

Polymetal

Flat production, better efficiency

► **Polymetal International (LSE: POLY) reported FY18 results.**

The company produced 1,562koz of GE in FY18, up 9% YoY from 1,433koz in FY17 and above 1,550koz guidance. Major contributors to the growth were Albazino (+15% YoY to 308koz), Varvara (+9% YoY to 142koz), Svetloye (+28% YoY to 136koz) and Kyzyl launch in 2018 (96koz). Gold sales reached 1,198koz, up 10% YoY, and silver sales were down 3% YoY to 25.7moz in FY18. The company reported \$1,882mn revenue (up 4% YoY) and \$780mn adjusted EBITDA (up 5% YoY) in FY18. Total cash costs (TCC) of Polymetal were down 1% YoY to \$649/GE oz, while AISC were down 4% YoY to \$861/GE oz. Polymetal reported \$355mn net earnings in FY18 compared to \$354mn in FY17. The company has completed its Kyzyl project in 2018 cutting the capex by 10% YoY to \$344mn. The acquired assets Nezhda and Prognoz added some extra capex to total \$395mn for the year. Net debt reached \$1,520mn at the end of 2018, that translates to 1.95x Net debt/Adjusted EBITDA ratio. The company announced a final dividend of \$0.31 per share for FY18. Polymetal reported strong ESG performance, however, it regrettably reported one fatal accident at Kapan underground mine in 2018. Overall, results came in line with expectations and slightly above the company's previous guidance.

► **Polymetal provided flat production guidance for FY19.** The sale of several production assets, including Kapan and Okhotsk operations will result in lower than expected production forecast for 2019-2021, while Kyzyl ramp-up shall offset this decline. Overall, the production target of 1,550koz per year is set by the management for the next two years. The Nezhda project and POX-2 operations will drive the production growth further to 1,750koz in 2022 and to 1,850koz in 2023 respectively. Polymetal rebalanced portfolio shall also have lower AISC at \$800-850/oz in 2019 down from \$861/oz in 2018 due to lower costs at Kyzyl and higher costs associated with sold assets.

► **We upgrade our 12-month price target to GBp 901, rating Hold.** The company's share price was up 37% between mid-September and the end of 2018, in line with global peers, while the gold price added 7% during the period. We expect a stable gold price in the range of \$1,250-1,300/oz in 2019. The Polymetal's flat production profile and improving AISC shall contribute to the stable share price with some 10% upside in our base scenario. Based on DCF, our 12-month price target is GBp901, up from GBp861 before. Polymetal trades with 43-54% discount based on Thomson Reuters consensus P/E'19-21 and premium 15-28% based on consensus EV/EBITDA'19-21. We change our rating from Buy to Hold.

Report date: 20 March 2019

Main exchange	LSE
Rating	HOLD
Number of shares, mn	
Current Price, GBp	864
12M Target price, GBp	901
Current MCap, \$ mn	5,363
Free float, %	55%

Description:

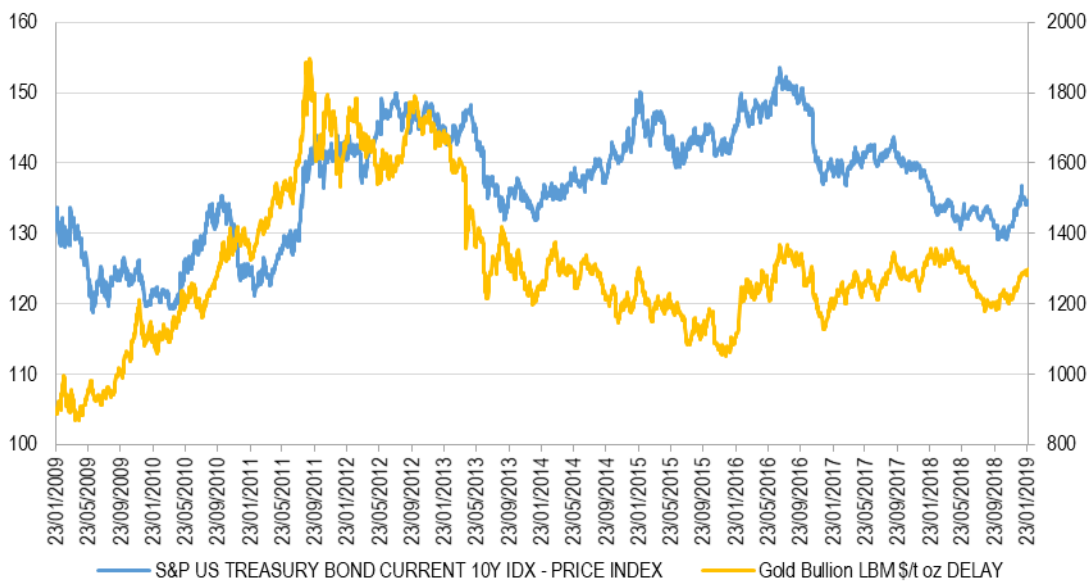
Polymetal International is a leading silver and gold producer with assets in Russia, Armenia, and Kazakhstan. The company is listed on LSE and is a part of FTSE-250. Polymetal has an impressive pipeline of projects under developments and targets essential production growth in 2017-2020. The company meets high ESG standards, being top ranked among its peers by Sustainalytics, RobecoSAM and others.

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Gold market overview

Over the last 15 months, the gold market went through tops and bottoms with a gold price varying from above \$1,300/oz to a below \$1200/oz level. The uncertain macro environment with changing interest rates contributed to the investors' gold-as-an-asset perception.

Figure 1. Raising interest rates supported a gold rally historically - UST 10Y Index vs Gold Bullion LBM price, \$/oz



Source: Thomson Reuters

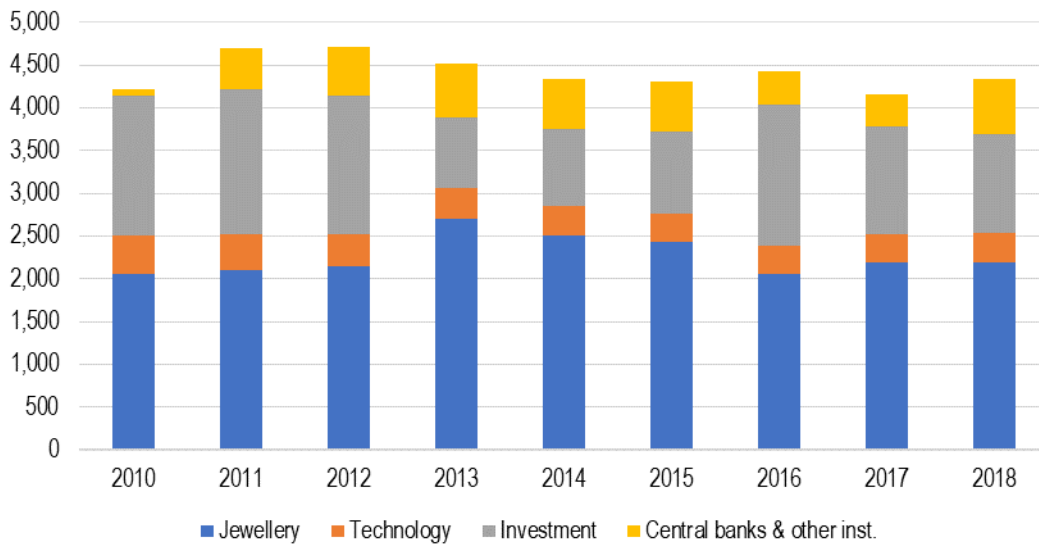
Figure 2. Strong equity market performance affected gold-as-an-asset attractiveness - S&P 500 Index vs Gold Bullion LBM price, \$/oz



Source: Thomson Reuters

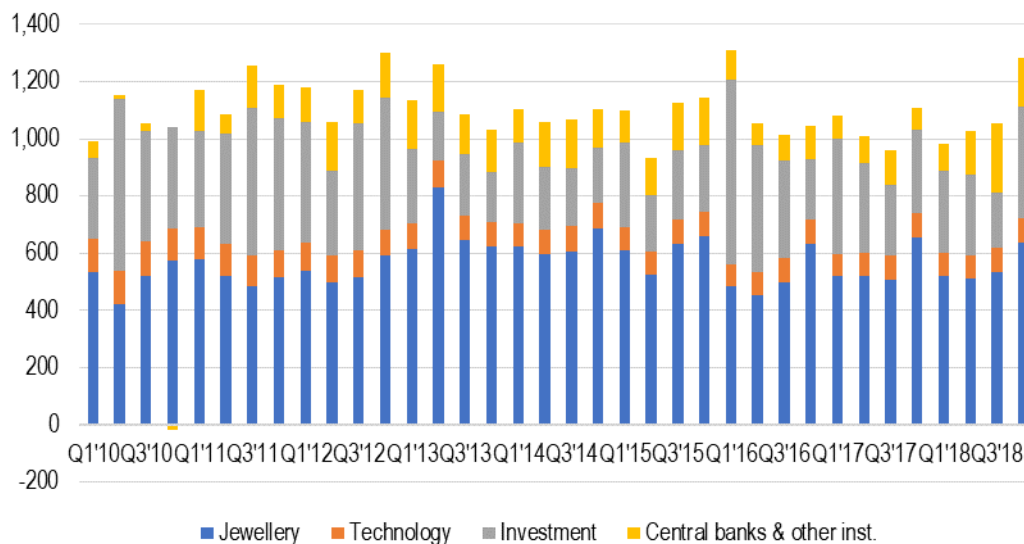
Gold demand remained robust in 2018. The global gold demand growth was 4.45% YoY at 4,345t, driven mostly by central bank and other institutions purchases (up 73.8% YoY) and technology demand (up 1% YoY). Although investments in gold were down 7.4% YoY to 1,159t, the investment in official coins were up 26% YoY to 236t offset by ETFs flow reduction by 66.6% YoY in 2018.

Figure 3. Central banks purchases were the main driving force of gold demand in 2018 - Gold demand was up 4% YoY in 201



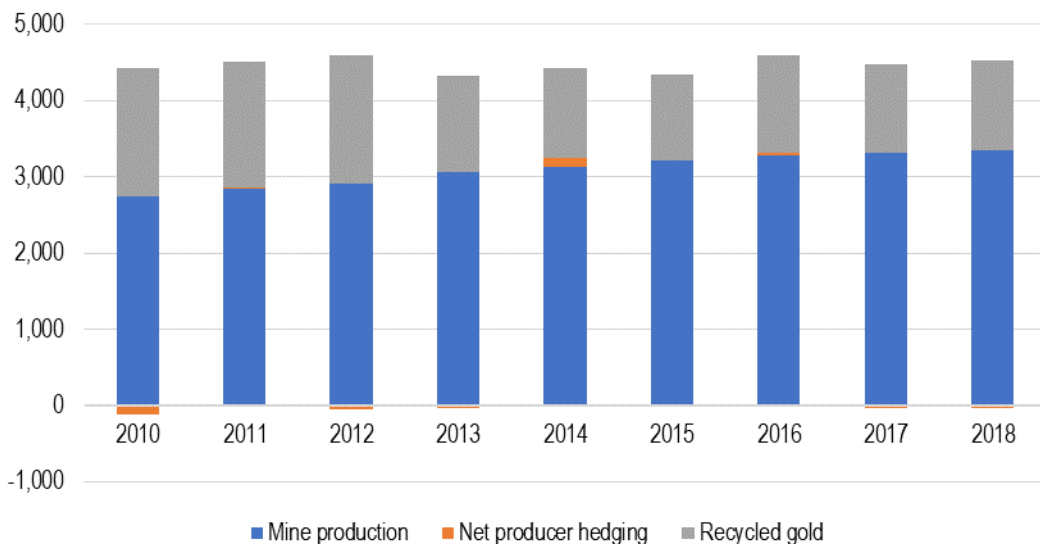
Source: World Gold Council, Thomson Reuters

Figure 4. Gold demand increased 15.7% YoY in 4Q18 due to strong investments in gold and central bank purchases – Quarterly structure of gold demand



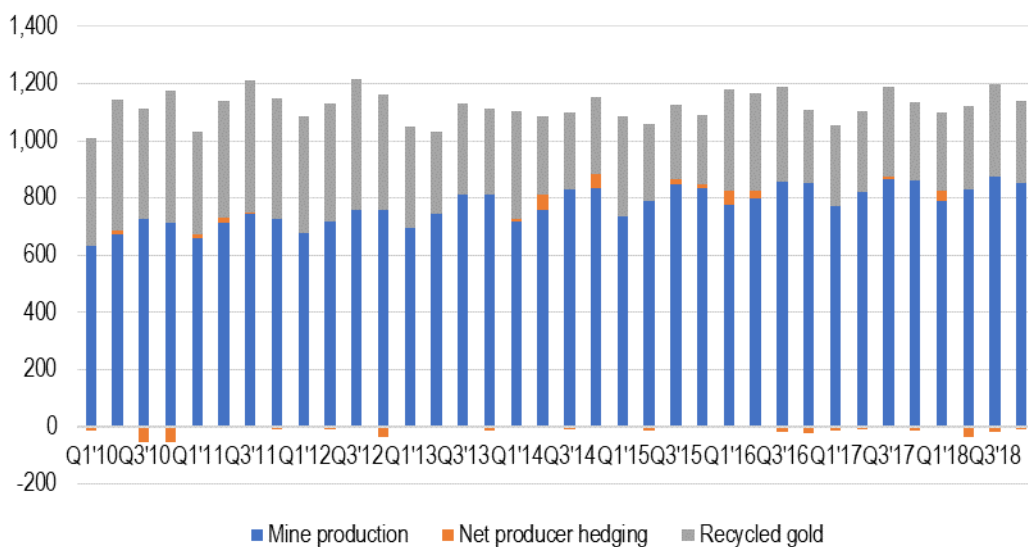
Source: World Gold Council, Thomson Reuters

Figure 5. Total gold supply increased 1% YoY in 2018 due to mine production and recycled gold increase – Gold supply structure



Source: World Gold Council, Thomson Reuters

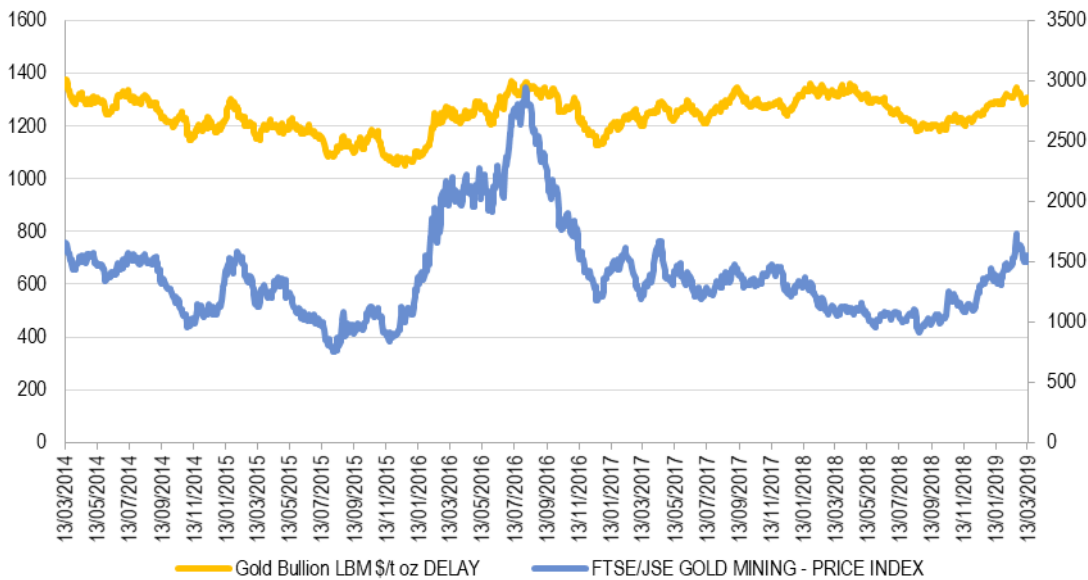
Figure 6. The gold supply remains stable with historically higher portion of mined gold (from below 65% in 2010 to above 75% in 2018)



Source: World Gold Council, Thomson Reuters

The performance of the global gold producers were strong over the last 6 months, following the US Fed rate increase and the S&P500 correction in October 2018.

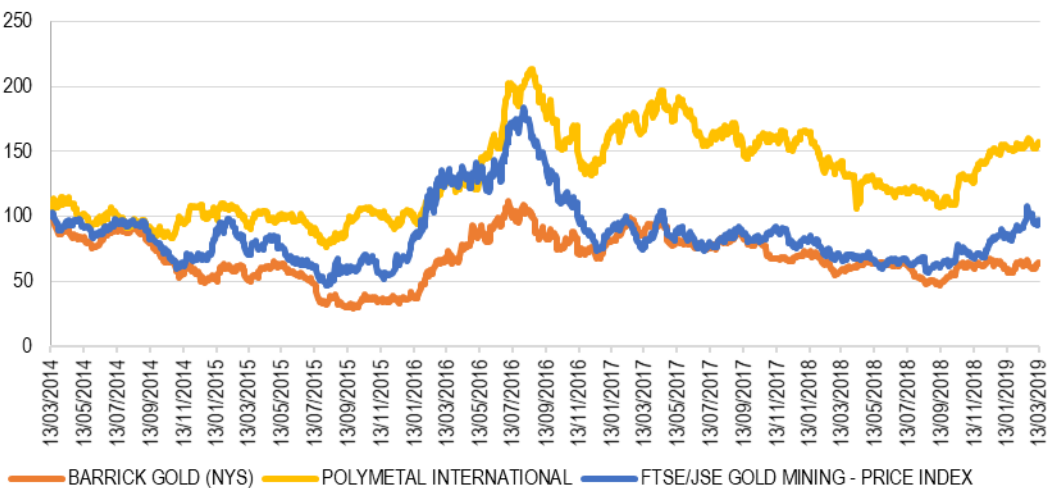
Figure 7. Gold mining stock price index outperformed the gold price in the last 5 months – FTSE/JSE Gold Mining price index vs Gold price



Source: Thomson Reuters

The gold price increase and the merger of largest gold producers Barrick and Randgold Resources, as well as Newmont and Goldcorp, announced in the last 9 months, affected the stock price performance of gold producers despite mixed financials.

Figure 8. Share price performance of Polymetal, Barrick Gold and FTSE/JSE gold mining price index



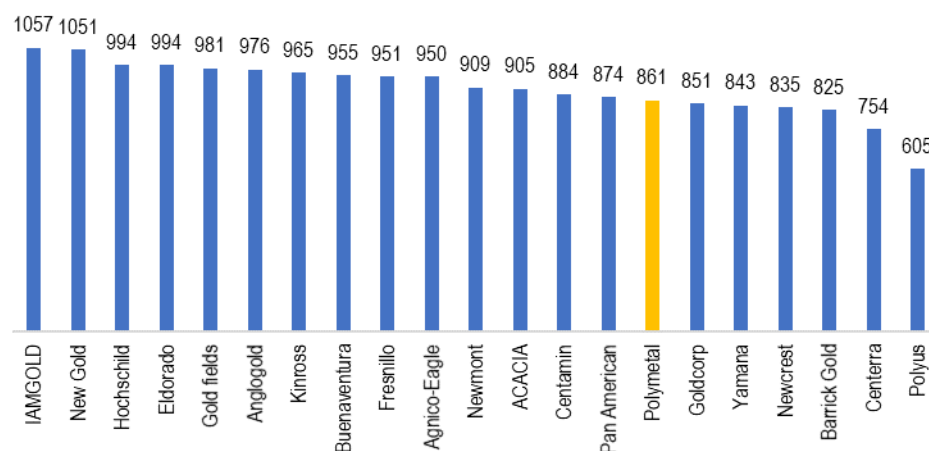
Source: Thomson Reuters

Company overview

Polymetal share price was up 37.6% between mid-September and the end of 2018 and made another 5% since the beginning of 2019. The company reported strong operating performance, launching its Kyzyl project in time, and delivering production results above expectations.

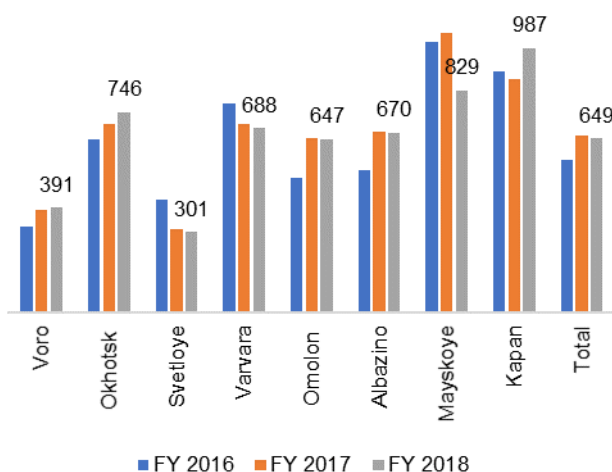
In 2018, Polymetal restructured the portfolio of its mining assets, with Kapan and Okhotsk operations sold while Nezhda project added to the portfolio. Polymetal reported \$861/oz all-in sustaining costs (AISC) for 2018 that puts it among the most efficient gold producers. The portfolio restructuring shall result in 2019 AISC reduction to the level \$840-850/oz.

Figure 9. AISC of gold producers in 2018, \$/oz



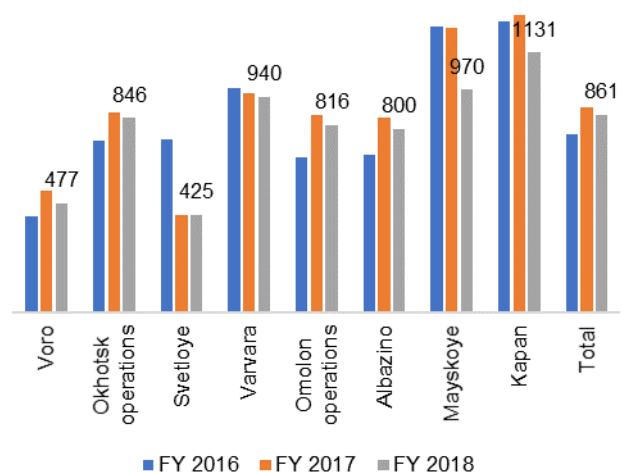
Source: companies data

Figure 10. Polymetal Total cash cost, \$/oz



Source: company data, data labels for 2018

Figure 11. Polymetal AISC, \$/oz



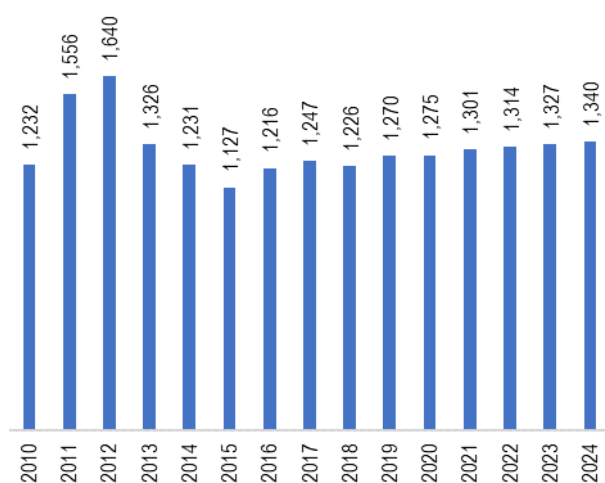
Source: company data

The flat production profile, stable price environment, and lower AISC shall provide relatively good profitability during 2019. The lower grade at existing mines and lower output are risks we see over the forecasting period 2019-2023.

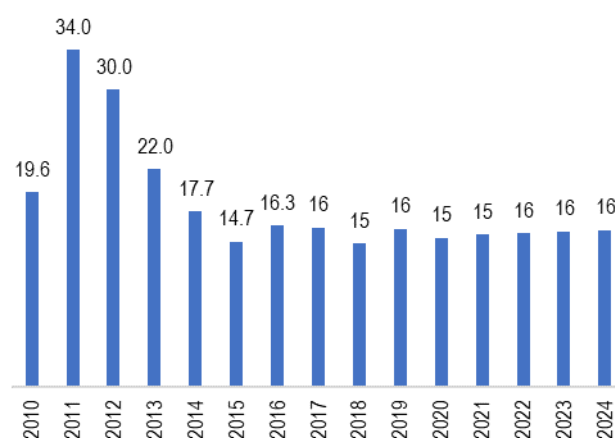
Figure 12. Polymetal key financial figures

Income statement						Statements of cash flows					
\$mn	FY17	FY18	FY19	FY20	FY21	\$mn	FY17	FY18	FY19	FY20	FY21
Revenue	1815	1882	1876	1784	1767	Net cash generated by operating activities	533	513	699	658	641
Cost of sales	-1106	-1096	-1042	-1042	-1044	Net cash used in investing activities	-477	-379	165	-546	-58
Gross profit	709	786	834	742	723	Net cash generated by financing activities	-67	224	-533	-139	-380
SG&A	-158	-175	-161	-160	-159	Net (dec.)/ inc. in cash and equivalents	-11	358	331	-27	204
Other expenses	-41	-76	-52	-54	-55	Cash and cash equivalents bop	48	36	379	710	683
Operating profit	510	535	621	528	510	Effect of foreign exchange rate	-1	-15	0	0	0
Non-operating income/expenses	-67	-109	-97	-92	-99	Cash and cash equivalents eop	36	379	710	683	887
PBT	443	426	523	436	411	Capex	370	365	377	403	417
Income tax expense	-89	-71	-87	-73	-69	Dividends					
Profit/Loss for the period	354	355	436	364	343	Dividends	189	213	283	254	240
EBITDA	761	762	897	815	807	Net debt	1420	1520	1443	1355	1291
Balance sheets											
USD mn	FY17	FY18	FY19	FY20	FY21	Ratios	FY17	FY18	FY19	FY20	FY21
PPE	2054	2426	2514	2605	2711	Gross margin, %	39%	42%	44%	42%	41%
Goodwill	18	15	15	15	15	Operating margin, %	28%	28%	33%	30%	29%
Investments in assoc. and JV	96	2	2	2	2	Net margin, %	20%	19%	23%	20%	19%
Non-current loans	15	6	6	6	6						
Deferred tax asset	61	73	73	73	73	Revenue growth	15%	4%	0%	-5%	-1%
Non-current inventories	123	95	90	90	90	Net profit growth	-10%	0%	23%	-17%	-6%
Total non-current assets	2367	2617	2701	2791	2897	EBITDA growth	0%	0%	18%	-9%	-1%
Total current assets	761	1218	1445	1410	1614	Capex growth, %	28%	-1%	3%	7%	3%
Total assets	3128	3835	4146	4201	4511	Payout ratio	53%	60%	65%	70%	70%
Total current liabilities	-214	-421	-324	-313	-321						
Long-term debt	-1430	-1782	-2015	-1907	-2038	EBITDA / Interest coverage	12.1	10.7	9.2	8.8	8.2
Contingent consid. liab.	-57	-49	-49	-49	-49	Net debt/EBITDA	1.9	2.0	1.6	1.7	1.6
Deferred tax liability	-77	-152	-152	-144	-143	Net debt/Equity	1.1	1.1	0.9	0.8	0.7
Environmental obligations	-39	-32	-32	-32	-32	Revenues/Assets	0.6	0.5	0.5	0.4	0.4
Other non-current liabilities	-4	-2	-2	-2	-2	Capex/ EBITDA	0.5	0.5	0.4	0.5	0.5
Total non-current liabilities	-1607	-2017	-2250	-2134	-2264	RoCE	18.5%	16.2%	16.7%	13.9%	12.4%
Total liabilities	-1821	-2438	-2573	-2447	-2585	FCF yield	3.1%	2.8%	6.1%	4.8%	4.2%
Net assets	1307	1397	1573	1755	1926	RoIC	6%	4%	4%	3%	3%
Total equity	1307	1397	1573	1755	1926	ROE	27%	25%	28%	21%	18%
Total liabilities and equity	3128	3835	4146	4201	4511						

Source: company data, Hypothesis Research estimates

Figure 13. Average realized gold price forecast, \$/oz

Source: Polymetal, Hypothesis Research estimates

Figure 14. Average realized silver price forecast, \$/oz

Source: Polymetal, Hypothesis Research estimates

Our DCF model provides GBp901 price target for the stock, based on our updated financial model. We see limited upside for the stock in flat price and production environment and change our rating from Buy to Hold.

Figure 15. Polymetal DCF calculation

\$mn	2019	2020	2021	2022	2023
EBIT	621	528	510	909	1025
Less taxation	-87	-73	-69	-131	-152
Tax adjusted EBIT	533	456	441	778	873
Depreciation	277	287	297	309	240
Less: Capex	-377	-403	-417	-341	-291
Change in working capital	-14	8	2	-23	-17
Unleveraged free cash flow	419	347	323	724	805
WACC	10.9%				
Future cash flow growth rate	1.0%				
Fair market capitalisation	5,584				
Fair value, \$	12				
Fair value, GBp	901				
WACC calculation					
Cost of equity	13.7%				
Cost of debt	4.0%				
Beta	1.22				
Rate of return on risk-free securities	3.5%				
Basic equity risk premium	6.5%				
Relative equity risk premium	6.5%				
WACC	10.9%				

Source: Hypothesis Research estimates

Polymetal trades with 43-54% discount based on Thomson Reuters consensus P/E'19-21 and premium 15-28% based on consensus EV/EBITDA'19-21. Compared to the global majors Newmont and Barrick average, Polymetal trades with 13-68% discount based on both P/E and EV/EBITDA multiples.

Figure 16. International peer comparison

Company name	Market Cap., \$mn	Enterprise Value, \$mn	P/E Fwd 1Y	P/E Fwd 2Y	P/E Fwd 3Y	EV/ EBITDA 1Y fwd	EV/ EBITDA 2Y fwd	EV/ EBITDA 3 fwd	EV/ Sales 1y fwd	EV/ Sales 2y fwd	EV/ Sales 3y fwd
International majors											
Newmont Mining	17727	19553	27.9	25.6	23.5	7.6	8.0	7.9	2.6	2.7	2.7
Barrick Gold	22493	28452	35.4	29.1	31.5	8.7	8.1	8.1	3.5	3.4	3.2
Newcrest Mining	13612	14671	24.9	20.6	22.0	9.1	8.0	8.3	3.9	3.6	3.8
Antofagasta	12629	15356	17.2	16.2	15.1	5.8	5.7	5.9	2.9	2.9	2.8
GoldCorp	9405	12338	36.4	24.4	29.5	7.4	5.9	5.6	3.3	2.9	2.8
Agnico Eagle Mines	10179	11518	88.1	48.6	47.4	12.6	9.9	10.0	5.0	4.2	4.2
Fresnillo	7854	8025	24.7	19.7	13.9	8.1	6.8	5.8	3.6	3.4	3.0
Kinross Gold	4140	5546	33.4	21.8	24.6	4.9	4.8	4.1	1.7	1.7	1.6
AngloGold Ashanti	5552	7309	13.5	12.1	12.1	4.8	4.6	4.6	1.8	1.7	1.7
Gold Fields	3195	5008	17.5	13.8	15.6	4.1	3.8	4.0	1.8	1.7	1.6
Sibanye Gold	2597	4167	12.9	9.4	9.2	4.0	3.2	4.0	0.9	0.8	0.9
Centamin	1400	1117	21.1	16.0	12.7	4.4	3.7	3.1	1.7	1.6	1.5
Harmony Gold Mining Company	1024	1339	12.7	7.2	9.2	3.8	2.6	3.1	0.7	0.7	0.7
Acacia Mining	1093	1005	13.2	9.8	11.6	4.3	3.7	3.9	1.4	1.3	1.5
Freeport-McMoRan Inc	18374	33392	26.5	13.8	6.7	9.3	7.0	4.5	2.2	2.1	1.7
Average for gold major group			27.0	19.2	19.0	6.6	5.7	5.5	2.5	2.3	2.2
Russian gold companies											
Polyus	11397	15371	7.6	7.9	6.9	6.1	6.4	6.0	4.1	4.1	3.9
Polymetal International	5363	6901	10.4	9.7	8.8	7.1	7.0	6.5	3.4	3.3	3.1
Petropavlovsk	363	937	11.0	11.0	5.5	6.9	7.7	5.9	1.7	1.7	1.6
Auriant Mining	27	102	3.6	3.6	3.3	5.3	4.9	19.3	2.3	Na	Na
Trans-Siberian Gold	69	80	6.4	6.4	6.4	3.1	3.1	3.1	1.3	1.3	1.3
Average for Russian peer group			7.8	7.7	6.2	5.7	5.8	8.2	2.6	2.6	2.5

Source: ThomsonReuters

Figure 17. Average realised gold price, \$/oz

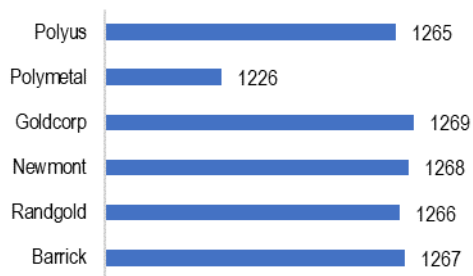


Figure 18. Gold production, moz

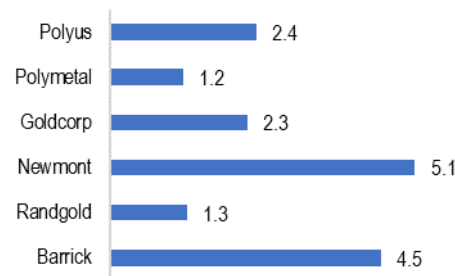
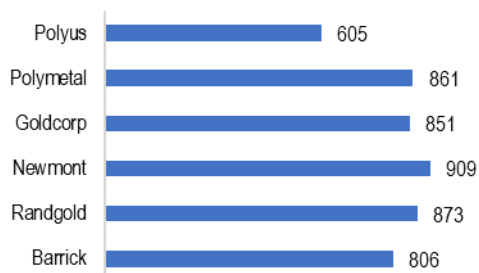
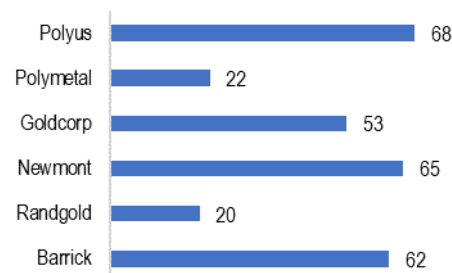


Figure 19. AISC, \$/oz



Source: companies' data

Figure 20. 2P gold reserves, mn oz



Source: companies' data

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