Macquarie First South
Securities Research

The Global Metals & Mining Specialist

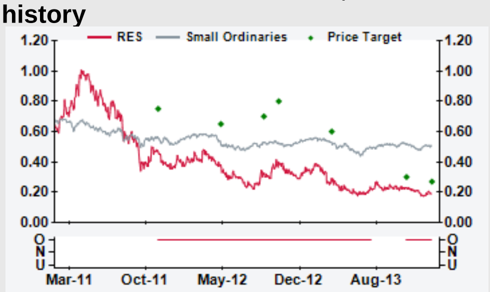
AUSTRALIA

RES AU		Outperform
Price (at 00:31, 18 Jan 2014 GMT)		A$0.19
Valuation	**A$**	**0.34**
- DCF (WACC 14.4%, beta 1.5, ERP 0.1%, RFR 0.1%)		
12-month target	**A$**	**0.27**
12-month TSR	**%**	**+42.1**
Volatility Index		**High**
GICS sector		**Energy**
Market cap	**A$m**	**110**
30-day avg turnover	**A$m**	**0.0**
Number shares on issue	**m**	**581.4**

Investment fundamentals

Year end 30 Jun		2013A	2014E	2015E	2016E
Revenue	m	0.0	0.0	0.0	130.3
EBIT	m	-3.2	-0.2	-0.2	13.1
Reported profit	m	-2.8	-0.4	0.2	7.3
Adjusted profit	m	-2.8	-0.4	0.2	7.3
Gross cashflow	m	-2.7	-0.3	0.4	32.0
CFPS	¢	-1.0	0.0	0.1	5.5
CFPS growth	%	nmf	95.1	nmf	8,404
PGCFPS	x	nmf	nmf	293.4	3.4
PGCFPS rel	x	nmf	nmf	34.38	0.44
EPS adj	¢	-1.0	-0.1	0.0	1.3
EPS adj growth	%	nmf	92.8	nmf	3,370.8
PER adj	x	nmf	nmf	524.4	15.1
PER rel	x	nmf	nmf	35.87	1.25
Total DPS	¢	0.0	0.0	0.0	0.0
Total div yield	%	0.0	0.0	0.0	0.0
ROA	%	-2.1	-0.1	0.0	1.8
ROE	%	-2.1	-0.3	0.1	2.9
EV/EBITDA	x	-1082.9	-2152.6	-2035.5	3.1
Net debt/equity	%	-0.7	64.7	205.7	136.5
P/BV	x	0.4	0.6	0.6	0.3

RES AU vs Small Ordinaries, & rec history



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, January 2014

(all figures in AUD unless noted)

Analyst(s)

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20 January 2014

Resource Generation

Firming up the business case

Event

1. Using learnings from our recent detailed analysis of the South African Thermal Coal market, we are adjusting some of our ResGen assumptions.

Impact

- **Updating what it costs to produce and move the coal.** With little guidance provided by ResGen, we rely on our industry knowledge for our operating cost assumptions. We have decreased our on-mine (mining and washing) cost from R130/t to R114/t (real 2014) but increased our logistics (rail to Durban and port charge) from R335/t to R442/t. The net result is an increase in our FOB Durban cost from R465/t (US$49/t @ R9.58/$) to R556/t (US$58/t). *While the undisclosed "indicative tariff" (agreed in the take-or-pay contract) with Transnet may be lower than this we are comfortable that these numbers represent a more robust depiction of current real costs and industry standards.*
- **Building in rail cost benefits further out.** Given our increasingly more optimistic view on Transnet Freight Rail's ability to deliver on its expansion strategy, we have built in the longer term cost benefits of 1) increased throughput on the Waterberg Line and 2) conversion/new build of a heavy haul line from the Waterberg to Mpumalanga. Thus, we have reduced our logistics charge from 2025 onwards from R442/t to R379/t (in real terms) to reflect this cost benefit.
- **Waterberg coal does price into Mpumalanga on a delivered basis.** In analysing the economics, we calculate that domestic tonnes from the Waterberg do price into an Mpumalanga PS (R359-375/t vs. R354-379/t) on a delivered basis considering current marginal (trucked) Eskom supply. Furthermore, the comparative price that Eskom would be willing to pay for Waterberg coal (considering the transport differential) is ~R160/t (free-on-rail). *We use R160/t as our base case but acknowledge upside could potentially be as high as R220/t.*
- **Durban option is substantially less optimal than RBCT.** ResGen's decision to pursue exports through Durban (vs. RBCT) has a negative cost impact in our view. We calculate RBCT to be R91/t ($9.5/t / 21%) cheaper than the Durban route given the higher port charge (R70 vs. R40) and fact that rail to Durban is a general freight line where to RBCT is heavy haul. Even if we include an allocation leasing charge for RBCT *(typically 10% of API 4)* it works out marginally cheaper.

Earnings and target price revision

- We have reduced FY16 EBITDA by 19% (we assume production commences in FY16) and our valuation from A$0.48/sh to A$0.34/sh (-30%). We have reduced our 12m target price by 10% to A$0.27 applying a 30% discount to Stage 2.

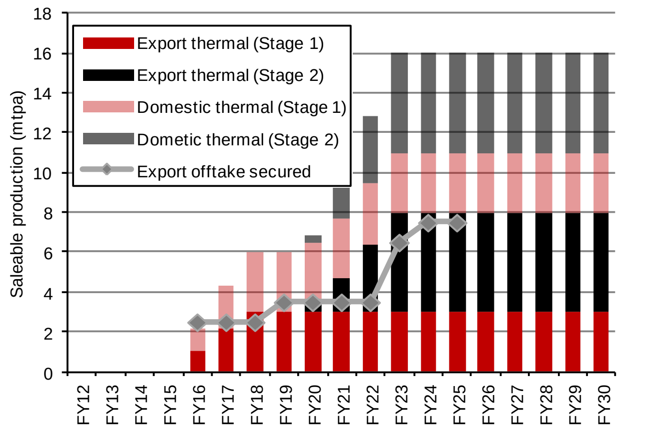
Price catalyst

- 12-month price target: A$0.27 based on a DCF methodology.
- Catalyst: Securing project/debt finance and further construction progress.

Action and recommendation

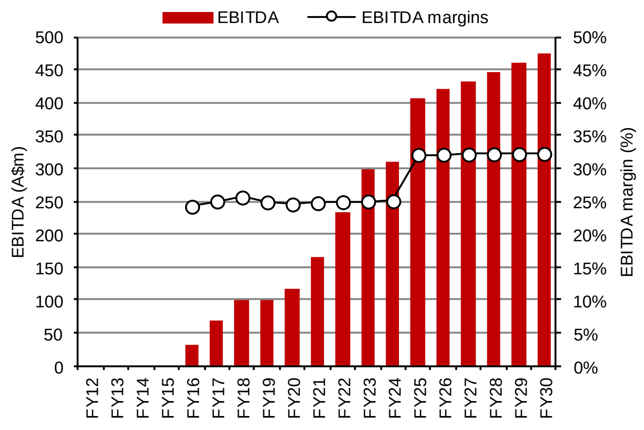
- **Maintain Outperform**.

Fig 1 ResGen – Production profile



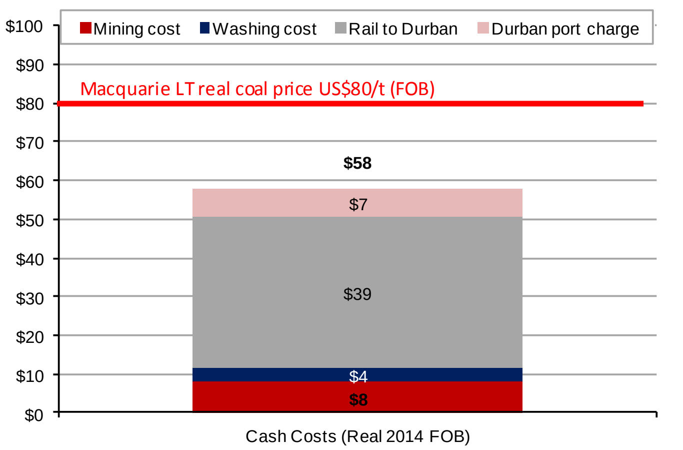
Source: Company data, Macquarie Research, January 2014

Fig 2 Forecast EBITDA and margins



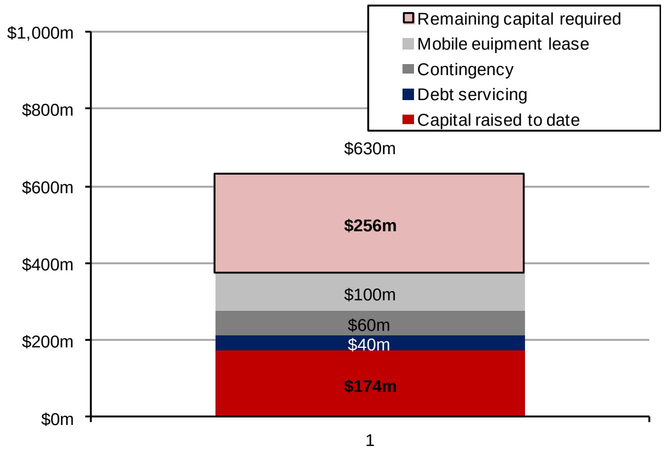
Source: : Company data, Macquarie Research, January 2014

Fig 3 Cash cost (FOB Durban)



Source: Macquarie Research, January 2014

Fig 4 Further funding required for Stage 1



Source: Macquarie Research, January 2014

Fig 5 Macquarie financial and operating assumptions

Parameter	Units	Stage 1	Stage 2
Timeline			
Initial production	FY	2016	2020
Full production	FY	2018	2023
Capital			
Capital cost	Rbn	5,500	4,000
Capital intensity	R/annual t	917	400
Volumes			
ROM production	kt	10,000	24,000
Saleable production	kt	6,000	10,000
- Export thermal coal	kt	3,000	5,000
- Domestic thermal coal	kt	3,000	5,000
Operating costs (real 2012$)			
FOR Mine / Eskom cost	R/t	114	114
Rail to Durban	R/t	372	309
Durban Port charge	R/t	70	70
Total	R/t	556	493
Coal prices (real 2012$)			
Long-term export thermal coal	US$/t	80	80
Long-term domestic thermal coal	R/t	160	160
Exchange rates			
Long-term R/US$		9.58	9.58
Long-term US$/A$		0.82	0.82

Source: Macquarie Research, January 2014

The comparative economics of the Waterberg

The key strategic driver from a national (i.e. Eskom/Government) perspective will be ensuring adequate coal supply to Eskom's existing Mpumalanga power stations. In most cases, Eskom's Mpumalanga PS's will outlive their available coal supply. Eskom is pushing for access to Waterberg coal in order to secure a new source of long-term supply as well as dilute its dependency on Witbank coals. Eskom has previously talked about needing ~20mtpa from the Waterberg and in 2013 conducted a 240kt bulk-sample burn-test at its Majuba PS on a "typical Waterberg" sample sourced from Exxaro's GG.

The capital investment by Transnet is THE key to unlocking the potential of the Waterberg by facilitating increased exports and/or coal supply to Eskom's Mpumalanga PS. The success of the "Waterberg Strategy" will depend on the rail tariff from the Waterberg (we understand that Transnet has indicated a tariff of ~R310/t from Lephalale to RBCT).

One of the key assumptions we have made in comparing the "typical" economics between the Waterberg and more "traditional" Witbank operations is with respect to the FOR (free-on-road/ rail) price Eskom is willing to pay. We have assumed that Waterberg coal would be required to compete on a delivered basis with the marginal Witbank tonnes. Given the logistics differential, we have used a number of ~R160/t FOR; however, this number could be as high as R220/t (R15/MJ/t).

Fig 6 "Typical" Witbank and Waterberg comparative economics

Typical Parameters		Witbank			Waterberg			
Mine Type		**Eskom Only**	**Eskom Only**	**Multi-Product**	**Eskom Only**	**Eskom Only**	**Multi-Product**	**Multi-product**
Eskom contractual relationship		**Tied**	**Commercial**	**Commerical**	**Tied (Waterberg PS)**	**Commercial (Witbank PS)**	**Commerical (Waterberg PS)**	**Commercial (Witbank PS)**
Example mine/company		Matla/Exxaro	Vangats/Keaton	GGV/ARM		WCC		ResGen
On Mine								
Stripping Ratio	x	2.5	2.5	2.5	0.8	0.8	0.8	0.8
Yield	%	80%	65%	75%	55%	55%	45%	45%
RoM Production Cost	R/ROM t	125	125	125	40	40	40	40
Washing Cost	R/Saleable t	-	35	35	35	35	35	35
On Mine Cost		156	227	202	108	108	124	124
Logistics Assumptions								
Heavy haul rail cost	R/t/km	-	-	0.22	-	-	0.22	0.22
General freight rail cost	R/t/km	-	-	-	-	0.40	0.40	0.40
Trucking cost	R/t/km	-	1.17	1.17	-	-	-	1.17
Eskom Logistics								
Logistics		Conveyor	Truck	Truck	Conveyor	General Freight	Conveyor	General Freight
Distance to Eskom	km	-	130	130	-	629	-	629
Logistics Cost to Eskom	**R/t**	**-**	**152**	**152**	**-**	**252**	**-**	**252**
Delivered cost to Eskom PS	R/t	156	379	354	108	359	124	375
Delivered price for Eskom (FOT + logistics)	R/t	172	410	367	159	410	159	410
Export Logistics								
Distance to RBCT	km	-	-	635	-	-	1,050	1,050
Logistics Cost to Export	**R/t**	**-**	**-**	**140**	**-**	**-**	**311**	**311**
RBCT Charges	**R/t**	**-**	**-**	**40**	**-**	**-**	**40**	**40**
Cost FOB RBCT	R/t	-	-	382	-	-	475	475
Cost FOB RBCT	US$/t							
Mine Economics								
% Eskom	%	100%	100%	55%	100%	100%	50%	50%
% Export	%	0%	0%	45%	0%	0%	50%	50%
Eskom Price (On Mine)	R/t	172	258	215	159	159	159	159
Eskom Price (On Mine)	R/MJ/kg	8.0	12.0	10.0	7.4	7.4	7.4	7.4
Export Price (FOB)	R/t	-	-	800	-	-	800	800
Revenue	R/t	172	258	478	159	159	479	479
Cash Cost	R/t	156	227	283	108	108	299	299
EBITDA Margin	R/t	16	31	196	51	51	180	180
EBITDA margin	**%**	**9%**	**12%**	**41%**	**32%**	**32%**	**38%**	**38%**

Source: Macquarie Research, January 2014

Witbank (Eskom Only – Tied) – With a typical mine-mouth operation, coal is delivered very short distances along conveyer belt from the mine to the PS. These mines only supply Eskom and typically have long-term cost-plus or fixed price contracts in place. Yields are higher, given lower-quality product, and we assume that these operations receive ~R8/GJ on a FOR basis from Eskom (industry ranges from R6 – R15 exist). Operations like these have largely sunk and depreciated capital and signed long-term contracts many years ago that have struggled to keep up with mining inflation. We have assumed open-cast mining with a stripping ratio of 2.5 and R50/strip for the mining costs (approx. current contractor rates). An example of this type of operation is Exxaro's Matla mine.

Witbank (Eskom Only – Commercial) – This represents the marginal Eskom supply from the Witbank region and is representative of Keaton's Vanggatfontein mine. Mined coal is of a lower quality that requires beneficiation (washing) and is then transported 130km via road transport (trucks) to an Eskom PS. Typically, Eskom will provide miners with a free-on-road/ rail (FOR) price for their coal; we have assumed R12/GJ (R227/t), given the shorter-term nature of the contracts.

Witbank (Multi-product – Commercial) – Representative of Glencore Xstrata and ARM Coal's JV Goedegevonden (GGV) mine. Both an export and domestic product is produced, split 45:55. All domestic coal is sold to Eskom and delivered by road at an average distance of 130kms. We have assumed the most competitive export route and US$80/t export coal price with a ZAR of R10.00.

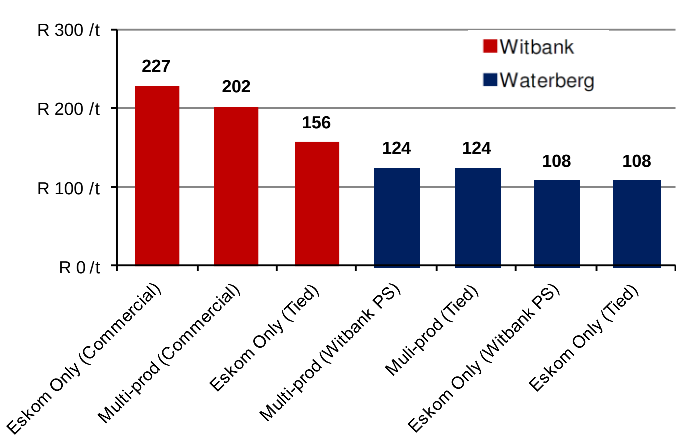
Waterberg (Eskom Only – Tied) – This is representative of a "Coal 3" or IPP scenario where coal is delivered to a new PS via conveyor in the Waterberg. For Waterberg operations, we have assumed a typical mining strip of 0.8:1. Higher yields are achievable due to a lower quality product, but all Waterberg coals require washing.

Waterberg (Eskom Only – Commercial Witbank PS) – This is indicative of the current WCC plans. All coal is railed from the Waterberg mine to supply coal to the existing Mpumalanga PS at a logistics cost of R252/t. On a delivered basis, it would cost R359/t to Eskom.

Waterberg (Multi-product – Commercial Waterberg PS) – Exxaro is at present the only operator in the Waterberg and supplies both Matimba and Medupi. Our model is representative of a new mine established in the Waterberg supplying a local PS and exporting the balance of its saleable production.

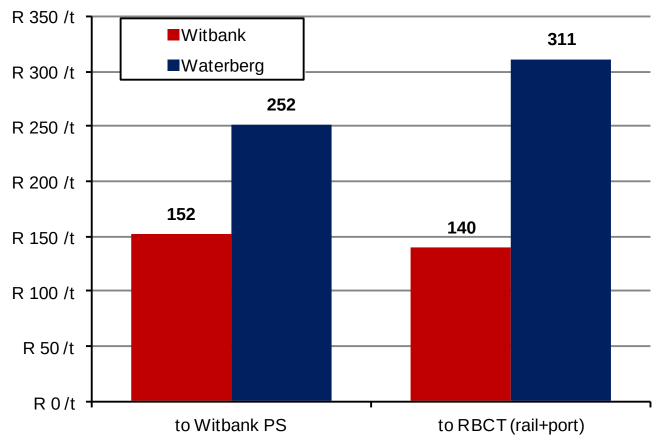
Waterberg (Multi-product – Commercial Witbank PS) – The ResGen model. Eskom coal is railed ~630km from the Waterberg to the Majuba power station in Mpumalanga while an export product is railed ~1050km to RBCT (used for simplicity; ResGen plans to export via Durban).

Fig 7 Mining & washing costs (FOR cost)



Source: Macquarie Research, January 2014

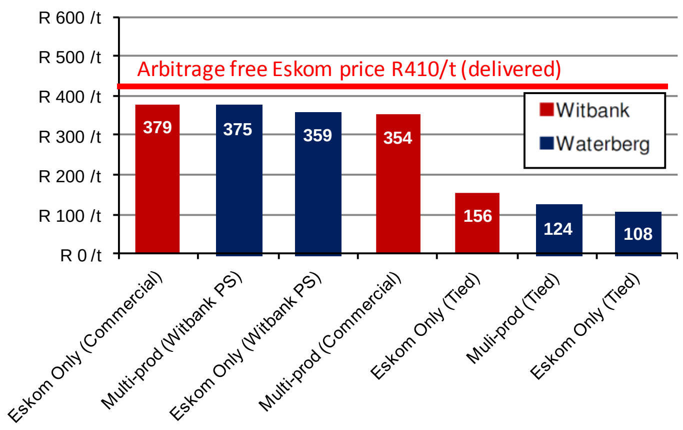
Fig 8 Comparative logistics costs



Source: Macquarie Research, January 2014

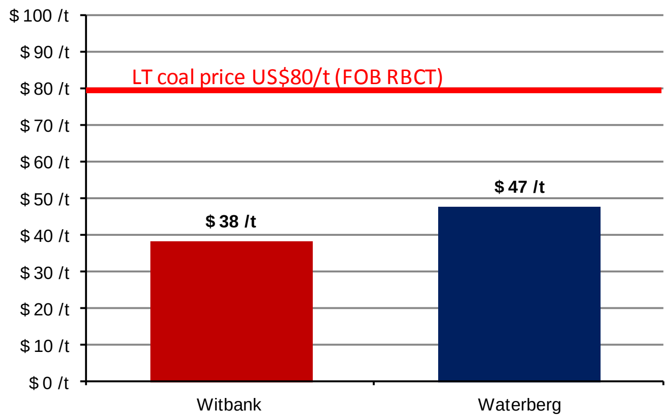
Despite suffering a yield disadvantage (due to significant interburden), ex-works costs for Waterberg coals generally cost lower to mine than those of Witbank given the lower strip. Rail costs from the Waterberg to a Mpumalanga PS are estimated at R252/t while those to RBCT are R311/t (~US$31/t). This compares to R152/t to truck material from Witbank and R140/t (~US$14/t) to rail from Witbank to RBCT on the heavy haul line.

Fig 9 Delivered cost to Eskom in Mpumalanga



Source: Macquarie Research, January 2014

Fig 10 Average export costs (FOB RBCT)



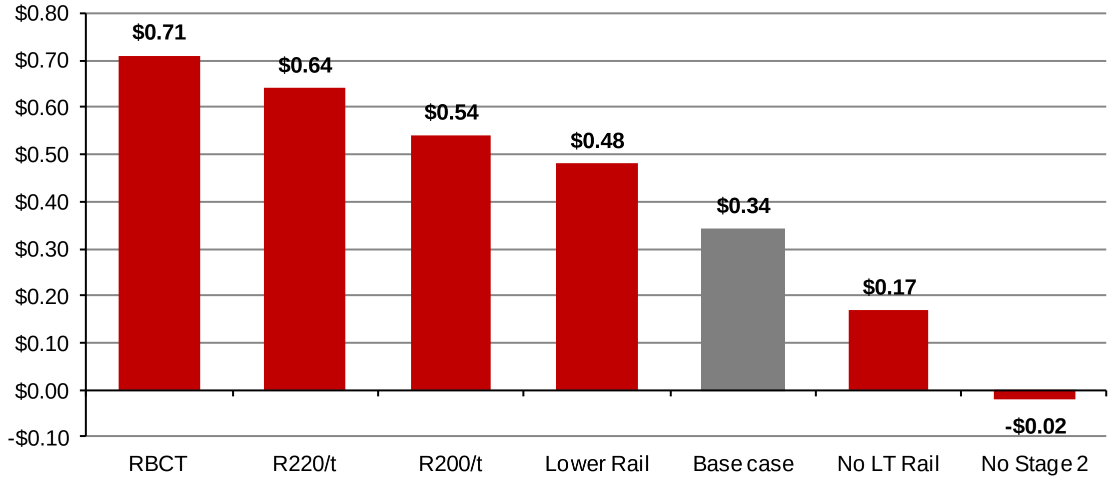
Source: Macquarie Research, January 2014

With lower mining costs but higher assumed logistics costs, it does appear that Waterberg coal can compete with the more marginal Witbank coal supplies on a delivered basis to Eskom. While slightly more expensive (US$47/t vs. US$38/t) Waterberg exports via RBCT still appear to have healthy margins.

A few different valuation scenarios for ResGen

We look at a couple of alternative scenarios for our ResGen valuation. While our base case represents what we consider to be fair value, these cases depict the potential up/downside.

Fig 11 Fair value under alternative scenarios



Source: Macquarie Research, January 2014

The assumptions used for the various scenarios are as follows:

RBCT – ResGen utilises the RBCT route as opposed to the Durban route.

R220/t – the domestic price received for coal is R220 vs. our R160/t base case.

R200/t – the domestic price received for coal is R220 vs. our R160/t base case.

Lower Rail – we build in the benefit from lower rail tariffs from day 1

No LT Rail – we assume that there is no long term benefit on rail tariffs from increased throughput and an upgrade or newly built heavy haul line.

No Stage 2 – we exclude stage 2 from our valuation entirely.

Fig 12 Financial summary page

Resource Generation (RES AU / RSG SJ)	Share price:	$0.19
	Target price:	$0.27

Profit and loss		FY12A	FY13A	FY14E	FY15E	FY16E
Revenue	A$m	0.0	0.0	0.0	0.0	130.3
Production costs	A$m	0.0	0.0	0.0	0.0	-96.5
EBITDA	**A$m**	**-2.3**	**-6.2**	**-3.3**	**-3.5**	**31.5**
Depreciation and amortisation	A$m	-0.1	-0.1	-0.2	-0.2	-22.1
Other income/(expenses)	A$m	-2.9	-0.0	-0.1	-0.1	1.4
EBIT	**A$m**	**-3.0**	**-3.2**	**-0.2**	**-0.2**	**13.1**
Net interest income/(expense)	A$m	2.1	0.4	-0.4	0.5	0.7
Profit before tax	A$m	-0.9	-2.8	-0.6	0.3	13.7
Taxation	A$m	-0.0	-0.0	0.2	-0.1	-3.8
Profit after tax	A$m	-0.9	-2.8	-0.4	0.2	9.9
Non-controlling interests	A$m	0.0	0.0	0.0	0.0	2.6
Reported Net Profit	**A$m**	**0.6**	**-2.8**	**-0.4**	**0.2**	**7.3**
Profit growth	A$m	-111%	-591%	-85%	-149%	3371%
Effective tax rate	%	-1%	-1%	28%	28%	28%
Average shares	m	263	274	581	581	581
EPS adjusted	**A$c**	**0.22**	**-1.03**	**-0.07**	**0.04**	**1.26**
DPS	A$c	0.00	0.00	0.00	0.00	0.00

Cash Flow		FY12A	FY13A	FY14E	FY15E	FY16E
Cash generated from operatio	A$m	-2.3	-2.3	-0.2	-0.2	14.0
Net interest	A$m	1.0	-0.4	-0.4	0.5	0.7
Tax paid	A$m	-0.0	-0.0	0.0	0.0	0.0
Operating cash flow	**A$m**	**-1.2**	**-2.8**	**-0.6**	**0.3**	**14.7**
Sustaining capex	A$m	0.0	0.0	0.0	0.0	-2.6
Project capex	A$m	-4.4	-5.6	-183.2	-273.0	-166.1
Investing cash flow	**A$m**	**-11.1**	**-16.6**	**-183.2**	**-273.0**	**-168.7**
Debt drawdown/(repayment)	A$m	0.0	20.0	130.0	280.0	50.0
Equity financing & other	A$m	0.0	8.6	58.0	0.0	115.9
Financing cash flow	**A$m**	**0.0**	**28.6**	**188.0**	**280.0**	**165.9**
Net cash flow	**A$m**	**-12.4**	**9.3**	**4.2**	**7.3**	**11.9**
Free cash flow	A$m	-12.4	-19.4	-183.8	-272.7	-154.0

Balance Sheet		FY12A	FY13A	FY14E	FY15E	FY16E
Cash	A$m	12.1	21.4	25.6	32.9	44.8
Inventory	A$m	0.0	0.0	0.0	0.0	11.9
Receivables	A$m	0.8	0.6	0.6	0.6	16.1
Total current assets	**A$m**	**13.3**	**22.3**	**27.0**	**34.5**	**73.1**
PPE	A$m	38.2	43.6	226.7	499.6	646.1
Mining & exploration	A$m	77.4	88.8	88.8	88.8	88.8
Total non-current assets	**A$m**	**127.2**	**145.2**	**328.3**	**601.2**	**747.7**
Total Assets	**A$m**	**140.5**	**167.5**	**355.3**	**635.7**	**820.8**
Payables	A$m	2.9	8.0	8.0	8.0	15.9
Total current liabilities	**A$m**	**4.1**	**29.2**	**8.8**	**8.8**	**18.0**
Borrowings	A$m	0.8	20.5	150.5	430.5	480.5
Total non-current liabilities	**A$m**	**3.1**	**2.8**	**153.4**	**433.6**	**483.8**
Total Liabilities	**A$m**	**7.2**	**32.0**	**162.2**	**442.4**	**501.7**
Total Equity	**A$m**	**133.3**	**135.5**	**193.1**	**193.3**	**319.1**

Coal Production		FY12A	FY13A	FY14E	FY15E	FY16E
ROM production	mt	0.0	0.0	0.0	0.0	5.0
Export yield	%	21%	21%	21%	21%	21%
Domestic yield	%	27%	27%	27%	27%	27%
Total saleable production	**mt**	**0.0**	**0.0**	**0.0**	**0.0**	**2.1**
Export	mt	0.0	0.0	0.0	0.0	1.1
Eskom	mt	0.0	0.0	0.0	0.0	1.1

Key assumptions		FY12A	FY13A	FY14E	FY15E	FY16E
RBCT FOB API4	US$/t	-	-	79	84	87
RBCT FOB API4	R/t	-	-	803	820	855
Domestic (Eskom price)	R/t	-	-	160	169	178
ZAR/US$	R/$	7.85	8.85	10.19	9.80	9.83
SA CPI	%	5.2%	5.7%	6.0%	5.8%	5.4%
SA Mining inflation	%	7.5%	8.2%	6.0%	5.8%	5.4%

Unit operating costs		FY12A	FY13A	FY14E	FY15E	FY16E
Mining & washing	R/t	-	-	78	82	87
Rail & port	R/t	-	-	372	-	-
Total	**R/t**	**-**	**-**	**450**	**82**	**87**
Mining & washing	US$/t	-	-	8	8	9
Rail & port	US$/t	-	-	36	-	-
Total	**US$/t**	**-**	**-**	**44**	**8**	**9**

Ratio analysis		FY12A	FY13A	FY14E	FY15E	FY16E
EBITDA margin	%	nmf	nmf	nmf	nmf	24%
Operating margin	%	nmf	nmf	nmf	nmf	6%
PE Ratio	x	0.87	-0.18	-2.56	5.24	0.15
Dividend Yield	%	0.0%	0.0%	0.0%	0.0%	0.0%
EV/EBITDA	x	-168	-64	-117	-111	12
ROE	%	0.4%	-2.1%	-0.2%	0.1%	2.3%
ROA	%	0.4%	-1.7%	-0.1%	0.0%	0.9%
Net Debt (cash)	%	0	-1	125	398	436
Gearing ratio	%	0.0%	-0.7%	39.3%	67.3%	57.7%

Valuation	100% NPV	Less Minorities	NPV Discount	NPV/sh	NPV/sh
	ZARm	%	%	ZAR/sh	A$/sh
Stage 1	1745	26%	0%	R 2.22	$0.23
Stage 2	2777	26%	0%	R 3.53	$0.36
Corporate & NWC	-708	0%	0%	-R 1.22	-$0.13
Enterprise value	**3814**			**R 4.54**	**$0.47**
Less: Net debt/(cash)	705			R 1.21	$0.12
Equity value	**3109**			**R 3.33**	**$0.34**
WACC					*14.4%*
Target Price					**$0.27**

Source: Factset, Macquarie Research, January 2014

Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand
Outperform – return >3% in excess of benchmark return
Neutral – return within 3% of benchmark return
Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield

Macquarie – Asia/Europe
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie First South - South Africa
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie - Canada
Outperform – return >5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return >5% below benchmark return

Macquarie - USA
Outperform (Buy) – return >5% in excess of Russell 3000 index return
Neutral (Hold) – return within 5% of Russell 3000 index return
Underperform (Sell)– return >5% below Russell 3000 index return

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low–medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.
* Applicable to Asia/Australian/NZ/Canada stocks only

Recommendations – 12 months
Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:
Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / efpowa*
ROA = adjusted ebit / average total assets
ROA Banks/Insurance = adjusted net profit /average total assets
ROE = adjusted net profit / average shareholders funds
Gross cashflow = adjusted net profit + depreciation
*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 31 December 2013

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	47.89%	60.13%	37.97%	39.49%	59.64%	48.65%	(for US coverage by MCUSA, 6.52% of stocks followed are investment banking clients)
Neutral	35.56%	22.65%	46.84%	54.50%	35.54%	32.43%	(for US coverage by MCUSA, 4.35% of stocks followed are investment banking clients)
Underperform	16.55%	17.22%	15.19%	6.01%	4.82%	18.92%	(for US coverage by MCUSA, 0.00% of stocks followed are investment banking clients)

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