

CHINA
DEVELOPMENT
FINANCIAL

Geo Energy Resources Limited

(GERL SP/GEOE.SI)

Cash machine

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- GEO is set to have a record year ahead as coal prices remain resilient. ICI 4 prices (4,200 kcal) are at more than 10-year highs. While we expect coal prices to soften in 2H2021, dynamics favour coal miners given the buoyant demand from India and China. On the other side of the equation, there's less risk of an oversupply-related correction for coal markets as ESG pressure has pushed capital toward clean energy (e.g., solar, electric vehicles, wind farms), thus limiting rapid coal supply growth.
- GEO's two key mines have a total estimated coal reserve of 84 million tonnes, based on a Joint Reserves Committee (JORC) Compliant report issued in December 2020.
- Our DCF calculation (13.5% WACC and no terminal value) estimates a fair value of S\$0.42 based on a conservative 6-year mine life and 66mn tonnes production.
- Upgrade to **Outperform** as we raise our fair value to S\$0.42. We forecast GEO will generate US\$247mn of free cash flows in 2021 and 2022, more than its current market cap. It currently trades at only 2.0x 2021F P/E and offers an above-industry 9% forward div yield.

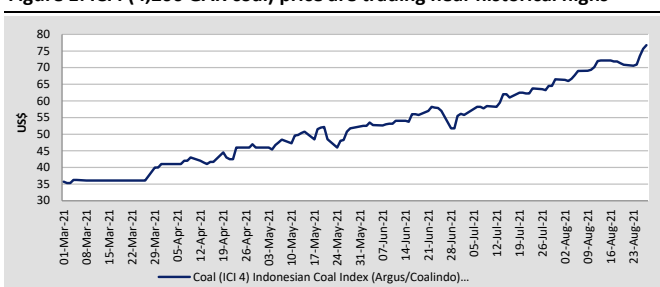
Financials & Key Operating Statistics

YE Dec (US\$m)	2019	2020	2021F	2022F	2023F
Revenue	249.1	306.8	609.0	550.0	440.0
PATMI	-47.5	94.9	119.3	86.7	68.6
Core PATMI	-47.0	33.7	119.3	86.7	68.6
Core EPS	-3.4	2.4	8.4	6.1	4.8
Core EPS grth (%)	-361.2	NA	254.2	-27.3	-20.9
Core P/E (x)	-5.1	7.2	2.0	2.8	3.5
DPS (SGCents)	0.0	0.8	2.0	1.3	1.1
Div Yield (%)	0.0	3.5	8.7	5.8	4.6
Net Margin (%)	-19.1	30.9	19.6	15.8	15.6
Gearing (%)	112.9	2.8	-21.4	-41.0	-52.4
Price / Book (x)	1.9	1.1	0.8	0.7	0.6
ROE (%)	-38.7	43.4	39.8	24.0	16.8

Source: Company Data, KGI Research

One for the record books. GEO reported a record semi-annual revenue of US\$220mn and core net profit of US\$48.5mn in 1H2021. Core net profit in the same period last year was -US\$8.7mn when we exclude the one-off gain of US\$75mn from the repurchase of senior notes. The strong 1H2021 performance was driven by volume and price increase. GEO delivered 5.4mn coal sales in 1H2021, an 8% YoY increase, while coal prices for ICI4 (4,200 GAR) rose to US\$48/tonne in 1H2021 from US\$31/tonne in 1H2020.

Figure 1: ICI4 (4,200 GAR coal) price are trading near historical highs



Source: Bloomberg, KGI Research

OUTPERFORM - Upgrade

Price as of 27 Aug 21 (SGD)	0.23	Performance (Absolute)	
12M TP (\$)	0.42	1 Month (%)	-7.8
Previous TP (\$)	0.14	3 Month (%)	17.2
Upside (%)	80.9	12 Month (%)	123.2
Trading data		Perf. vs STI Index (Red)	
Mkt Cap (\$mn)	322		
Issued Shares (mn)	1,399		
Vol - 3M Daily avg (mn)	3.7		
Val - 3M Daily avg (\$mn)	0.9		
Free Float (%)	40.8%		
Major Shareholders		Previous Recommendations	
Master Resources	28.3%	24-Sep-19	NEUTRAL \$0.14
		29-Aug-19	NEUTRAL \$0.15
		26-Mar-19	NEUTRAL \$0.21

Cash generating machine. We estimate GEO will generate around US\$247mn (S\$333mn) of free cash flows in 2021 and 2022, more than its current market cap of S\$330mn. Our estimates are based on US\$58/US\$50 coal prices and 10.5mn/11.0mn tonnes of coal production in 2021 and 2022, respectively. Our 10.5mn tonnes production assumption is 12.5% below the group's application to increase production to 12.0mn tonnes in 2021. Meanwhile, Current ICI4 future prices are trading well above US\$70/tonne. Even when accounting for the domestic market obligation, (25% of production volume) and where prices can be as much as 46% discount to export prices, our assumption of US\$60 and US\$50 per tonne for 2021 and 2022 is reasonable.

An inconvenient truth. While public perception is that thermal coal is in an inevitable decline, the hard data for the Asian region suggests otherwise. Asia will account for more than two-thirds of global electricity demand growth, supported by 150,000MW of new coal-fired capacity built across the region, according to Commodity Insights' research. The economic reality is that unlike in the US and Europe, Asia has a minimal supply of cheap gas for electricity, leaving coal as the primary supply over the decade ahead.

Valuation & Action: We upgrade GEO to Outperform and raise our TP to S\$0.42. Our fair value is based on DFC with a conservative set of assumptions: 1) 13.5% discount rate, 2) six-year mine life up to 2026, and 3) no terminal value. The strong cash flows over the next two years will provide GEO options to diversify via acquisitions. GEO currently trades at an average 2.8x P/E for 2021-2023F and offers an above-industry dividend yield of 8.7%, 5.8% and 4.6% for 2021-2023F, based on a conservative 30% payout ratio.

Risks: Decline in thermal coal prices due to weaker demand/increased production from China. Regulatory risks in Indonesia.

Figure 2: DCF Valuation

Discounted Cash Flow Valuation (US\$m)	2021F	2022F	2023F	2024F	2025F	2026F
Coal production million tonnes	10.5	11.0	11.0	11.0	11.0	11.0
Coal price (ASP) US\$/tonne	58.0	50.0	40.0	40.0	40.0	40.0
Cash cost US\$/tonne	40.3	37.0	29.2	29.2	29.2	29.2
Revenue	609.0	550.0	440.0	440.0	440.0	440.0
Growth (%)	98.5%	(9.7%)	(20.0%)	–	–	–
EBIT	164.4	121.0	96.8	96.8	96.8	96.8
EBIT margin (%)	27.0%	22.0%	22.0%	22.0%	22.0%	22.0%
EBIT (1-T)	123.3	90.8	72.6	72.6	72.6	72.6
+ Depreciation and Amortization	21.0	22.0	22.0	22.0	22.0	22.0
- Capital Expenditures	(2.0)	(2.0)	(2.0)	(2.0)	(2.0)	(2.0)
- Increase in Net Working Capital	(19.6)	8.1	3.3	1.9	1.7	1.6
FCF	122.8	118.9	95.9	94.5	94.3	94.2
PV of FCF	115.2	98.3	69.9	60.7	53.4	46.9
FCF Total (Present Value)	444.4					
Terminal Value (Present Value)	–	No terminal value. Assumption of 6 years operational life of mine				
Firm Value	444.4					
Less Net debt/(cash)	6.1					
Equity Value	438.3					
No of Shares (m)	1,422.4					
Equity Value per Share (US\$)	0.31					
Exchange rate (SGD/USD)	1.35					
Equity Value per Share (S\$)	0.42	Implied market cap (S\$m)		591.7		
Current Price (S\$)	0.23	Implied 2020 P/E		4.6x		
Upside/Downside	81%	Implied 2021F P/E		3.7x		

WACC Assumptions

Tax Rate	25%	
Terminal Growth Rate	–	No terminal value. Assumption of 6 years operational life of mine
WACC	13.5%	12.5% WACC + 1.0% Small-cap premium

Implied multiples of our fair value	2021F	2022F	2023F	2024F	2025F	2026F
P/E	3.7x	5.1x	6.4x	6.4x	6.4x	6.4x

Source: KGI Research

DCF assumptions:

- Total coal production of 66mn tonnes based on the production profile above. Our forecasted total production is around 20% lower than the coal reserve published in the IQPR.
- Most of the production is from GEO's two main mines, SDJ and TBR. These two mines had a total of 84mn tonnes reserves as of end Dec-2020. This reserve translates to a longer 7.5 years life of mine based on 11mn tonnes per year production. We excluded the reserves from the BEK mine that had 12.4mn tonnes of reserves as of end Dec-2020.
- ASP is based on 75% exports and 25% DMO.
- 13.5% WACC and no terminal growth.

Figure 3: Reserve estimates for SDJ and TBR mines

Description	Proved (Mt)	Probable (Mt)	Proved and Probable (Mt)
Previous Estimate as of 31 October 2020			
SDJ Reserve	15.9	7.4	23.3
TBR Reserve	47.2	15.9	63.1
Total SDP Previous Estimate	63.1	23.3	86.4
Current Estimate as of 31 December 2020			
SDJ Reserve	14.8	7.4	22.2
TBR Reserve	45.9	15.9	61.8
Total SDP Current Estimate	60.7	23.3	84.0
Total Difference	-2.34	0.000	-2.34

Source: IQPR by SMG Consultants, February 2021

Figure 4: Reserve estimates for BEK mine

Description	Date	Proved (Mt)	Probable (Mt)	Proved and Probable (Mt)
Previous BEK	31 December 2019	9.6	2.8	12.4
Current BEK	31 December 2020	9.6	2.8	12.4
Difference		-	-	-

Source: IQPR by SMG Consultants, February 2021

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Neutral (N)	We take a neutral view on the stock. The stock is expected to perform in line with the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
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