Recommendation: BUY **Target Price (12/31/2016): $34**

1. Reasons for the Recommendation

After recent weakness in FCX I have given the stock a recommendation of buy. Events in the past year have led to major declines in the stock, but I believe that the investing environment is close to a turnaround and major returns are possible.

The reasons for the buy recommendation start with the fact that recent, ongoing, and future mine expansion projects will lead to greater weight of mined ore and higher expected ore grades, which will lead to higher metal concentration weights. Also, I believe that commodity prices (specifically gold, copper, molybdenum, and oil and nat. gas equivalents) have started to stabilize. I expect prices for FCX specific commodities to remain relatively stable or experience slight increases, as mentioned below, over the next few years. Furthermore, FCX management has stated, and it is in their best interest, that they will restrict some capital spending in the near future. This action by management will help protect net income against higher depreciation expenses that will occur in the coming years.

FCX will start to benefit from higher production levels of copper and gold at the Morenci mine in the U.S., after expansions in South America, and future expansions and mine openings over the next few years in Indonesia. I am not as optimistic as FCX on weight produced over the near term, but even with my corrections to FCX management forecast, all else equal, my price target for 2016 provides a 64% increase as of April 17 (in stock price excluding dividends).

Regards to Indonesia specifically, expansions will lead FCX to take advantage of higher ore grades. Along with higher concentration weights per ton of ore, higher ore grades will help FCX keep costs stable while metal weights increase.

Copper prices are expected to be subdued, with small decreases, in coming years due to China's slowing economy. Though recent flooding and power outages in Chile and Australia, respectively, will provide an upward force on copper (and gold) price due to expected production disruptions in the near term. Gold prices are expected to increase to under $1300/ounce by the end of 2016 (IBIS).

I expect the price of oil and natural gas equivalents to remain below 2014 levels for several years unless major changes are seen in U.S. and/or OPEC output levels, all else equal. This also takes into account that there is no expectation that China's economy will observe any major turnaround in the short term (through the end of 2016).

The recommendation of buy may be hampered by the fact that FCX may not meet production levels expected, commodity prices remain lower than expected, or other unforeseen events that affect price, supply, or demand. Moreover, my forecast does provide a scenario for 2015 where stock prices could further decrease, but investors should buy on any further weakness especially due to information coming from first-quarter 2015 results.

2. Company Analysis

FCX remains the largest producer of molybdenum, one of the largest copper producers, along with producing large quantities of gold, silver, and cobalt hydroxide. Over the coming years I forecast copper to retain approximately 62-63% share of total revenues. Also, as of mid-2013 FCX also provides approximately 56-million BOE (MMBOE) per year, and this volume is expected to remain relatively consistent through 2016. Approximately 90% of FCX revenues come from copper, gold, molybdenum and oil and natural gas equivalents (Freeport).

FCX has experienced much organizational change in the last 2 years. Aside from expanding into U.S. oil and gas, which added to management and changed the composition of the board, FCX has also sold it's stake in the Candelaria and Ojos del Salado mines in Chile in 2014 (Freeport). FCX had hoped to sell other assets to both decrease future depreciation expenses and help lower debt levels; however, with lower commodity prices FCX will have a difficult time finding a buyers at an acceptable price – FCX CEO has stated this scenario at a presentation early in 2015 (Mordant).

Oil and Natural gas will remain less profitable than FCX may have expected back in 2013 due to world supply outmatching demand and for the fact that FCX output levels are expected to remain flat over the next few years. FCX is conducting major exploring projects at multiple sites and is optimistic about future production levels in U.S. oil and gas.

FCX will continue to deal with government interference, labor issues, and weather events mainly outside the U.S. that could add costs and/or delays. For example, the Grasberg mine in Indonesia possesses each of these risks. Indonesia is located in a geological active area, with the possibility of heavy rains and flooding, and FCX has had to deal with government interference and labor strikes in the past year. The issue(s) with the Indonesian government is ongoing and investors will need to stay tuned as early as mid-2015 for further updates on this relationship.

One major strength currently for FCX stock is it's weakness in the last eight-nine months. One of the reasons for FCX stock's decline is that it's products are greatly tied to each other. For example, copper is heavily used throughout construction and so to are molybdenum and cobalt, and the daily change in oil and copper prices have a correlation over .6. Construction growth is going to be tied closely with economic performance, and economic performance will be correlated with gold and oil activity. However, aside from oil, the remainder of the FCX commodity portfolio should benefit from bottoming prices.

FCX will also see its cost per pound of copper increase in 2014 to $1.53 in 2015 from 1.51 in 2014 (after by product price assumptions), and cost of production per BOE is expected to decrease to $18 in 2015 from $20 in 2014 (Freeport). The increase in mining net cash costs for FCX, per pound of copper, should be muted by the fact that FCX will be able to produce at higher levels in coming years. It is fortunate that FCX expects costs for BOE production to decrease by 10% between 2014-2015 since output levels will be flat with little expected positive movement in oil and equivalent pricing.

3. Industry Analysis

FCX participates in oil and mining industries producing a range of copper, gold, molybdenum, cobalt, and other metal end/by-products. Although FCX may have declared that the expansion into oil and gas was a diversification move, many of the same supply-side and macroeconomic events that affect one of these resources would most likely affect the others. The latest example of this relationship was observed starting in mid-2014 through the beginning of 2015 as oil prices declined, due to demand-supply mismatch and global growth missing expectations, and FCX-specific commodities declined dramatically.

Oil and natural gas equivalent prices have been casualties of economic slowdown outside of the U.S. and a price/market-share war between OPEC (Saudi Arabia) and the U.S. (among others) shale oil enterprise. Though the U.S (and other non-OPEC countries) has recently taken many rigs offline (down approximately 30% in 2015), we still observe increases in U.S. weekly oil stockpiles – historically high levels not seen in decades (EIA). Therefore, until some positive demand shock and/or production decrease occurs by the major parties, OPEC and/or the U.S., oil and equivalent pricing growth will be relatively muted.

Oil demand will need to come from developing nations (non-OECD) since much petroleum in OECD nations have remained relatively constant in the last fifteen years – consumption for OECD (including the U.S.) has actually shifted lower as of the last seven years. However, natural gas equivalents have seen increasing consumption by both developed and developing nations (EIA).

As mentioned above, copper prices have fallen to levels not seen since the financial crises, but this is only one of many independent variables among copper producing firms' output levels. FCX is currently the second largest copper producer after Codelco (majority owned by the Chile government), while the Australian firm BHP Billiton and Southern Copper (majority owned by Mexican firm Grupo Mexico) are other major competitors. FCX may soon take the lead from Codelco as the number one copper producer in the near term after expansions made by FCX, falling ore grades and late/delayed expansion plans by Codelco, and recent weather events and water restrictions causing Codelco to loose out on concentration (Craze).

Until recently, copper prices would be pressured by increasing supply and falling demand specifically from China who recently consumes 40% of world copper. However, recent natural disasters, labor matters, and infrastructure issues, along with falling ore grades across many firms including Codelco will restrict supply in the near term. For instance, many firms such as Codelco and BHP Billiton have warned lower production levels in the near term. Moreover, as India and China return to focus on urbanization demand for copper will increase, but this may not be enough for any significant price increases. For instance, copper is highly recyclable, and in places like the U.S. just as much scrap is recycled as copper freshly mined – though scrap is currently being used less at low price levels. Thus it makes senses that copper prices are expected to remain close to $3/pound for the next several years (Crompton).

Gold prices are expected to remain in a tight range in the coming years. India and China's love for gold, as there economies improve, will be met with higher interest rates in the U.S. that will lead investors away from gold investments. Investors may also keep more gold in their portfolios out of fear left over from the financial crises. Therefore, gold prices are expected to remain in the range of 1200-1350 over the next several years (IBISWorld: Gold).

Molybdenum is used in creating strong heat resistant metal alloys and, like all other commodities, is strongly correlated with economic growth. Though steel production is expected to rise leading to greater demand in molybdenum, production is also expected to increase by miners worldwide due to increased interest in copper (molybdenum many times is a by-product of copper). Therefore prices are expected to remain between $10.50 to $11/lb. over the next several years (Crompton).

Like many mining industries gold and copper mining (including other by-products) is a mature industry with large barriers to entry. Many of the mines of any high quality are already spoken for in contract. Moreover, the cost of equipment and facility will keep many newcomers from entering. Most organizational change occurs from mining companies selling other mining companies rights or share of a mine. Moreover, it would also be feasible, in an ideal scenario, for a large corporation to enter the industry by buying out the existing firm. Competition in mining (copper, gold, and molybdenum specifically) is strong and highly concentrated (IBISWorld: Gold)(Crompton: Copper) (Crompton: Molybdenum) where more than half of market share can be shared across 3-4 companies.

Similarly, the oil and natural gas industry is mature with great barriers to entry due to high costs and risk, among others. However, we do observe firms like FCX choosing to expand into the industry through acquisition. In this scenario FCX bought Plains Exploration & Production Company (PXP) and McMoRan Exploration Co. (MMR) and kept familiar management on board to run the new segment. Competition in the industry is strong but with little concentration of market share with so many firms (large and small) participating in extraction (IBIS). For instance, in the U.S. the biggest players include Exxon, Chevron, BP PLC, and ConocoPhillips but even they only amount to 23.5% of the U.S. Oil Drilling & Gas Extraction industry, as of February 2015 (Crompton). World market share is just as concentrated with the top five firms (including only Exxon from above) control less than 20% of the market (IBISWorld: Oil). Although FCX O&G operates in the U.S. only it is still dependent upon global factors.

Appendix: Inputs into valuation using multiples

	2009	**2010**	**2011**	**2012**	**2013**	**2014**	***2014 w/out Impairment (all else equal)***	**2015**	**2016**	**2017**
Stock Price	55.77	81.27	46.23	37.72	32.51	32.33	*32.33*	12.89	34.04	38.59
EPS (basic)	3.05	4.67	4.82	3.20	2.65	-1.26	*3.99*	1.24	3.26	3.70
Sales	*15,040*	*18,982*	*20,880*	*18,010*	*20,921*	*21,438*	*21438*	18998	22513	25066
Sales Per Share Basic	18.14	20.75	22.05	18.98	20.88	20.63	*20.63*	18.28	21.67	24.12
P/E	18.29	17.40	9.60	11.77	12.26	-25.68	*8.10*	10.43	10.43	10.43
P/S	3.07	3.92	2.10	1.99	1.56	1.57	*1.57*	0.70	1.57	1.60

- *Analyst's own calculations. Source of basic data: company's 10-K; Yahoo! Finance*

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