



**REMIGIUSZ ROSICKI**

Adam Mickiewicz University

Faculty of Political Science and Journalism



## ***"The Copper Market: KGHM Polska Miedź S.A. (Poland)"***

### **KGHM Polska Miedź S.A. as a strategic company of the State Treasury**

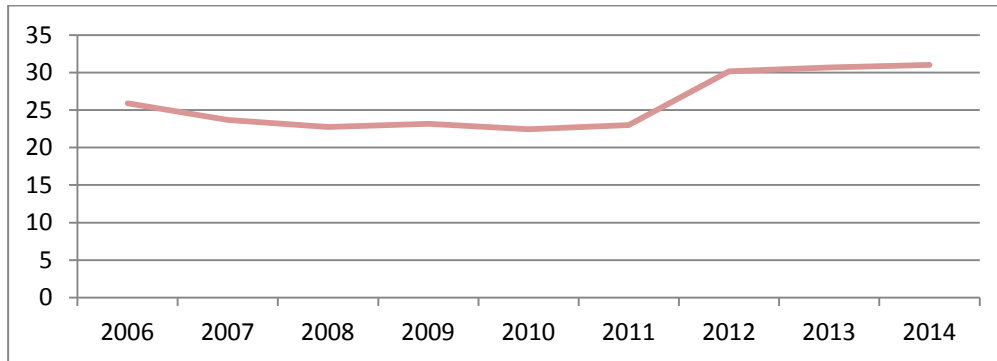
Globally, KGHM comes eighth in respect of the size of recoverable copper reserves it owns. The company holds mining licences that allow it to tap domestic copper deposits amounting to 26 million tons. Owing to the investments made abroad in 2012, the deposits were estimated at 37.5 million tons, which shifted KGHM - as a result of the reserves owned - to the fourth position. Besides, in 2014 KGHM began extracting copper ores in one of the biggest mines in the world, in Sierra Gorda (copper-molybdenum deposits). The copper exported from Poland is valued at 2.6 billion USD (the share in the global export is 3.85%).

### **Deposits and extraction of copper ores and copper in Poland**

In 2014 the extraction of the copper ores amounted to more than 31 million tons; it should be noted that a substantial rise in the extraction of the raw material took place in 2012 [see Diagram 1]. The geological deposits of copper ores are estimated at 1.73 billion tons, whereas the industrially viable deposits at 1.19 billion tons. In the period of 2006-2014 a depletion of the copper deposits could be noticed, which was chiefly related to the exploitation of deposits. As for copper itself, the extraction amounted to 473 thousand tons in 2014. Similarly, as regards copper ores, in the period of 2006-2014 a depletion of the deposits of copper was observable – in 2014 its deposits were at 33.22 million tons.

**Diagram 1.**

Extraction of copper ore in Poland in 2006-2014 (in million tons).



**Source:** based on the State Geological Institute data.

According to KGHM in 2014 the copper ore it extracted was used to produce, inter alia, 1,256.2 tons of silver and 226.1 kilograms of gold. In addition, in 2014 KGHM produced 576.9 thousand tons of electrolytic copper (copper of high purity), where 420.4 thousand tons came from the company's own concentrates, and 156.5 thousand tons came from foreign concentrates.

### **KGHM and the domestic situation**

The economic standing of KGHM is chiefly conditional upon external factors, that is the price of copper on international markets. Still, it is noteworthy that the internal policy may influence the company's receipts and/or better quotes on the stock exchange. In the second half of 2015 (Q3) the KGHM share price dropped to a six-year low. The quotes did not improve and continued declining despite the fact that three years earlier some foreign investments had been made, and these were supposed to be of strategic and prospective relevance for the international standing of the company. In 2012 KGHM took over the Canadian company Quadra FNX Mining Ltd. (presently known as KGHM International Ltd.) for approx 2.8 billion USD.

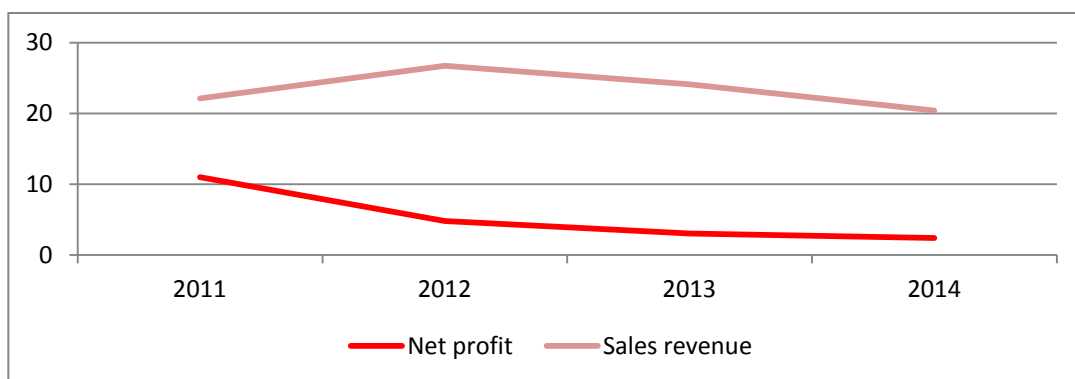
Analysts point out the debatable direction of investments made by KGHM in the deposits outside the country, however the appraisal is far from unambiguous. Yet, it

is worth noting that for the company to be globally competitive against other operators, a strategic move must be made to acquire external deposits. As regards the domestic deposits, KGHM is bound to be grappling with increasingly difficult geological conditions, and by extension with increasing costs of extraction. This problem has not been emphasised because of the company's sizeable receipts in the period of rising prices of copper, but it must be stressed that the mining depth is increasing (at present it is about 1000-1500 metres, e.g. the mining area of "Głogów Głęboki-Przemysłowy"). The depth is not the only problem, for there is the quality of the deposits to be taken into consideration (content of copper in ores) as well as the issue of transport of ores with a view to concentrating them.

The negative impact of decreasing prices of copper on global markets can be minimized by changes to the taxation of raw material extraction. Still, one should not expect such a move in the internal policy, for it would considerably reduce the government revenue, and the state budget has seen its better days. For instance, the tax on the extraction of some ores – in the case of KGHM – amounted to 1.5 billion PLN, and made up 12% of the costs of operating activity in 2014.

### Diagram 2.

Net profit and sales revenue of KGHM Capital Group in 2011-2014 (in billion PLN).



Source: own study based on KGHM data.

The economic downturn has a special effect on the company's sales revenue and net profit, which have been on the decline since 2011 [see Diagram 2]. The net



profit in 2011 amounted to 11 billion PLN, in 2012 – 4.8 billion PLN, and in 2013 it decreased by 1.7 billion PLN, while in 2014 it was estimated at 2.4 billion PLN. It is also worth remarking that the very flagship project – Sierra Gorda – puts a considerable economic strain on KGHM. The outlays on tangible fixed assets and intangible assets in the project amounted to 3.5 billion PLN in 2013, and 3.3 billion PLN in 2014.

### **KGHM and the international situation**

Prices of copper on international markets are of great importance; for instance, in the six-year period (18.08.2009 – 18.08.2015) the raw material became cheaper by about 19-20%, that is roughly by 1,185 USD for a ton of copper. It must also be stressed that in the period prices rose significantly, e.g. in February 2014 the prices were as high as 10,165 USD for a ton of copper. A lack of steady prices on the copper market is sure to influence the company's worth and its revenue. Analysts point out that prices falling down to or even below the level of 4,500 USD for a ton will negatively impact the financial stability of KGHM, and the bear market over a period of two years may markedly destabilize the operation of the company. Besides, the functioning of the company will be conditioned by the prices on the global markets of silver (e.g. in the period of 2012-2015 we witnessed a downward trend, where the decline was of about 45%). In the case of both copper and silver, the reduction in the price of copper on global markets in 2014 was caused by the fact that the dollar was rising.

Furthermore, it is stressed that the low prices of copper result from a reduced demand, which comes mainly from China with regard to the growing economy. One should however be sceptical about the official Chinese data on the GDP growth of 7%. If the trend of the declining Chinese GDP sets in, then we can expect a further decrease in the copper prices on international markets. The economic situation of China is of strategic significance because of the fact that the country accounts for



about 34% of global import, that is 24.6 billion USD (whereas the value of the import for the whole of Asia amounts to about 44.5 billion USD). The next region in respect of the size of import is Europe (the level of import is about 19 billion USD).

A decline in the company's value may potentially lead to a hostile takeover by foreign capital. This can be facilitated by the fragmented ownership, where the state treasury owns 31.79% of shares. From the viewpoint of geographical distribution of shareholding, Polish shareholders account for 52.45%, shareholders from USA – 12.91%, whereas unidentified shareholders – 18.92%. It must be however noted that in the analysis of the shareholding structure, 81.08% of shares issued by the company were identified. It all goes to show that if a determined investor came along, they might buy in the KGHM shares, and the cost of the takeover of the half of the shares today may be estimated at around 2 billion USD.

### Sources:

[1] *Quotes*, in: <http://www.bankier.pl/inwestowanie/profile/quote.html?symbol=MIEDZ>.

[2] *Copper Development Association*, in: <http://www.copper.org>.

[3] *International Copper Association*, in: <http://copperalliance.org>.

[4] *European Copper Institute*, in: <http://www.copperalliance.eu>.

[5] *KGHM Polska Miedź SA*, in: <http://kgm.com>.

[6] *Polish Geological Institute*, in: <http://baza.pgi.gov.pl>.