

CHINA  
DEVELOPMENT  
FINANCIAL

# Geo Energy Resources Limited

(GERL SP/GEOE.SI)

## Hazy outlook as China demand weakens

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- GEO reported a 90% YoY decline in 2Q19 PATMI to US\$0.8mn due to lower coal sales of 1.4mn and a decline in average selling price (ASP) to US\$36.5/tonne.
- Outlook for 2019 remains challenging while its bonds are trading at 20% yield-to-maturity (YTM).
- We maintain our NEUTRAL 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	280.0	418.0	418.0
PATMI	36.7	18.0	1.5	26.4	26.4
Core PATMI	36.7	18.0	1.5	26.4	26.4
Core EPS	3.0	1.3	0.1	1.9	1.9
Core EPS grth (%)	55.8	-57.7	-91.7	1662.0	0.0
Core P/E (x)	3.7	8.6	103.6	5.9	5.9
DPS (SGCents)	1.0	1.4	0.5	0.5	0.5
Div Yield (%)	6.7	9.3	3.3	3.3	3.3
Net Margin (%)	11.6	6.0	0.5	6.3	6.3
Gearing (%)	14.4	50.5	68.5	54.5	49.1
Price / Book (x)	0.9	0.9	0.9	0.8	0.8
ROE (%)	23.7	10.3	0.9	14.4	13.2

Source: Company Data, KGI Research

**Post-management meeting.** 2Q19 production was negatively impacted by 14 days of flood emergency status declared in mid-June 2019 by the local government. GEO recorded a significant drop in coal sales to 1.4mn tonnes from both its SDJ and TBR mines, a decline from around 2mn achieved in 1Q19 and 2Q18.

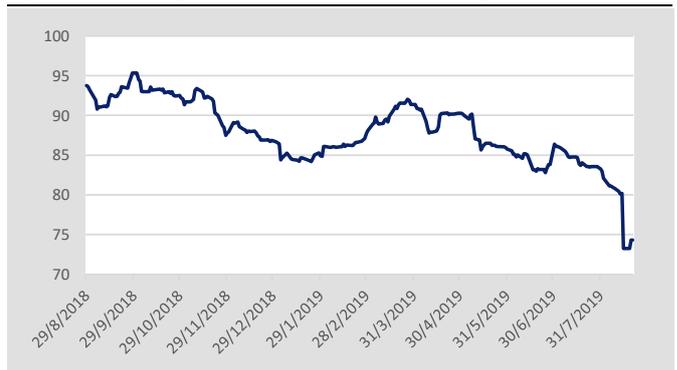
**Coal prices under pressure.** GEO's ASP has declined around 14% YoY to US\$36.5. We expect thermal coal prices in 2019 and 2020 to remain subdued amid elevated inventories in both China and India. China makes up 20% of the global market share in terms of coal imports and a key downside risk is a much deeper slowdown in the country's growth amid the ongoing US-China trade tensions. Exports to China accounted for 80% of GEO's FY18 revenues.

**Lower dividends as cash required for acquisition.** We lower our dividend forecast to 0.5 Sing cents for FY19-FY21F, down from 1.0 Sing cents previously, given our view that the group will need to conserve cash for an acquisition. GEO will need to make an acquisition within the next two years if it is to avoid redeeming its bonds in April 2021, which would then subject the group to refinancing issues if coal prices were to remain low.

**Bond yields signalling concerns.** GEO's US\$300mn bond (Maturity 4/10/22; Call 4/10/20 @ 104.0) is currently trading at 19.8% YTM and reflects investors' concerns of the challenging industry landscape and the need for the group to increase its coal reserves through an acquisition. The bond is rated B- Negative by S&P, B2 Negative by Moody's and B Negative by Fitch. We are of the view that refinancing will only be an issue if it is unable to make an acquisition by 2H20.

NEUTRAL - Maintain			
Price as of 28 Aug 19 (SGD)	0.15	<b>Performance (Absolute)</b>	
12M TP (\$)	0.14	1 Month (%)	0.0
Previous TP (\$)	0.21	3 Month (%)	1.4
Upside (%)	(9.4)	12 Month (%)	-28.6
<b>Trading data</b>		<b>Perf. vs STI Index (Red)</b>	
Mkt Cap (\$mn)	210		
Issued Shares (mn)	1,399		
Vol - 3M Daily avg (mn)	1.2		
Val - 3M Daily avg (\$mn)	0.2		
Free Float (%)	41.7%		
<b>Major Shareholders</b>		<b>Previous Recommendations</b>	
Master Resources	28.3%	26-Mar-19	NEUTRAL \$0.21
		27-Nov-18	NEUTRAL \$0.21
		4-Jun-18	OP \$0.30

Figure 1: Geo Energy's 8% bonds are currently trading at 19.8% YTM



Source: Bloomberg, KGI Research

**Valuation & Action:** We maintain our NEUTRAL recommendation on the back of a cautious outlook on the coal sector in the next 12 months. Chinese policies and macro-economic environment once again drove market sentiments and caused coal prices to weaken in 2019, and we expect a similar level of volatility in 2020 amid weaker global economic growth.

**Changes to forecast; conservative assumptions.** We have lowered our coal production estimates to 8mn tonnes in 2019 from 10mn previously and adjusted 2020-2024 production to 10mn from our original estimates of 12mn per annum. As a result, our DCF-backed valuation drops from S\$0.21 to S\$0.14. Other key assumptions are on the conservative side, such as the 13.5% WACC and long-term ASP forecast of US\$38/tonne for 4,200 GAR coal.

**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)	2018	2019F	2020F	2021F	2022F	2023F	2024F
Coal production million tonnes	7.9	8.0	11.0	11.0	11.0	11.0	11.0
Coal price (ASP) US\$/tonne	42.1	35.0	38.0	38.0	38.0	38.0	38.0
Cash cost US\$/tonne	30.9	29.4	30.3	30.3	30.3	30.3	30.3
<b>Revenue</b>	<b>299.2</b>	<b>280.0</b>	<b>418.0</b>	<b>418.0</b>	<b>418.0</b>	<b>418.0</b>	<b>418.0</b>
Growth (%)	(5.4%)	(6.4%)	49.3%	–	–	–	–
EBIT	55.3	29.0	62.2	62.2	62.2	62.2	62.2
EBIT margin (%)	18.5%	10.4%	14.9%	14.9%	14.9%	14.9%	14.9%
EBIT (1-T)		21.8	46.7	46.7	46.7	46.7	46.7
+ Depreciation and Amortization		16.0	22.0	22.0	22.0	22.0	22.0
- Capital Expenditures		(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
- Increase in Net Working Capital		(9.8)	(1.6)	(9.3)	(5.3)	(5.4)	(5.6)
<b>FCF</b>		<b>27.0</b>	<b>66.1</b>	<b>58.4</b>	<b>62.4</b>	<b>62.3</b>	<b>62.1</b>
PV of FCF		25.3	54.6	42.6	40.1	35.2	31.0
FCF Total (Present Value)	228.7						
Terminal Value (Present Value)	–	No terminal value. Assumption of 7 years operational life of mine					
<b>Firm Value</b>	<b>228.7</b>						
Less Net debt/(cash)	87.9						
<b>Equity Value</b>	<b>140.8</b>						
No of Shares (m)	1,399.0						
<b>Equity Value per Share (US\$)</b>	<b>0.10</b>						
Exchange rate (SGD/USD)	1.35						
<b>Equity Value per Share (S\$m)</b>	<b>0.14</b>	<b>Implied market cap (S\$m)</b>		<b>190.1</b>			
<b>Current Price</b>	<b>0.15</b>	<b>Implied 2018 P/E</b>		<b>7.8x</b>			
<b>Upside/Downside</b>	<b>(9%)</b>	<b>Implied 2019E P/E</b>		<b>93.9x</b>			
<b>WACC Assumptions</b>							
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					
<b>Implied multiples</b>							
P/E	2018	2019F	2020F	2021F	2022F	2023F	2024F
	7.8x	93.9x	5.3x	5.3x	5.3x	4.9x	4.3x

Source: KGI Research

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<b>Neutral (N)</b>	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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