



Geo Energy Resources Limited

(GERL SP/GEOE.SI)

Latest acquisition to increase reserves by 56%

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- GEO announced on Monday that it had acquired an effective interest of 51% in two producing mines in South Sumatra, Indonesia.
- The two mines have a total estimated coal tonnage of 89 million tonnes, based on a Joint Reserves Committee (JORC) Compliant report issued in 2018.
- The mines are of higher calorific value compared to its existing mines in Kalimantan. In 2018, the two mines produced 3.8mn tonnes of coal with an average calorific value of 4,419 on a gross as received (GAR).
- However, we maintain our NEUTRAL recommendation as the acquisition is still subject to the fulfilment of certain conditions. Furthermore, the coal industry is still facing headwinds from 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

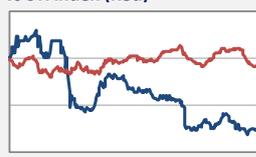
Source: Company Data, KGI Research

Too good to be true? GEO announced on 23rd September that it has entered into a conditional share purchase agreement to acquire a 51% effective interest in two mines located in South Sumatra: PT Bara Anugrah Sejahtera (BAS) and PT Banjarsari Pribumi (BP). The total consideration will be US\$25mn for the two mines, translating to a purchase price of US\$0.57 per tonne, and to be fully funded by internal funds (GEO had US\$200mn cash as at end 2Q19).

At first glance, the acquisition of the two mines are a bargain given that they are of slightly higher calorific value of 4,550 on a GAR basis compared to the 4,200 GAR of its existing mines. The two mines have been in production since 2012 and produced 3.8mn tonnes of coal in 2018. The acquisition is highly earnings accretive; had it been completed on 1 Jan 2018, GEO's full-year 2018 earnings would have increased from US\$18mn to US\$72mn, and 1H19 earnings would have reversed from a loss of US\$8mn to profits of US\$40mn.

Better to wait for acquisition to complete. The acquisition is definitely positive for GEO. However, we would advise to wait until after the completion as there are still certain conditions to be met, including 1) completion of due diligence, 2) the target mines obtaining necessary consent from their respective creditors, and 3) minimum JORC reserves of at least 60mn tonnes and not less than 4,550 GAR.

NEUTRAL - Maintain

Price as of 24 Sep 19 (SGD)	0.15	Performance (Absolute)	
12M TP (\$)	0.14	1 Month (%)	0.0
Previous TP (\$)	0.21	3 Month (%)	1.4
Upside (%)	(9.4)	12 Month (%)	-28.6
Trading data		Perf. vs STI Index (Red)	
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%		
Major Shareholders		Previous Recommendations	
Master Resources	28.3%	29-Aug-19	NEUTRAL \$0.15
		26-Mar-19	NEUTRAL \$0.21
		27-Nov-18	NEUTRAL \$0.21

Bond yields still 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. 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. The bond is rated B- Negative by S&P, B2 Negative by Moody's and B Negative by Fitch.

Valuation & Action: We maintain our NEUTRAL recommendation on the back of a cautious outlook on the coal sector in the next 12 months. Despite the announcement of the acquisition of the two mines, our fair value of S\$0.14 remains unchanged until we have certainty of the deal. We have not made any changes to our DCF-backed forecasts and assumptions.

Still weak industry outlook. Chinese policies and the macro-economic environment once again drove market sentiments and caused coal prices to weaken in 1H 2019, and we expect a similar level of volatility in 2020 amid weaker global economic growth. 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.

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

Figure 1: 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
Revenue	299.2	280.0	418.0	418.0	418.0	418.0	418.0
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)
FCF		27.0	66.1	58.4	62.4	62.3	62.1
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					
Firm Value	228.7						
Less Net debt/(cash)	87.9						
Equity Value	140.8						
No of Shares (m)	1,399.0						
Equity Value per Share (US\$)	0.10						
Exchange rate (SGD/USD)	1.35						
Equity Value per Share (S\$m)	0.14	Implied market cap (S\$m)		190.1			
Current Price	0.15	Implied 2018 P/E		7.8x			
Upside/Downside	(9%)	Implied 2019E P/E		93.9x			
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					
Implied multiples							
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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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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