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Gold Equities | Europe

A tough start to the year, but a lot in the price now

From weak trading updates, to Fed policy, to geopolitical risks, gold equities have had a difficult start to the year. But we argue that lowered expectations and poor sentiment leaves risk rewards looking appealing, with stocks discounting a gold price 8-17% below spot. Polymetal top pick.

Gold stocks remain out of favour for a variety of reasons... YTD, all gold equities in our coverage are down bar one, with drops of up to 30%. This compares to the gold price, flat. What is driving this disconnect? In the Russian names, cost of equity assumptions have increased on the back of rising geopolitical tensions. In addition, weak trading updates from [Fresnillo](#) and [Polymetal](#) have also weighed on stocks, along with a military coup in Burkina Faso where Endeavour has more than 50% of its production. Moreover, continued focus on Fed tightening in 2022 (with [our strategists expecting 4 hikes this year](#)), means that investors have been asking whether the gold price, and by extension gold equities, can perform in that environment.

...but low expectations and poor sentiment has left risk rewards looking appealing in our view - with stocks discounting a gold price 8-17% below spot.

We think the YTD weakness presents an opportunity for investors. Based on our multiples-based analysis, stocks are now discounting a gold price 8-17% below spot. That represents a price in the low \$1,500's/oz. We would argue that leaves fears on rate hikes and geopolitical tensions, as things stand, in the price. In terms of valuation multiples, Polymetal offers the highest cash return potential with a dividend yield on spot of 9% in 2022, but across the space, FCF generation remains high despite inflation pressures, with stocks on 5.5-11% FCF yields.

Polymetal remains top pick. We continue to see an attractive risk reward at Polymetal where spot will ~70% YoY increase in FCF in 2022 vs 2021. This is as the current market cap sits ~30% below the average for last year. This illustrates the magnitude of the de-rating that we have seen, with the stock now trading on an 9% FCF and dividend yield in 2022e. This would make it one of the biggest cash returners in the gold space. We would add that whilst the recent guidance update disappointed, market expectations have rapidly adjusted and we would argue that the inflation factors driving the increase in costs and capex are likely to impact the wider sector, and Polymetal is potentially just one of the first to readjust market expectations to reflect this. We stay Overweight.

Where next for the gold price? Gold has been remarkably resilient against a backdrop of rising real and nominal interest rates, as investors hedge against still-strong inflation prints and geopolitical tensions. Many of these factors remain through Q1, keeping gold well supported. However, rising real rates

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Gold and Precious Metals

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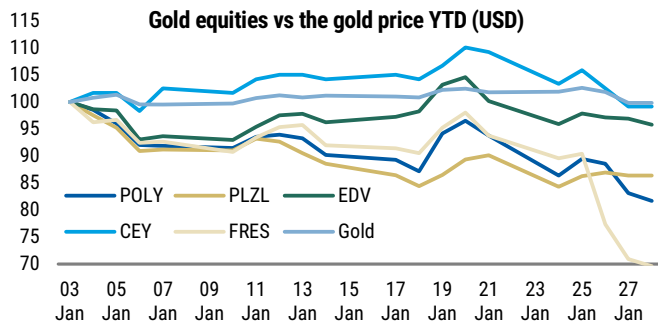
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should eventually put gold under pressure, with our strategists calling for 10y real yields to rise to -0.1% by year end, from -0.5% currently, taking gold to \$1620/oz in our view. The bull case centres around more persistent inflation, or if lower growth impacts central banks' ability to raise rates - listen to this [podcast](#) for more detail.

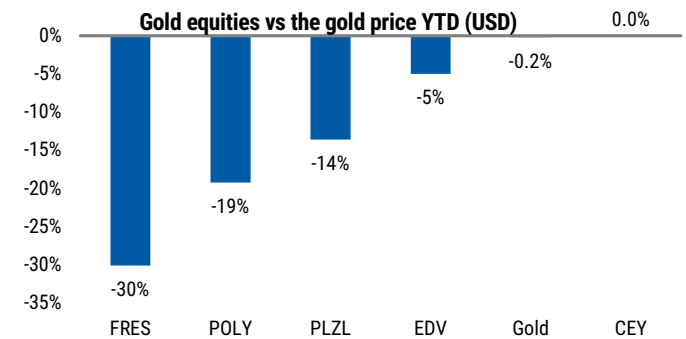
Key charts

Exhibit 1: Only Centamin in our coverage has posted a positive return YTD...



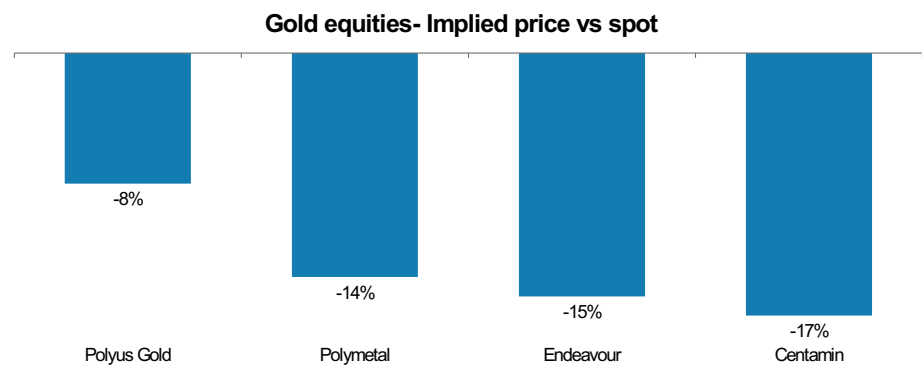
Source: Datastream, Morgan Stanley Research

Exhibit 2: ...whilst the rest of our coverage sits in negative territory despite gold being up.



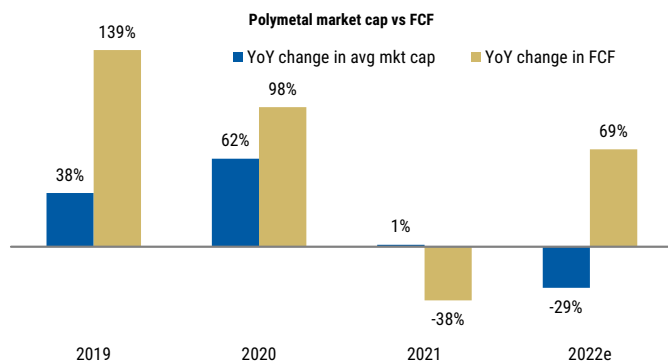
Source: Datastream, Morgan Stanley Research

Exhibit 3: Across the board, gold equities are discounting a gold price well below spot.



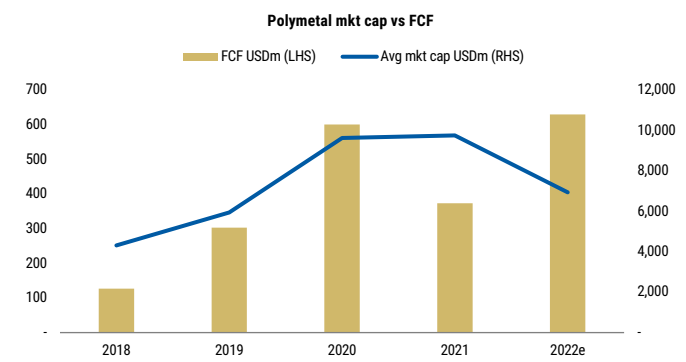
Source: Morgan Stanley Research estimates

Exhibit 4: Top pick Polymetal is down 26% vs 2021 avg despite 2022 spot FCF being ~90% above 2021e



Source: Datastream, Morgan Stanley Research estimates (e)

Exhibit 5: Looking at it another way, FCF is almost doubling, but the stock is down ~25% from 2021 avg



Source: Datastream, Morgan Stanley Research estimates (e)

Exhibit 6: Gold comps on spot

USDm		EBITDA		EV/EBITDA		FCF		FCF yield		Divi yield		ND/EBITDA	
Company	Rating	2022e	2023e	2022e	2023e	2022e	2023e	2022e	2023e	2022e	2023e	2022e	2023e
Centamin	Equal-weight	405	463	2.9x	2.5x	75	126	5.5%	9.3%	5.1%	8.5%	NM	NM
Endeavour Mining	Equal-weight	1,324	1,469	4.5x	4.0x	621	661	11.3%	12.1%	8.7%	9.2%	Cash	Cash
Polymetal	Overweight	1,700	1,785	4.9x	4.6x	653	788	9.3%	11.2%	9.3%	11.2%	0.7x	0.6x
Polyus	Equal-weight	3,633	3,985	6.1x	5.4x	1,521	1,882	7.5%	9.2%	5.3%	5.8%	0.3x	0.1x

Source: Company Data, Morgan Stanley Research estimates

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Valuation Methodology and Risks

Centamin PLC (CEY.L)

Our base case is derived from the simple average of NAV at spot (WACC 10.1% and 1% LT growth), a forward P/BV of 1.1x in line with historical average for base case earnings level, & a continued EV/Reserve Resource value ratio of 0.07x (close to its historical av.). Our rounded 100p PT is derived by assigning a 60% weight to our base case, 35% to bull, and 5% to bear, to reflect spot above our L-T real forecast of \$1,155/oz.

Risks to Upside

A more rapid return to 500koz of production (MSe 2024e).

Risks to Downside

Lower than expected commodity prices and slower return to 500koz production. An adverse decision in the Sukari concession court case would also negatively impact the share price.

Endeavour Mining (EDV.L)

Base case derived from the simple average of NAV at spot prices (WACC 9.4% and 0% LT growth), a forward P/BV of 1.3x and a continued EV/Reserve & Resource value of 0.12x. Our rounded 1,850p PT is derived by assigning a 60% weight to our base, 35% to our bull, and 5% to our bear case. This better reflects market expectations of the gold price, with spot currently above our base case.

Risks to Upside

If the gold price remains above our base case longer-term, we see upside risk to our estimates, whilst faster delivery of production growth would provide an NPV boost.

Risks to Downside

A weaker gold price than we include in our numbers, and political risks in West Africa, provide downside risks. In addition, growth depends on delivery of one greenfield project, which carries inherently more risk than a brownfield.

Polyus Gold (PLZLq.L)

Our base case is a simple average of NAV at gold forward prices (WACC 10.0% and 1% long-term growth), and a continued EV/Reserve Resource value ratio of 0.05x (the historical average). Our \$100 price target is rounded, weighted 60% to our base case, 35% bull case and 5% bear case to better reflect market expectations of the gold price, with spot above our base case.

Risks to Upside

- Upside gold price risks including a weakening US dollar and negative real rates, combined with weakening equity markets, central bank buying, and the beginnings of a recovery in fabrication demand
- Better operational performance at current mines, with Blagodatnoye and Olimpiada both key

Risks to Downside

- Capex overspend on projects
- Weaker gold price on stronger USD, rising rates

Polymetal International PLC (POLYP.L)

Base case derived from the simple average of NAV at spot prices (WACC 9.8% and 0% LT growth), a forward P/BV of 3.0x (LT ROE is higher than COE by 12.00% and LT growth rate of 0%) and a continued EV/Reserve & Resource value of 0.11x. Our rounded 1,450p PT is derived by assigning a 60% weight to our base, 35% to our bull, and 5% to our bear case. This better reflects market expectations of the gold price, with spot currently above our base case.

Risks to Upside

Gold price is more resilient than expected. Cash cost improvements at Mayskoye and better economics than expected at new mine Nezhda.

Risks to Downside

A weaker gold price and stronger rouble and resultant impact on costs are risks to the downside. In addition, potential for recent de-rating to be a structural change.

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(as of December 31, 2021)

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STOCK RATING CATEGORY	COVERAGE UNIVERSE		INVESTMENT BANKING CLIENTS (IBC)			OTHER MATERIAL INVESTMENT SERVICES CLIENTS (MISC)	
	COUNT	% OF TOTAL	COUNT	% OF TOTAL IBC	% OF RATING CATEGORY	COUNT	% OF TOTAL OTHER MSC
Overweight/Buy	1505	42%	403	45%	27%	671	42%
Equal-weight/Hold	1547	43%	402	45%	26%	695	44%
Not-Rated/Hold	0	0%	0	0%	0%	0	0%
Underweight/Sell	544	15%	90	10%	17%	220	14%
TOTAL	3,596		895			1586	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding off of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

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Stock Price, Price Target and Rating History (See Rating Definitions)

Centamin PLC (CEY.L) - As of 1/30/22 in GBP
Industry : Gold and Precious Metals

Stock Rating History: 2/1/17 : O/I; 6/21/17 : E/I; 11/16/18 : O/I; 3/7/19 : E/I

Price Target History: 12/12/16 : 150; 3/13/17 : 170; 9/25/17 : 140; 3/19/18 : 150; 6/28/18 : 120; 9/24/18 : 130; 11/16/18 : 125; 12/12/18 : 130; 3/7/19 : 110; 6/24/19 : 120; 9/23/19 : 135; 3/24/20 : 115; 5/7/20 : 160; 6/22/20 : 170; 8/7/20 : 200; 9/23/20 : 205; 11/15/20 : 130; 12/9/20 : 125; 3/23/21 : 110; 9/28/21 : 100

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)

Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) —

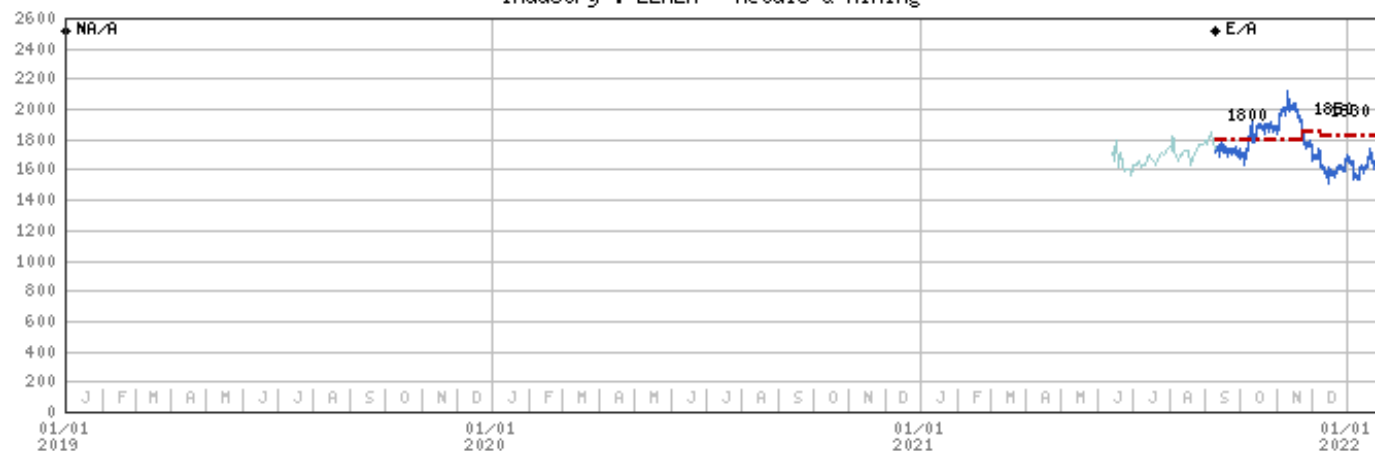
Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View

Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)

Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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Endeavour Mining (EDV.L) - As of 1/30/22 in GBP
Industry : EEMEA - Metals & Mining

Stock Rating History: 2/1/17 : NA/I; 9/24/18 : NA/A; 9/10/21 : E/A

Price Target History: 9/10/21 : 1800; 11/23/21 : 1850; 12/8/21 : 1830

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)

Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) —

Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View

Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)

Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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Polymetal International PLC (POLYP.L) - As of 1/30/22 in GBp
Industry : EEMEA - Metals & Mining



Stock Rating History: 2/1/17 : E/I; 9/24/18 : E/A; 12/8/21 : O/A

Price Target History: 12/12/16 : 740; 3/13/17 : 920; 6/26/17 : 950; 9/25/17 : 820; 12/11/17 : 900; 3/19/18 : 840; 6/28/18 : 800; 9/24/18 : 740; 12/12/18 : 800; 6/24/19 : 950; 9/23/19 : 1100; 12/11/19 : 1150; 5/7/20 : 1550; 6/22/20 : 1650; 8/7/20 : 1800; 9/23/20 : 1900; 11/15/20 : 1750; 12/9/20 : 1650; 3/19/21 : 1550; 3/23/21 : 1520; 9/28/21 : 1400; 12/8/21 : 1650; 1/28/22 : 1450

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Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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Industry : Gold and Precious Metals



Stock Rating History: 2/1/17 : NA/I; 7/25/17 : NA/I; 8/10/17 : O/I; 12/8/21 : E/I

Price Target History: 7/25/17 : NA; 8/10/17 : 41; 9/25/17 : 50; 6/28/18 : 48; 9/24/18 : 44; 3/25/19 : 48; 6/24/19 : 53; 9/23/19 : 63; 12/11/19 : 60; 3/24/20 : 65; 5/7/20 : 80; 6/22/20 : 90; 8/7/20 : 120; 9/18/20 : 130; 9/23/20 : 135; 11/15/20 : 120; 3/19/21 : 115; 3/23/21 : 110; 9/28/21 : 105; 11/5/21 : 110; 12/8/21 : 100

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INDUSTRY COVERAGE: Gold and Precious Metals

COMPANY (TICKER)	RATING (AS OF)	PRICE* (01/28/2022)
Dan Shaw		
Centamin PLC (CEY.L)	E (03/07/2019)	88p
Polyus Gold (PLZLq.L)	E (12/08/2021)	US\$75.60

Stock Ratings are subject to change. Please see latest research for each company.

* Historical prices are not split adjusted.