of 59,000 tonnes and copper prices would arguably only fall to \$3.00 per pound. Again, hardly the end of the world. In this scenario, net of cash and investments, Antofagasta and Kazakhmys could be trading at just 8.4X and 6.5X 2008 earnings. Are our copper stocks too cheap?

Our current house forecast of \$3.00 per pound in 2008 could now be conservative especially if demand does not disappoint nearly as much as the equity markets would appear to be suggesting. If we enter a soft landing and assume then ROW demand growth is likely to be 1% with BRIC growth of 7%, this would generate global demand of 2.9%, which is still well above our supply forecast of 1.9%. Under this scenario, the copper market would be in a deficit of 184,000 tonnes and prices would have a good chance of rallying to \$4.00 per pound. In this scenario our copper shares are even less expensive. Net of their cash and investments, Antofagasta and Kazakhmys would be trading at just 5.9X and 4.6X 2008 price to earnings, respectively.

However, what if the strong commodity prices are telling us something about the global economy that the equity markets have not yet figured out. What if we actually see a re-acceleration of growth in the second half of 2008 as central banks continue to cut rates and the economies grow. Figure 3 illustrates the potential supply deficits under each scenario, assuming the ROW copper consumption actually grows by 2% and BRIC growth varies between 7-9%. Under the most bullish scenario, prices have the potential to actually spike to our *Brave New World II* target of \$12,000 per tonne or \$5.50 per pound. Under this scenario, Antogasta and Kazakmys would be trading on less than 4X and 3X,

respectively. Are these two copper producers the two cheapest stocks in the FTSE 100? Time will tell.

Figure 3: Copper demand growth scenarios for 2008 – assuming the US economy rebounds strongly in 2H '08

	ROW at 2% and BRIC at 7%	ROW at 2% and BRIC at 8%	ROW at 2% and BRIC at 9%
BRIC demand (kt)	6,255	6,314	6,372
ROW demand (kt)	12,858	12,858	12,858
Global demand (kt)	19,113	19,172	19,230
Yoy	3.6%	3.9%	4.2%
Global supply (kt)	18,803	18,803	18,803
Yoy	1.9%	1.9%	1.9%
Surplus / (Deficit) (kt)	(310)	(369)	(427)
Copper price (USc)	450	500	550
Upside / (downside) to spot	+28%	+43%	+57%

Source: Credit Suisse estimates

Even more importantly is 2009. If we do begin to see a re-acceleration of growth at the back end of 2008, then growth in 2009 could be much higher than we expect. If 2009 does accelerate then global copper demand could grow by as much as 6% in 2009. On this basis, the extent of the rally will depend on the extent of the downturn in 2008.

We have created three scenarios as a follow up to 2008 and assuming that global demand would grow by 6% in 2009 (Figure 4). If copper demand does grow by 0.9% (worst case) in 2008 and 6% in 2009, the supply would still fall short of demand in 2009 leading to a copper market deficit of 319,000 tonnes. This would again set the scene for a spike in prices to as much as \$4.50 per pound. This compares with our current 2009 copper forecast of \$3.00 per pound. Clearly any M&A in the copper universe today, would look very smart if this scenario turns out to be correct.

Figure 4: Copper demand growth scenarios for 2009

	6% demand growth in 2009 following		
	Worst case in 2008	Mild recession case in 2008	Soft landing in 2008
BRIC demand at 6% (kt)	6,506	6,630	6,630
ROW demand at 6% (kt)	13,229	13,362	13,496
Global demand (kt)	19,735	19,993	20,126
Yoy	6.0%	6.0%	6.0%
Global supply (kt)	19,416	19,416	19,416
Yoy	3.3%	3.3%	3.3%
Surplus / (Deficit) (kt)	(319)	(577)	(710)
Copper price (USc)	450	500	600
Upside / (downside) to spot	28%	43%	71%

Source: Credit Suisse estimates

If the copper demand could grow by 1.6% (mild recession) in 2008 and 6% in 2009, the market would be in a deficit of 577,000 tonnes, which would set the scene for a price of as much as \$5.00 per pound. Under the third scenario, we have assumed that copper demand would grow by 2.9% (base case) in 2008 and 6% in 2009. This scenario would leave the market in a massive deficit of 710,000 tonnes. Such a deficit could spike prices to over \$6.00 per pound.

In short, if copper can hold firm and trade through this current slowdown, then it could set the scene for a major spike in prices in the back end of 2008 and 2009. Of course, predicting demand is difficult but we hope these tables provide a useful indication that the

downside to copper prices is relatively limited unless we enter a major economic depression globally. This is primarily because supply remains the key swing factor for the market.

Global copper supply – continues to face start-up delays & cost overruns

Supply returned as the key theme for copper this week, given power and water shortages in Chile. The ongoing SAG mill problems at Antamina and the power shortages in Zambia have also not helped in recent weeks. In this study, we take the opportunity to review the 66 new copper projects we had discussed in our report *Brave New World III - Copper supply 2007–15: Too much or too little?* dated 14th September 2007 (Figure 5). We have also added four new copper projects to our supply study. The reality is that the industry has woefully under invested in new capacity after a decade of bear markets that commenced in 1990. Going by the current industry trends, where project delays and cost overruns are the order of the day, several of these 70 projects could face start up delays, in our view. Since our last report *Brave New World III 'Copper supply: Too much or too little'* we have further revised down our near term supply targets. We estimate that at least 700,000 tonnes of copper supply will slip between 2008-12. We are downgrading our 2008 supply estimate from 2.3% to 1.9% and our 2009 estimate from 3.6% to 3.3%.

The following four projects have been added to our report :

El Boleo

El Boleo copper project, owned by Baja Mining, is located near the town of Santa Rosalia in Mexico. According to the company, the deposit is estimated to contain 277 million tonnes of measured and indicated ore resources grading 1.77% copper. The ore also hosts cobalt, zinc and manganese as by-products. The annual design capacity of the project is 60kt of copper, 3,100 tonnes of cobalt, 36kt of zinc and 100-250kt of manganese. The first production from the project is expected in 2009 and the initial capex to develop the mine is estimated at US\$568 million.

Northmet

The Northmet project in Minnesota, USA is owned by Polymet Mining. The deposit, which was first discovered by US Steel in 1960s, is estimated to contain 422 million tonnes of ore resources grading 0.31%. The company intends to produce 33kt of copper from the project every year. The project, which is expected to cost US\$ 380 million to develop, would come on stream by 2009.

Gibraltar – Phase 2

Taseko Mines Limited, a Canadian miner, wholly owns the Gibraltar mine. The mine, which had a production restart in 2004, produced 22kt of copper and 372 tonnes of molybdenum in FY 2006. The company is currently expanding the operations of Gibraltar mines to increase the production capacity to more than 50kt of copper and 635 tonnes of molybdenum by 2009. The company is expected to spend US\$ 130 million for this expansion project.

Prosperity

The prosperity project, located in Canada, is wholly owned by Taseko Mines. The deposit is estimated to contain 412 million tonnes of ore resources grading 0.22% copper. The project, which is expected to be commissioned in 2012, would cost US\$250 million to build. The design capacity of the project is 49kt of copper.

Figure 5: New copper projects

Mines	Country	Company	Capex (\$ mn)	Contained Cu (kt)	Grade (%)	2007e	2008e	2009e	2010e	2011e	2012e	2013e	2014e	2015e	2016e	2017e
Los Bronces 61-148kt/d Exp	Chile	Anglo American	1,000	5,626	0.29%					81	162	162	162	162	162	162
Quellaveco	Peru	Anglo American	1,200	5,962	0.64%							86	180	180	180	180
Michiquillay	Peru	Anglo American	800	4,347	0.69%							59	122	117	117	113
Esperanza Project	Chile	Antofagasta	1,500	5,085	0.55%					18	108	171	171	171	171	171
Reko Diq - W Porphyry	Pakistan	Antofagasta / Barrick Gold	2,300	12,240	0.51%								90	180	180	180
Kinsevere	DR Congo	Anvil	300	1,222	3.70%	14	20	32	60	60	60	60	60	60	60	60
Mubshi	DR Congo	Anvil	200	248	2.25%					9	18	18	18	18	18	18
Cerro Casale	Chile	Arizona Star / Kinross	1,430	2,588	0.25%						27	90	135	122	113	113
Duck Pond	Canada	Aur Resources	136	135	3.30%	11	17	17	19	19	19	19				
Andacollo	Chile	Aur Resources	350	2,775	0.34%					34	68	68	68	68	68	68
El Boleo	Mexico	Baja Mining	568	4,906	1.77%			10	50	60	60	60	60	60	60	60
Spence	Chile	BHP Billiton	1,100	3,986	0.95%	144	176	171	185	185	185	185	185	185	185	185
Olympic Dam Exp	Australia	BHP Billiton	5,000	22,440	1.10%									18	135	203
Escondida - 3rd conc	Chile	BHP Billiton / Rio Tinto	1,500	3,658	1.07%									108	180	180
Luita - Phase 1	DR Congo	CAMEC	180	1,500	2.14%	7	36	72	100	100	100	100	100	100	100	100
Chuqi - Phase 1	Chile	Codelco	730	9,976	0.64%			158	245	208	208	208	205	205	205	285
Gaby	Chile	Codelco	870	2,522	0.41%			54	120	150	150	150	150	150	150	150
Andina - Phase 1	Chile	Codelco	580	3,330	0.75%					18	45	45	45	45	45	45
Andina - Phase 2	Chile	Codelco	2,000	23,310	0.75%									90	315	315
Chuqi - Phase 2	Chile	Codelco	1,000	4,726	0.64%							68	108	135	135	135
Kinsenda restart	DR Congo	Copper Resources	100	840	5.30%		9	36	54	54	54	54	54	54	54	54
Muliashi	Zambia	Cunco	300	596	1.42%			27	55	60	60	60	60	60	60	60
One One Eight	Brazil	CVRD	232	294	0.92%		18	36	38	36	33	33	33	33	33	33
Salobo I	Brazil	CVRD	855	3,350	0.87%					45	90	90	90	90	90	90
Lumwana	Zambia	Equinox	850	2,708	0.73%		45	135	160	160	160	130	130	130	130	130
Frontier (ex Lufua)	DR Congo	First Quantum	226	2,111	1.16%		30	73	73	73	73	73	73	73	73	73
Kolwezi Tailings	DR Congo	First Quantum	300	1,681	1.49%					15	35	50	50	50	50	50
Safford	USA	Freeport	675	2,218	0.36%		41	90	100	100	100	100	100	100	100	100
Tenke-Fungurume I	DR Congo	Freeport	900	1,150	2.30%			20	20	98	100	100	100	100	115	115
Tenke-Fungurume II	DR Congo	Freeport	750	1,082	2.10%								135	135	135	135
Petaquilla	Panama	Inmet / Petaquilla / Teck C	1,708	7,265	0.50%					25	194	194	189	180	171	171
Las Cruces	Spain	Inmet Mining	685	1,091	6.20%		10	40	72	72	72	72	72	72	72	72
Oyu Tolgoi - Phase 1	Mongolia	Ivanhoe (10% Rio Tinto)	2,700	8,434	0.60%							32	180	189	189	189
Oyu Tolgoi - Phase 2	Mongolia	Ivanhoe (10% Rio Tinto)	1,300	9,119	0.60%									90	135	180
Kamoto	DR Congo	Katanga Mining	424	5,670	3.50%	8	35	60	115	145	145	145	145	145	145	145
Boschekul	Kazakhstan	Kazakhmys	450	2,497	0.69%						14	72	90	90	90	90
Ruashi Etoile	DR Congo	Metorex	160	1,467	2.78%			9	30	35	35	35	35	35	35	35
Rio Blanco	Peru	Monterrico	1,440	7,165	0.57%						54	189	171	171	171	162
Pebble	USA	NDM / Anglo	1,500	27,780	0.43%									90	225	225
KOV Restart	DR Congo	Nikanor	1,700	8,755	5.09%							54	150	225	225	225
Agua Rica	Argentina	Northern Orion	2,055	5,217	0.47%							72	149	149	131	131
Galeno	Peru	Northern Peru	1,000	3,749	0.49%								90	182	182	182
Galore Creek	Canada	Nova Gold / Teck Comino	2,000	2,994	0.55%							36	144	176	176	176
Prominent Hill	Australia	Oxiana Resources	650	1,500	1.24%		18	50	100	100	80	70	70	70	70	70
Phu Kham	Laos	Pan Australian	232	1,190	0.62%			18	50	52	52	52	52	52	52	52
Toromocho	Peru	Peru Copper Inc	1,524	9,237	0.47%							90	225	243	243	243
Northmet	USA	Polymet	380	1,308	0.31%			9	33	33	33	33	33	33	33	33
Resolution	USA	Rio / BHP	3,000	15,000	1.50%											180
La Granja	Peru	Rio Tinto	1,500	12,000	0.60%									90	180	180
Cananea SX EW III and exp	Mexico	Southern Copper	206	10,312	0.40%			15	60	65	65	65	65	65	65	65
Cuajone conc exp	Peru	Southern Copper	334	3,018	0.52%			10	20	25	25	30	55	55	55	55
Tia Maria	Peru	Southern Copper	300	na	na			15	40	40	90	90	90	90	90	90
Toquepala Conc Expansion	Peru	Southern Copper	395	5,474	0.49%						23	27	27	59	59	59
El Arco	Mexico	Southern Copper	1,583	5,267	0.52%								36	171	171	171
Los Chancas	Peru	Southern Copper	417	2,000	1.00%								32	45	45	45
Cananea (new conc)	Mexico	Southern Copper	971	22,845	0.40%						18	45	72	144	144	144
Mwambashi	Zambia	TEAL	25	209	2.43%		5	9	12	15	15	15	15	15	15	15
Gibraltar - Phase 2	Canada	Taseko Mines	130	1,638	0.31%		14	23	32	32	32	32	32	32	32	32
Prosperity	Canada	Taseko Mines	250	907	0.22%							24	39	49	49	49
Konkola Deep	Zambia	Vedanta	400	8,900	3.50%							32	100	153	153	153
Lomas Bayas Expansion	Chile	Xstrata	120	783	0.32%			5	10	10	10	10	10	10	10	10
Antapaccay	Peru	Xstrata	300	2,665	0.75%					27	59	90	90	90	90	90
Antamina Expansion	Peru	Xstrata	125	3,574	1.15%						14	27	31	31	31	31
El Pachon	Argentina	Xstrata	1,000	4,705	0.65%							90	198	198	198	198
Las Bambas	Peru	Xstrata	2,000	5,227	1.21%								180	257	257	257
El Morro	Chile	Xstrata	1,000	2,894	0.59%							45	108	108	108	108
Frieda River	PN Guinea	Xstrata	3,000	4,559	0.68%									150	225	225
Collahuasi - Phase 1	Chile	Xstrata / Anglo	660	2,868	0.17%						92	184	184	184	184	184
Collahuasi - Phase 2	Chile	Xstrata / Anglo	2,000	4,780	0.44%								153	307	307	307
Total - New copper			65,556	360,674	0.61%	184	472	1,172	1,852	2,257	3,179	4,405	6,074	7,340	8,153	8,587
Incremental production from ramp-up of current mines						565	709	715	715	715	715	715	715	715	715	715
Decrease due to depletion & lower grades						-	(77)	(171)	(347)	(365)	(390)	(718)	(874)	(1,337)	(1,447)	(1,505)
Incremental copper supply						749	1,103	1,716	2,220	2,607	3,504	4,402	5,915	6,717	7,420	7,796
yoy growth						4.2%	1.9%	3.3%	2.6%	1.9%	4.4%	4.2%	6.8%	3.4%	2.9%	1.5%

Source: Company Data, Credit Suisse estimates

Companies Mentioned (Price as of 02 Aug 08)

Antofagasta (ANTO.L, 632.50 p, NEUTRAL, TP 600.00 p, OVERWEIGHT)

Kazakhmys Plc (KAZ.L, 1310.00 p, OUTPERFORM, TP 2000.00 p, OVERWEIGHT)

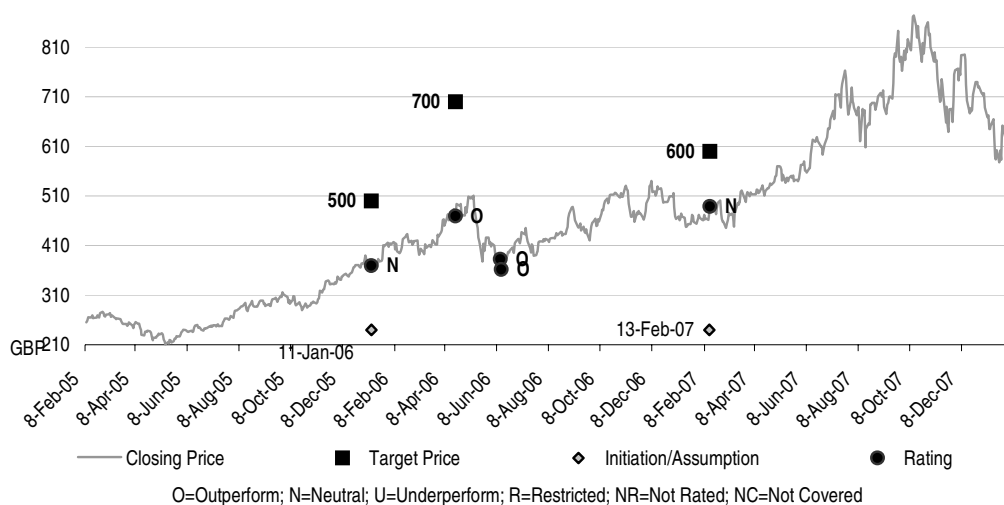
Disclosure Appendix

Important Global Disclosures

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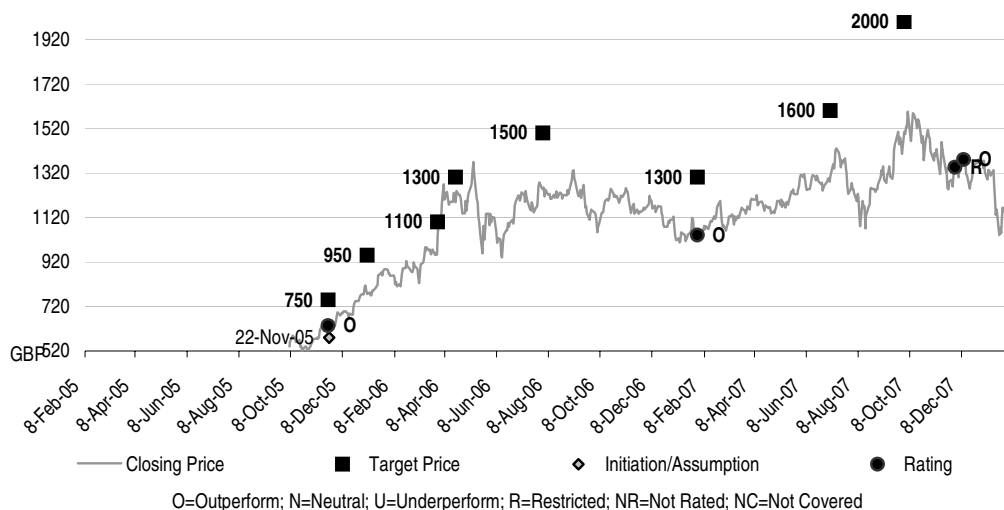
See the *Companies Mentioned* section for full company names.

3-Year Price, Target Price and Rating Change History Chart for ANTO.L



ANTO.L Date	Closing Price Price (p)	Target Price Price (p)	Rating	Initiation/ Assumption
11-Jan-06	369.6	500	NEUTRAL	X
20-Apr-06	469.6	700	OUTPERFORM	
12-Jun-06	382.2		OUTPERFORM	
13-Jun-06	361.6		OUTPERFORM	
13-Feb-07				X
14-Feb-07	489	600	NEUTRAL	

3-Year Price, Target Price and Rating Change History Chart for KAZ.L



KAZ.L Date	Closing Price Price (p)	Target Price Price (p)	Rating	Initiation/ Assumption
21-Nov-05	633	750	OUTPERFORM	
22-Nov-05				X
6-Jan-06	775	950		
30-Mar-06	1042	1100		
20-Apr-06	1188	1300		
1-Aug-06	1249	1500		
30-Jan-07	1040	1300	OUTPERFORM	
6-Jul-07	1305	1600		
1-Oct-07	1505	2000		
30-Nov-07	1345		RESTRICTED	
10-Dec-07	1380		OUTPERFORM	

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Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.

Underweight: Industry expected to underperform the relevant broad market benchmark over the next 12 months.

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***The broad market benchmark is based on the expected return of the local market index (e.g., the S&P 500 in the U.S.) over the next 12 months.*

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Underperform/Sell*	12%	(49% banking clients)
Restricted	3%	

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Price Target: (12 months) for (ANTO.L)

Method: Sum-of-the-parts valuation, with the value of the individual operations derived by using a Discounted Cash Flow method of the operating/reserve life of the asset (an 8% discount rate for operating assets, 10% for Esperanza and 12% for Tethyan) and the team commodity price forecasts

Risks: Prices of commodities (Copper), exploration success in finding new resources, Operational risks in bringing new projects to full production, Acquisition risks given the significant net cash position of the company, political risks of operating in Chile

Price Target: (12 months) for (KAZ.L)

Method: Discounted Cash Flow method (based on a 2.5% LT growth rate, a WACC of 10.5% derived from a cost of equity estimate of 11.2% and a tax rate of 36%) and the team commodity price forecasts

Risks: Prices of commodities (Copper), exploration success in finding new resources, Operational risks in bringing new projects to full production, Acquisition risks given the significant net cash position of the company, political risks of operating in Kazakhstan, Corporate governance risks of shareholding by major 'oligarchs'

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