

Southern Copper Corporation – Grupo Mexico

Contents

SCCO overview	2
SCCO valuation	7
GRUPO MEXICO	8

In the Former Republic of Yugoslavia the airline was called JAT (jugoslavian air transport or JOKING ABOUT TIME). With SCCO it looks like South Commmedy Continually Overpromising!!!!

I have analyzed Southern Copper Corporation (NYSE: SCCO) in October of [2019 SCCO Stock Analysis](#) where I said to take a look at \$27. It fell to that level just for a short time in March 2020 but I missed it 😞.



SCCO stock price chart

However, the stock price chart shows one thing is certain, there will be more ups and downs and given it is a good business, it will definitely be on the watch list.

Plus, 90% of stocks are owned by Grupo Mexico that trades on the Mexican stock exchange (available with TD Ameritrade and InteractiveBrokers from what I see), so that is also an interesting option to check. I'll start with a quick overview of SCCO, make a new valuation and then look at Grupo Mexico.

[SCCO overview](#)

In short:

- It all depends on the price of copper – copper up 20%, add a billion go free cash flow per year.
- Longest mine life for copper in the world (70 years)
- Lowest costs of mining in the world too
- One of the best assets out there.
- Started a new growth program that will need \$2 billion in capex per year up till 2025 but will then double production to 2Mt copper per year.
- Debt is \$5.5 billion with total debt/EBITDA below 2 – to be kept so
- Dividend will be volatile, especially if lower copper prices engage high capex need (time to buy).
- All in all, if they manage to do what they plan to do, free cash flows should be above \$4 billion in 2026 on double production. This is what makes it cheap on the long-term but I would love to catch it a bit lower, where I missed it in March 2020.

In 2019 I estimated free cash flows of \$3 billion in 2026 when things get going after the capital projects and capex falls to \$600 million.

SCC Financial Summary

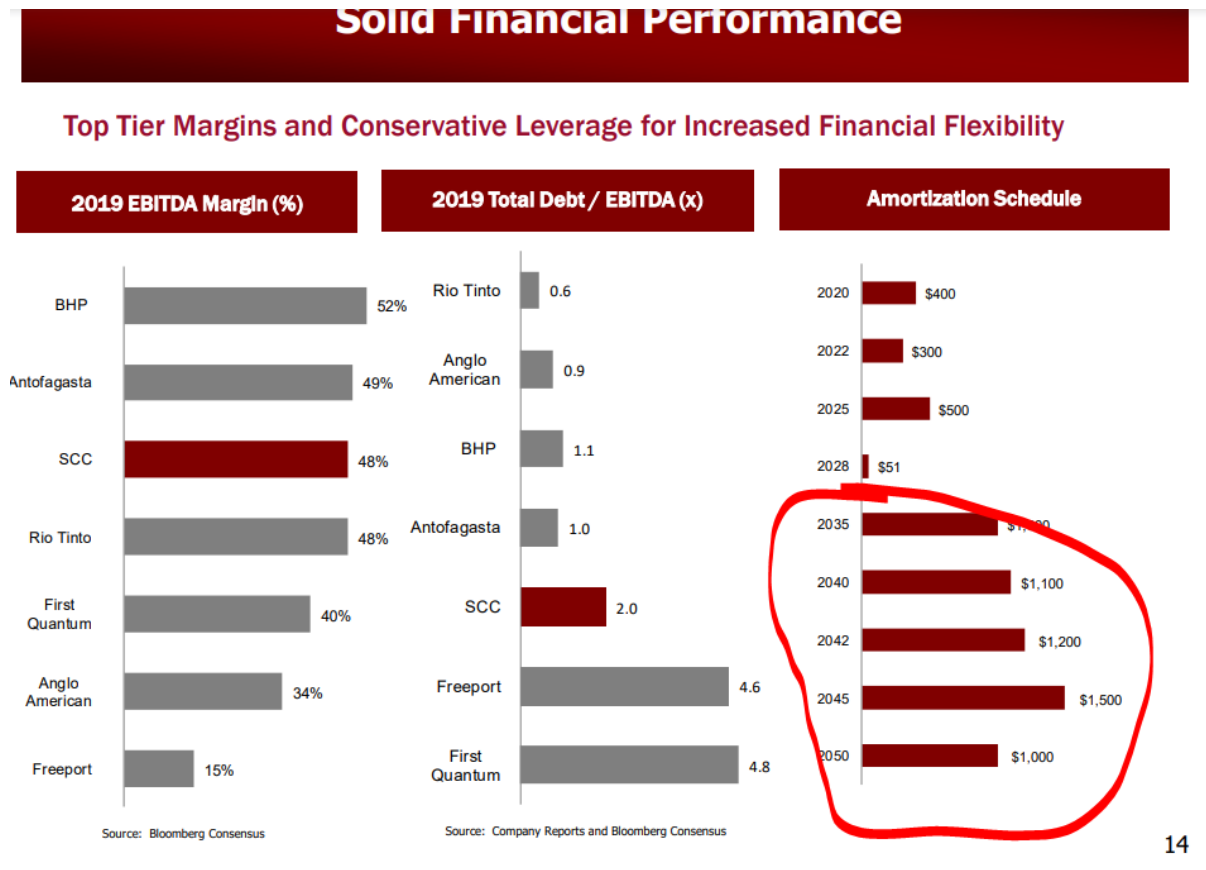
(US\$ MM)	2017	2018	2019	2020 E	
Copper Price (LME) US\$ per pound	2.80	2.96	2.72	2.62	2.75
Income Statement:					
Net Revenues	\$6,655	\$7,097	\$7,286	\$7,257	\$7,503
EBITDA	3,292	3,556	3,527	3,322	3,526
EBITDA Margin	49%	50%	48%	46%	47%
U.S. Income Tax Reform Adjustment	(743)				
Net Income	729	1,543	1,486	1,466	1,600
Dividends paid per share	0.59	1.40	1.60	0.60	0.60
Balance Sheet Statement:					
Cash, Equivalents & Short Term					
Investments	\$1,055	\$1,058	\$2,006	\$2,640	\$2,783
Total Assets	13,771	14,485	16,407	17,083	17,260
Total Debt	5,957	5,960	6,941	6,541	6,541
Total Liabilities	7,621	7,872	9,549	9,098	9,141
Total Shareholders' Equity	6,108	6,567	6,810	7,933	8,067
Cash Flow Statement:					
Capital Expenditures	\$1,024	\$1,121	\$708	\$800	\$800
Free Cash Flow ¹	953	1,114	1,204	1,377	1,520
Dividends paid to common shareholders	456	1,082	1,237	464	464
Total Debt / EBITDA	1.8x	1.7x	2.0x	2.0x	1.9x
Net Debt / EBITDA	1.5x	1.4x	1.4x	1.2x	1.1x

¹ Free Cash Flow defined as net cash from operating activities less capital expenditures.

They have lowered the dividend to \$0.6 which is good and perhaps the stock will follow, or not 😞.

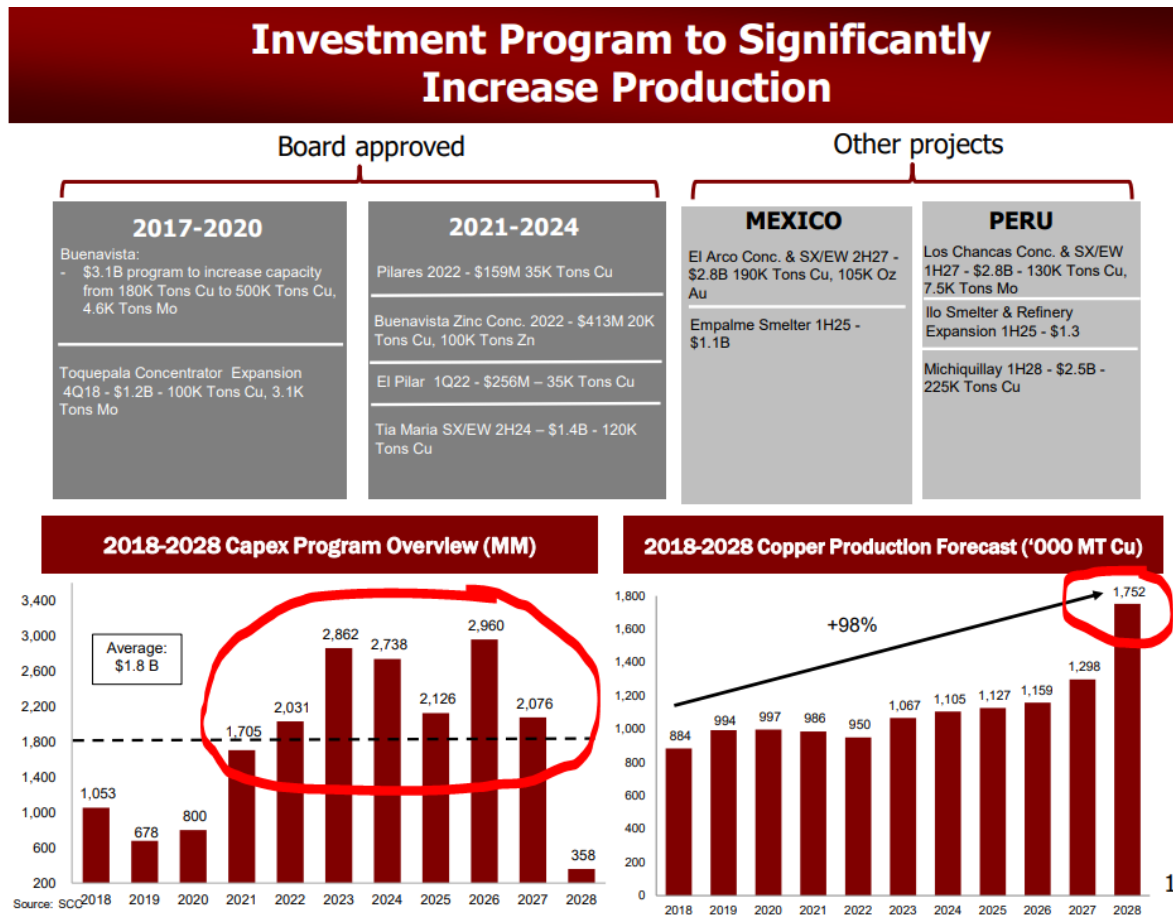
They will likely make \$1.5 billion in FCF, with copper at \$2.75, if in 2026 copper is at \$3 or \$3.5, they will likely make \$3 or \$4 on higher production, perhaps even \$5. But that is 5 years from now. Until then they will make zero due to the high capital investments.

They have some debt, but with very long-term maturities.



[SCCO investor presentation](#)

And this is the investment program:



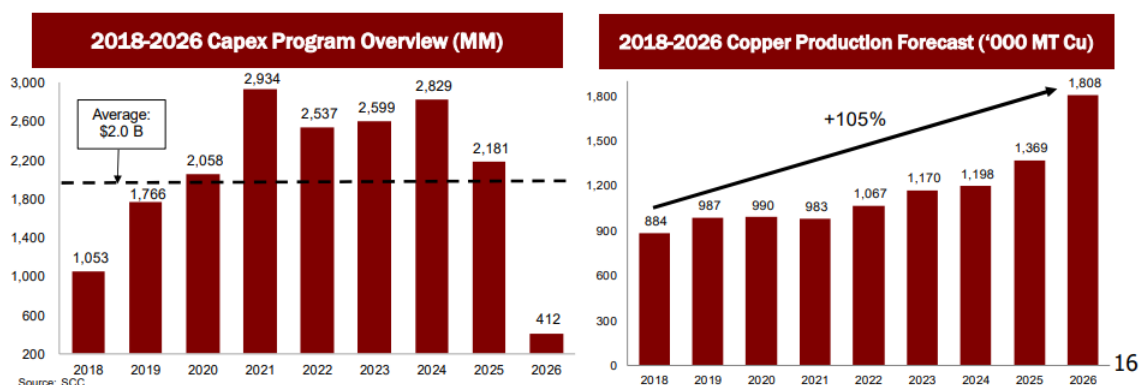
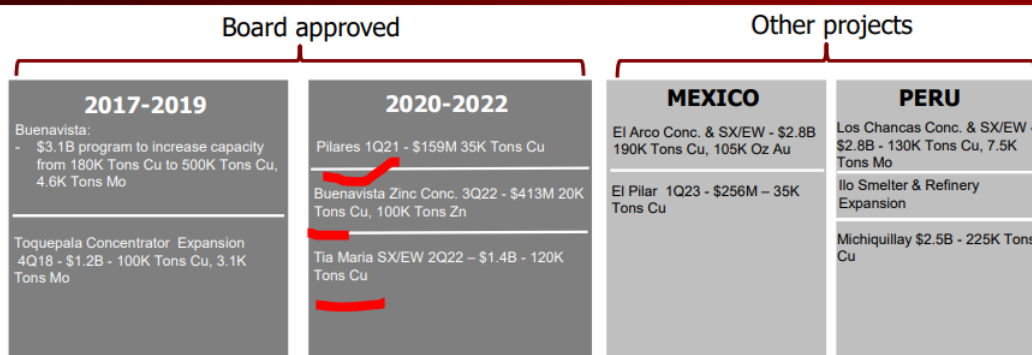
And here comes the catch, everything has been delayed for two years. This is 1MT of copper that will not be on the market in 2026 and 2027 as supposed but only, and that optimistically in 2028. That is 4% of global supply and that is

HUGE!

, This means that copper will boom somewhere

in the 2020s when demand outstrips supply.

Investment Program to Significantly Increase Production



2019 stock analysis – SCCO!

The first question in the last conference call was about the delay, as said this is huge.

Raul Jacob: Better. So much better. Yes.

Alfonso Salazar: Yes. Okay. So the first question is regarding cost. We saw an increase in the cash cost in the fourth quarter. So just want to know what is behind that, and if you can provide some guidance for the future years regarding cash cost.

The second question is, if you can give an update on the growth opportunities. We saw that you delayed the 1.5 million-ton copper production target by 2 years. So if you can explain what is behind that delay.

[Conference call Q2 2020 transcript](#)

The answer is slightly and a little bit – two years and \$6 billion in cash flows is slightly and a little bit for them – hahahahahahahahaha.

This guy is hilarious ; ‘usually make projects slow down a little bit’

Raul Jacob: Okay. On the growth projects, well, basically, more like a finance or some other kind of reason it's just how are we progressing on the projects. We have made a review on how are we expecting them to evolve in the next few years. Generally speaking, let me say that we have not adjusted any budgets for the projects at this point. It's more like a timing thing; as I said not finance-driven or anything like that. It's just more like normal events that usually make projects slow down a little bit.

Another funny thing, instead of panicking about the delay, analysts focused on maybe getting higher dividends and buybacks now that the projects are delayed – that is likely why the stock is going up. I'll patiently watch and wait for the dividend to go down, capex up, issues arise and I think this will go back to \$30 (there a good chance – they, I'll look at it again in detail).

And they have lowered their production target for 2028, to 1.7MT and I think they are going to miss it. There are some greenfield projects, it looks like they are not sure about the ore, the way to do things and therefore the delay, it seems like a lot of promises made that are hard to deliver on. There will be many surprises because that is in the nature of the mining business, but let's just take it like the CEO says ‘it is usually so that things slow down a bit in life’ hahaha.

SCCO valuation

Now I have no free cash flows up till 2028, and then I should have 1.7MT of production with costs around \$1. Let's go for 1.5 MT of production with same costs.

Let's take copper prices of \$7,000, I get to revenues of \$10.5 billion. Costs should be around 50% of that to get to EBITDA of \$5.5 billion, perhaps \$6 billion on higher copper prices.

SCC Financial Summary

(US\$ MM)	2017	2018	2019	2020 E	
Copper Price (LME) US\$ per pound	2.80	2.96	2.72	2.62	2.75
Income Statement:					
Net Revenues	\$6,655	\$7,097	\$7,286	\$7,257	\$7,503
EBITDA	3,292	3,556	3,527	3,322	3,526
EBITDA Margin	49%	50%	48%	46%	47%
U.S. Income Tax Reform Adjustment	(743)				
Net Income	729	1,543	1,486	1,466	1,600
Dividends paid per share	0.59	1.40	1.60	0.60	0.60
Balance Sheet Statement:					
Cash, Equivalents & Short Term					
Investments	\$1,055	\$1,058	\$2,006	\$2,640	\$2,783
Total Assets	13,771	14,485	16,407	17,083	17,260
Total Debt	5,957	5,960	6,941	6,541	6,541
Total Liabilities	7,621	7,872	9,549	9,098	9,141
Total Shareholders' Equity	6,108	6,567	6,810	7,933	8,067
Cash Flow Statement:					
Capital Expenditures	\$1,024	\$1,121	\$708	\$800	\$800
Free Cash Flow ¹	953	1,114	1,204	1,377	1,520
Dividends paid to common shareholders	456	1,082	1,237	464	464
Total Debt / EBITDA	1.8x	1.7x	2.0x	2.0x	1.9x
Net Debt / EBITDA	1.5x	1.4x	1.4x	1.2x	1.1x

1 Free Cash Flow defined as net cash from operating activities less capital expenditures.

13

Capex in 2028 should be just \$350 million, or ‘slightly around’ that ahahahaha – on that kind of production, minimally \$700 million whatever you think of it. Taxes, royalties and who knows what, Let’s say free cash flows get to between \$3 billion when copper is at \$2.75 on average and \$4 billion when copper is at \$3.15.

Let's put this into excel for comparative reasons, let's take \$3.5 billion per year on average free cash flow! Keep in mind the current market cap is \$35 billion and the first free cash flow should arrive in 2028, or slightly around that, I can't stop laughing sorry.....

SCCO valuation

[illegible]

I get to \$17 billion, half the current price at a 10% discount rate – thus at a price or around \$25 to \$30 it might be a good buy! If the management doesn't miss a little bit, slightly delay things or teach us how business is usually done in Mexico 😊)))

Let's look at grupo Mexico.

GRUPO MEXICO

Grupo Mexico owns 90% of SCCO – given the market capitalization, that is \$30 billion or given my valuation, that is \$15.3 billion.

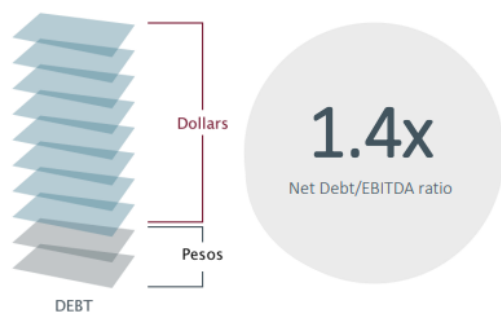


Market cap is 467 pesos, divided by 21.09 = 22 billion. So, there is a big discount, or just a little bit how the SCCO CEO would say.

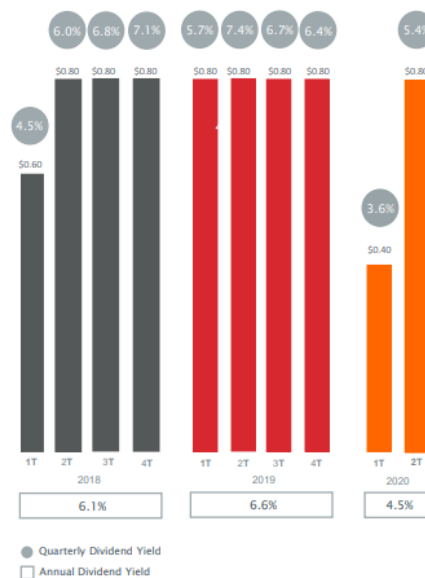
The company is a stable dividend payer and the debt to EBITDA is at 1.4, just like SCCO in a good year, perhaps even a bit lower.

Grupo Mexico maintains a solid balance sheet

With a low leverage and a net debt to EBITDA ratio of **1.4x**, **84%** of the debt is in US Dollars, and **16%** in Mexican Pesos (MXN). **96%** of the debt has a fixed rate. In addition, Grupo México has a comfortable debt payment schedule.



Dividend Payments



Grupo Mexico Presentation

Most of the debt is from SCCO.

Debt Maturity Profile

- Comfortable maturity schedule.
- No significant payments until 2035.



According to the [2019 Annual report](#), Grupo Mexico doesn't have debt on the holding level, so all the debt is at the subsidiary level.

FOURTH QUARTER RESULTS 2019

GRUPO MÉXICO

Financing

	2018	As of December 31, 2019		
(US\$'000)	Gross Debt ⁽¹⁾	Gross Debt ⁽¹⁾	Cash & Banks ⁽²⁾	Net Debt
Grupo México	-	-	227,548	(227,548)
Americas Mining Corporation	-	-	17,657	(17,657)
Southern Copper Corporation	5,960,107	6,940,847	2,005,791	4,935,056
Asarco	36,513	33,513	40,831	(7,318)
GMéxico Transportes	1,173,242	1,227,783	106,645	1,121,138
GFM - Ferromex	253,664	265,043	76,298	188,745
Ferrosur	10,873	6,518	20,642	(14,124)
México Proyectos y Desarrollos	949,473	903,123	46,211	856,912
Grupo Mexico (Consolidated)	8,383,872	9,376,828	2,541,623	6,835,205

(1) include Debt Fees

(2) include Short Term Investment

Grupo Mexico debt – Source: [Q4 2019 Financial release](#)

Product	Volume in Tons			Thousands of USD\$		
	2018	2019	Var %	2018	2019	Var %
Division Mining						
Copper	1,001,388	1,094,252	9	\$ 6,481,696	\$ 6,522,655	1
Silver (thousands of ounces)	19,477	20,739	6	299,042	318,760	7
Molybdenum	22,055	26,849	22	509,864	549,369	8
Zinc	106,483	103,668	(3)	329,923	277,779	(16)
Sulfuric acid	1,990,185	1,832,662	(8)	119,731	169,239	41
Gold (ounces)	55,938	49,163	(12)	70,348	67,521	(4)
Lead	22,983	21,020	(9)	52,380	41,670	(20)
Others				20,905	18,614	(11)
Transportation Division	1,962,215	1,887,766	(4)*	2,317,001	2,427,201	5
Infrastructure Division				293,906	287,840	(2)
Total sales				\$10,494,796	\$10,680,649	2

* Loaded cars (thousands of units)

61% of sales is from the copper division, 22.6% from the transportation division and 2.6% from the infrastructure division.

The transportation division has EBITDA of \$1 billion.

Transportation Division

Grupo México Transportes (GMXT)

Thousands of USD

	January - December		Variation	
	2019	2018	thousands of USD	%
Vol. Transported (Million tons / km)	65,444	64,809	635	1.0
Railcars moved	1,887,766	1,962,214	(74,448)	(3.8)
Sales	2,473,004	2,360,317	112,687	4.8
Cost of Sales	1,326,497	1,356,712	(30,215)	(2.2)
Operating income	693,063	638,729	54,334	8.5
EBITDA	1,096,148	1,013,161	82,987	8.2
EBITDA margin (%)	44.3%	42.9%		
Net profit	312,450	362,346	(49,896)	(13.8)
Profit margin (%)	12.6%	15.4%		
Investments / Capex	342,663	372,365	(29,702)	(8.0)

Capex is \$317 million.

CAPEX 2020

(Million USD)

- Our Capex for 2020 has been adjusted to **\$372 MUSD**, of which \$109 MUSD have been spent and \$80 MUSD have been committed

Description	CAPEX	Main Projects
MAINTENANCE	\$ 179.9	<ul style="list-style-type: none"> New Rail & Ties (1) Locomotive overhaul Rail maintenance Tools and equipment Bridges Surfacing Track Equipment
EFFICIENCY	\$ 75.3	<ul style="list-style-type: none"> Construction and reconfiguration of yards Construction/extension of sidings LNG Locomotives conversion Transportation Management System Double track Construction Trip Optimizer Equipment
GROWTH	\$ 66.1	<ul style="list-style-type: none"> M&S Project's Intermodal Terminal (2) Bajío Shuttle Train Terminal (3) Refined Products Terminal (4) Chihuahua -Ojinaga Corridor Rehabilitation
STRATEGIC	\$ 50.3	<ul style="list-style-type: none"> Celaya bypass (5) Monterrey bypass (6)
	\$ 371.7	



Grupo México

23

**OVER
11,000
KILOMETERS OF RAIL TRACK**

We are the leading company in rail freight transport **with the greatest level of coverage and connectivity**

Grupo México's Transportation Division is represented by its subsidiary GMéxico Transportes, SAB de CV (GMXT). GMXT provides logistics and land freight transportation solutions in a safe, efficient, reliable and sustainable way, which contributes to strengthening connectivity and competitiveness of the markets in which we operate.

GMXT's main subsidiaries are:

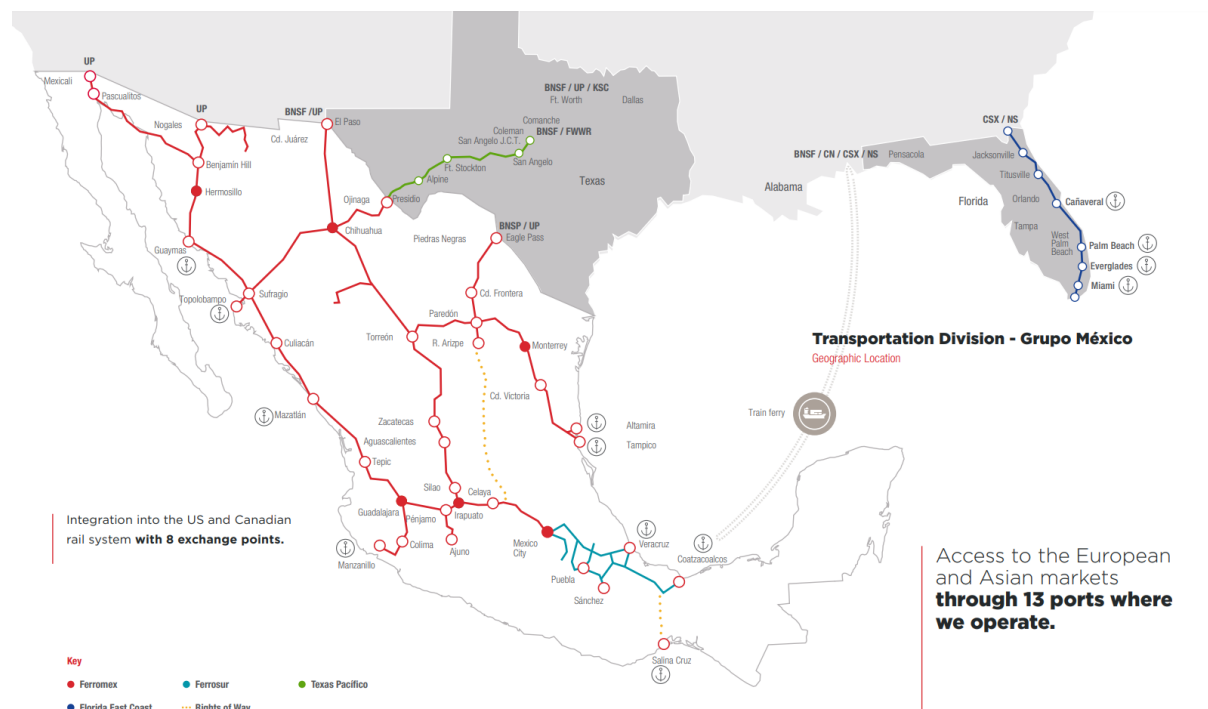
- Ferrocarril Mexicano, S. A. de C. V. (Ferromex)
- Ferrosur, S. A. de C. V. (Ferrosur)
- Florida East Coast (FEC)
- Texas Pacific Transportation, LTD. (TXPF)
- Intermodal México, S. A. de C. V. (IMEX)

We have 11,136 kilometers of tracks in 24 states of Mexico, as well as in Florida and Texas in the United States.

Our Class 1 Railroad connects with five border crossings with the United States, and we provide services to nine ports in the Pacific Ocean and four more in the Gulf of Mexico.

Coverage in 24 states of Mexico, **together they accumulate 86% of the GDP.**

Union Pacific has 51,700km or 32,100 miles! With a market capitalization of \$142 billion, one fifth of that is \$28.4 billion, but that would be 28 times EBITDA, too much!



The tracks have a concession up to 2098. I'll update in 2088 when it might become an issue.

Ferromexico could make half a billion in free cash flows going forward, for a \$5 billion valuation. Let's add \$2 billion for the infrastructure and I am at \$7, plus the \$17 for the copper division, that is \$24 billion. Expected business return from current perspective is 10%.

That is not bad but it doesn't convince me yet. To watch!

All in all Grupo Mexico is fairly valued, SCCO is overvalued.