COMPANY UPDATE — Commodities ▪ Singapore

Geo Energy Resources Limited

(GERL SP/GEOE.SI)

Downgrade to HOLD; cautious outlook on industry

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- 3Q18 profits declined 35% YoY to US$5.6mn due to lower coal sales of 1.6mn tonnes compared to 1.9mn tonnes in 3Q17.
- The lower volume sold in the quarter offset the higher average selling price (ASP) of US$43.5 per tonne in 3Q18, compared to US$39.0 per tonne in 3Q17.
- Average production costs also increased 9% YoY to US$30.7 per tonne in 3Q18 due to overburden removal costs as its TBR coal mine started production.
- Downgrade to HOLD as we turn more cautious on the sector amid slowing economic growth and coal prices that are starting to show signs of weakness.
- Main changes to our DCF-backed valuations include lower ASP from 2019 onwards and higher production costs.

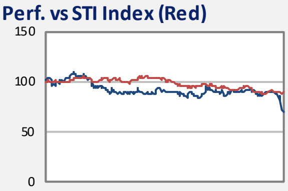
Financials & Key Operating Statistics

YE Dec (US$m)	2016	2017	2018F	2019F	2020F
Revenue	182.1	316.3	320.0	456.0	494.0
PATMI	22.2	36.7	26.3	34.5	39.0
Core PATMI	23.5	36.7	26.3	34.5	39.0
Core EPS	2.0	3.0	1.9	2.5	2.8
Core EPS grth (%)	-411.0	55.8	-38.1	31.0	13.2
Core P/E (x)	7.3	4.7	7.5	5.7	5.1
DPS (SGCents)	1.0	1.0	1.0	1.0	1.0
Div Yield (%)	5.4	5.4	5.4	5.4	5.4
Net Margin (%)	12.2	11.6	8.2	7.6	7.9
Gearing (%)	0.8	14.4	24.4	22.0	16.7
Price / Book (x)	1.4	1.1	1.2	1.1	1.0
ROE (%)	17.8	23.7	16.2	19.3	19.5

Source: Company Data, KGI Research

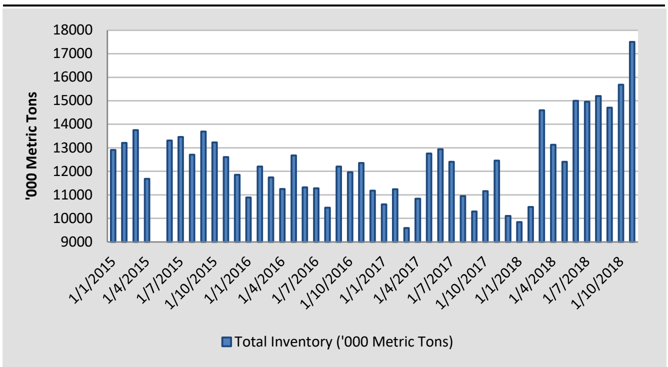
HOLD - Downgrade

Price as of 22 Nov 18 (SG	0.18	**Performance (Absolute)**	
12M TP ($)	0.21	1 Month (%)	-4.5
Previous TP ($)	0.30	3 Month (%)	-2.6
Upside (%)	16.2	12 Month (%)	-14.0
Trading data		**Perf. vs STI Index (Red)**	
Mkt Cap ($mn)	294		
Issued Shares (mn)	1,399		
Vol - 3M Daily avg (mn)	2.3		
Val - 3M Daily avg ($mn)	0.5		
Free Float (%)	42.4%		
Major Shareholders		**Previous Recommendations**	
Master Resources	28.3%	4-Jun-18	BUY $0.30
		11-Sep-17	BUY $0.36



Weak industry outlook. Indonesian coal miners may have the largest impact from a potential cut to China's coal imports in 2019 – China makes up 20% of the global market share in terms of coal imports, with 50% of its imports originating from Indonesia. Total coal inventory at China's major power plants increased to 34 days of consumption recently, the highest in at least three years, according to Bloomberg data.

Figure 1: China's coal inventory at 6 major power plants



Source: Bloomberg, KGI Research

Weak 1Q19 spilling over into 2Q19. China's demand is typically slower in 1Q due to the Chinese New Year. With the added pressure of China's power plants' high inventory levels, import from China may see a slowdown in 1Q19 and possibly carry over into 2Q19. Geo Energy generated 72% of its 3Q18 revenues from China. As such, the slowdown in China import demand is a key risk to Geo Energy at least until 2H19.

Bond may offer better value. Geo Energy's US$300mn bond (Maturity 4/10/22; Call 4/10/20 @ 104.0) is currently trading at 11.7% YTM and may offer a better risk-reward profile for investors comfortable investing in the coal sector.

Figure 2: Geo Energy's 8% bonds are currently trading at 11.7% YTM

Source: Bloomberg, KGI Research

Valuation & Action: We adjust our DCF-backed valuation: 1) Long-term ASP to US$38 from U$40 per tonne and 2) Long-term higher cash cost of US$30.1 per tonne. As a result, our fair value drops from S$0.30 to US$0.21.

Despite the 16% upside potential to our fair value of 21 cents, we downgrade to HOLD. We are cautious on the outlook of the sector as China faces declining coal imports amid high inventory and a slowing economy.

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

Figure 3: DCF Valuation

Discounted Cash Flow Valuation (US$m)	2015	2016	2017	2018F	2019F	2020F	2021F	2022F	2023F
Coal production million tonnes				8.0	12.0	13.0	13.0	13.0	13.0
Coal price (ASP) US$/tonne				40.0	38.0	38.0	38.0	38.0	38.0
Cash cost US$/tonne				29.6	30.1	30.1	30.1	30.1	30.1
Revenue	**18.2**	**182.1**	**316.3**	**320.0**	**456.0**	**494.0**	**494.0**	**494.0**	**494.0**
Growth (%)	*-*	*900.1%*	*73.7%*	*1.2%*	*42.5%*	*8.3%*	*–*	*–*	*–*
EBIT	(1.3)	40.7	65.0	67.6	73.0	79.0	79.0	79.0	79.0
EBIT margin (%)	*-7.2%*	*22.4%*	*20.5%*	*21.1%*	*16.0%*	*16.0%*	*16.0%*	*16.0%*	*16.0%*
EBIT (1-T)	-	30.5	48.7	50.7	54.7	59.3	59.3	59.3	59.3
+ Depreciation and Amortization		12.5	18.2	16.0	21.4	23.2	23.2	23.2	23.2
- Capital Expenditures		(0.2)	(30.4)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
- Increase in Net Working Capital		(7.0)	39.1	(17.6)	(15.1)	(14.7)	(7.1)	(7.2)	(7.2)
FCF		**35.8**	**75.7**	**48.1**	**60.0**	**66.8**	**74.4**	**74.3**	**74.3**
PV of FCF				45.1	49.6	48.6	47.8	42.0	37.0

FCF Total (Present Value)	270.2		
Terminal Value (Present Value)	–	No terminal value. Assumption of 7 years operational life of mine	
Firm Value	**270.2**		
Less Net debt/(cash)	39.6		
Equity Value	**230.6**		
No of Shares (m)	1,399.0		
Equity Value per Share (US$)	**0.16**		
Exchange rate (SGD/USD)	**1.30**		
Equity Value per Share (S$m)	**0.21**	**Implied market cap (S$m)**	**299.8**
Current Price	**0.18**	**Implied 2017 P/E**	**5.4x**
Upside/Downside	**16%**	**Implied 2018E P/E**	**8.8x**

WACC Assumptions		
Tax Rate	25%	
Terminal Growth Rate	–	No terminal value. Assumption of 7 years operational life of mine
WACC	13.5%	12.5% WACC + 1.0% Small-cap premium

Source: KGI Research

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Rating	Definition
	KGI Securities Research's recommendations are based on an Absolute Return rating system.
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HOLD	-10% to +10% total return over the next 12 months
SELL	<-10% total return over the next 12 months

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