

# Geo Energy Resources Limited

(GERL SP/GEOE.SI)

## Hazy outlook as global economic growth slows

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- GEO reported a loss of US\$5mn in 4Q18 compared to US\$3.4mn net profit in 4Q18, due mainly to lower coal production and weaker coal prices.
- Full-year FY18, GEO achieved 7.9mn tonnes of coal production, below its 8-9mn tonnes target. Coal prices declined to as low as US\$28.85/tonne on 30 Nov 2018 as China restricted imports of seaborne coal in Nov/Dec 2018.
- We maintain our HOLD recommendation on the back of an uncertain industry outlook amid slowing global economic growth.

### Financials & Key Operating Statistics

YE Dec (US\$m)	2017	2018	2019F	2020F	2021F
Revenue	316.3	299.2	380.0	456.0	456.0
PATMI	36.7	18.0	27.0	38.4	38.4
Core PATMI	36.7	18.0	27.0	38.4	38.4
Core EPS	3.0	1.3	1.9	2.7	2.7
Core EPS grth (%)	55.8	-57.7	50.0	42.2	0.0
Core P/E (x)	4.6	10.8	7.2	5.0	5.0
DPS (SGCents)	1.0	1.4	1.0	1.0	1.0
Div Yield (%)	5.6	7.8	5.6	5.6	5.6
Net Margin (%)	11.6	6.0	7.1	8.4	8.4
Gearing (%)	14.4	50.5	47.8	35.9	29.9
Price / Book (x)	1.1	1.1	1.1	1.0	0.9
ROE (%)	23.7	10.3	14.8	18.9	17.2

Source: Company Data, KGI Research

**Weak 4Q18.** GEO reported a loss of US\$5.0mn in 4Q18 as revenues declined 39% YoY. The group sold 1.6mn tonnes of coal during the quarter, down from 2.2mn tonnes in 4Q17. GEO reported an average selling price (ASP) of US\$35.16/tonne, lower than the US\$42.40/tonne in 4Q17. Coal prices declined significantly in November 2018, dropping to as low as US\$28.85/tonne for 4,200 GAR coal, and was largely driven by China policies restricting imports of seaborne thermal coal in Nov-Dec 2018.

**Lower forecast.** GEO is targeting a production of at least 8mn tonnes of coal for both its SDJ and TBR mines in 2019. This is lower than our forecast of 12mn and management's original forecast of 13-15mn tonnes. However, GEO will be reviewing the production quota with the Indonesian authorities in six months and there is scope to increase production by at least 10%.

**Cloudy outlook.** We expect thermal coal outlook in 2019 to be challenging amid weaker economic growth in China and additional capacity coming online in Australia. China, which makes up 20% of the global market share in terms of coal imports, may further add to coal demand risk in 2019 as it grows its domestic capacity and shifts towards gas-fired power plants. Bloomberg Intelligence forecasts a 7% YoY drop in China coal imports to about 200m tonnes in 2019.

**Bond may offer better value.** GEO's US\$300mn bond (Maturity 4/10/22; Call 4/10/20 @ 104.0) is currently trading at 11.3% YTM and may offer a better risk-reward profile for investors with a higher risk tolerance and are comfortable investing in the coal sector.

<b>HOLD - Maintain</b>	
Price as of 25 Mar 19(SGD)	0.18
12M TP (\$)	0.19
Previous TP (\$)	0.21
Upside (%)	5.0
<b>Performance (Absolute)</b>	
1 Month (%)	-0.5
3 Month (%)	10.1
12 Month (%)	-12.1
<b>Trading data</b>	<b>Perf. vs STI Index (Red)</b>
Mkt Cap (\$mn)	259
Issued Shares (mn)	1,399
Vol - 3M Daily avg (mn)	0.9
Val - 3M Daily avg (\$mn)	0.2
Free Float (%)	42.4%
110	
90	
70	

  

<b>Major Shareholders</b>		
Master Resources	28.3%	27-Nov-18 HOLD \$0.21
		4-Jun-18 BUY \$0.30
		11-Sep-17 BUY \$0.36

Figure 1: Geo Energy's 8% bonds are currently trading at 11.3% YTM



Source: Bloomberg, KGI Research

**Valuation & Action:** We maintain our HOLD recommendation on the back of a cautious outlook on the coal sector in 2019. Chinese policies once again drove market sentiments and caused coal prices to weaken in 4Q18, and we expect a similar level of volatility in 2019 amid weaker global economic growth. However, we think GEO's share price could be supported by its attractive 5.6% forward dividend yield and manageable debt levels.

**Changes to forecast; conservative assumptions.** We have lowered our coal production estimates to 10mn tonnes in 2019 from 12mn originally, and adjusted 2020-2024 production to 12mn from our original estimates of 13mn per annum. As a result, our DCF-backed valuation drops from S\$0.21 to S\$0.18. Our other assumptions are on the conservative side such as the 13.5% WACC and long-term ASP forecast of US\$38/tonne.

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

**Figure 2: DCF Valuation – Previous update in 3Q 2018**

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
<b>Revenue</b>	<b>18.2</b>	<b>182.1</b>	<b>316.3</b>	<b>320.0</b>	<b>456.0</b>	<b>494.0</b>	<b>494.0</b>	<b>494.0</b>	<b>494.0</b>
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)
<b>FCF</b>	<b>35.8</b>	<b>75.7</b>	<b>48.1</b>	<b>60.0</b>	<b>66.8</b>	<b>74.4</b>	<b>74.3</b>	<b>74.3</b>	<b>74.3</b>
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)	—								
<b>Firm Value</b>	<b>270.2</b>								
Less Net debt/(cash)	39.6								
<b>Equity Value</b>	<b>230.6</b>								
No of Shares (m)	1,399.0								
<b>Equity Value per Share (US\$)</b>	<b>0.16</b>								
Exchange rate (SGD/USD)	1.30								
<b>Equity Value per Share (\$m)</b>	<b>0.21</b>								
Current Price	0.18								
Upside/Downside	16%								
Implied market cap (\$\$m)		299.8							
Implied 2017 P/E			5.4x						
Implied 2018P/E				8.8x					
<b>WACC Assumptions</b>									
Tax Rate	25%								
Terminal Growth Rate	—								
WACC	13.5%								
No terminal value. Assumption of 7 years operational life of mine									

Source: KGI Research

**Figure 3: DCF Valuation – Current valuation post 4Q 2018 results**

Discounted Cash Flow Valuation (US\$m)	2018	2019F	2020F	2021F	2022F	2023F	2024F
Coal production million tonnes	7.9	10.0	12.0	12.0	12.0	12.0	12.0
Coal price (ASP) US\$/tonne	42.1	38.0	38.0	38.0	38.0	38.0	38.0
Cash cost US\$/tonne	30.9	29.7	29.5	29.5	29.5	29.5	29.5
<b>Revenue</b>	<b>299.2</b>	<b>380.0</b>	<b>456.0</b>	<b>456.0</b>	<b>456.0</b>	<b>456.0</b>	<b>456.0</b>
Growth (%)	(5.4%)	27.0%	20.0%	—	—	—	—
EBIT	55.3	63.0	78.2	78.2	78.2	78.2	78.2
EBIT margin (%)	18.5%	16.6%	17.1%	17.1%	17.1%	17.1%	17.1%
EBIT (1-T)		47.3	58.7	58.7	58.7	58.7	58.7
+ Depreciation and Amortization		20.0	24.0	24.0	24.0	24.0	24.0
- Capital Expenditures		(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
- Increase in Net Working Capital		(4.1)	(6.4)	(10.0)	(5.6)	(5.8)	(5.9)
<b>FCF</b>	<b>62.2</b>	<b>75.2</b>	<b>71.7</b>	<b>76.1</b>	<b>75.9</b>	<b>75.7</b>	<b>75.7</b>
PV of FCF		54.8	58.4	49.0	45.8	40.3	35.4
FCF Total (Present Value)	283.7						
Terminal Value (Present Value)	—						
No terminal value. Assumption of 7 years operational life of mine							
<b>Firm Value</b>	<b>283.7</b>						
Less Net debt/(cash)	87.9						
<b>Equity Value</b>	<b>195.8</b>						
No of Shares (m)	1,399.0						
<b>Equity Value per Share (US\$)</b>	<b>0.14</b>						
Exchange rate (SGD/USD)	1.35						
<b>Equity Value per Share (\$m)</b>	<b>0.19</b>						
Current Price	0.18						
Upside/Downside	5%						
Implied market cap (\$\$m)		264.4					
Implied 2018 P/E			14.7x				
Implied 2019P/E				9.8x			
<b>WACC Assumptions</b>							
Tax Rate	25%						
Terminal Growth Rate	—						
WACC	13.5%						
12.5% WACC + 1.0% Small-cap premium							

Source: KGI Research

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

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