ResGen scores respect from South Africa deal

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Resource Generation (RES) 81c

NO ONE'S going to give the benefit of the doubt to an emerging coal project in South Africa, where sovereign risk demands a valuation discount.

But let's show some respect to ResGen, which yesterday chalked up a deal that underpins its 6.1 billion tonne, 74 per cent-owned Boikarabelo project in the northern Waterberg region.

ResGen has signed a deal with Integrated Coal Mining, an arm of India's RPG Group, to lift its offtake from 37 million tonnes of thermal coal to 139 million tonnes, over 38 years. Another RPG arm, CESC is stumping up $10 million for a placement of 12.1 million shares at 82c a share (for an 11 per cent ResGen stake).

The news might seem like mere box-ticking, but it means that ResGen doesn't have to wait for utility Eskom to decide whether to build a third power station in Waterberg, where 40 per cent of the country's coal reserves reside.

Now, CESC plans to build two 660MW stations powered by Boikarabelo's finest, with corresponding volumes of high-margin export coal produced. "We have diversified the risk of having a single buyer by doing this deal," ResGen CEO Paul Jury says.

The next crucial step is a haulage deal with the state-run railway Transnet. Negotiations have been a "bit protracted" because money needs to be spent to upgrade parts of the railway. But given South Africa's need for power, a handshake should eventuate.

Then there's the question of funding the $550m cost of Stage One, expected to be a mix of project debt funding (60 per cent) and equity (40 per cent). "We now have various indicative offers from various banks regarding project funding," Jury says.

Investors yesterday were unmoved, perhaps because CESC isn't stumping up a premium for its stake. "If it was just an investment in the company maybe you would expect a premium, but the premium here . . . is the nature and the size of the contract," Jury says.

"They are talking about underwriting this mine for 38 years."

Jury acknowledges the "South Africa" discount, but questions whether sovereign risk is any less here. "There's only one way of overcoming the perception and that's bringing it to reality."

Criterion maintains a speculative buy (we had the stock as such at 47c last November and then at $1 in April this year). Shaw Stockbroking in March valued ResGen at $1.72 a share, or $4.06 if Stage Two gets up.