

Resource Generation (RES.AX)

Getting skinny with it

- Capex reduced** — RES has announced that it has signed a power offtake deal with Eskom. This effectively negates the need to build a power station on site and removes around \$120m of capex from the budget. The contract from Eskom is for 30MW in years 1+2 of mining and for 50MW in years 3 plus. We estimate that purchasing of power would lift power costs by only US\$0.04-0.05/kwh and thus have only a marginal impact on the cost profile for the company.
- Lower capex good for financing** — Banks' due diligence is continuing on the funding package for the project. We believe that an announcement on the preferred banks will likely be completed in mid-September and then subject to the banks' credit approval, debt funding could be announced mid Q4. Our understanding is that the c\$120m capex reduction will lower the amount of money that the company needs to raise in the equity market. If we assume c\$400m of debt financing, then today's announcement could possibly reduce the equity component of financing from c\$400m to around \$250-\$300m. We see the capex reduction as potentially shrunken equity component of financing a huge positive for RES.
- Stage 1: the base case** — The current rail deal with Transnet provides 6mtpa of rail access over 10 years (the tenure can easily be extended when production starts). We see Stage 1 of the Boikarabelo project delivering 3mt of domestic and 3mt of export coal from 2015 onwards at a reduced capital cost of c\$700m (higher than company guidance) with a mine cost including washing of ZAR190/t and a rail & port cost of ZAR290/t. On these metrics we estimate Stage 1 delivers an NPV of \$0.82 per share.
- Stage 2: the upside** — We see potential to expand the project to 50mtpa of RoM coal (12mt domestic and 12mt export). However given the lack of domestic offtake for Stage 1, the current uncertainty in global coal markets and the large capital cost (c\$800m), we do not assume any value for stage 2 in our base case value. However on an upside scenario test, the project would deliver an IRR of 24% and an NPV of \$2.07 per share.
- Keep the Buy/High Risk** — We lift our target price to \$0.80/sh to reflect the higher NPV generated from the lower capex. We continue to like the RES story and with the removal of many of the short term issues (rail, funding, etc) almost complete we see long term upside in the name. As such RES remains our core small cap pick.

- Company Update
- Target Price Change
- Estimate Change

Buy/High Risk	1H
Price (22 Aug 12)	A\$0.23
Target price	A\$0.80
	<i>from A\$0.60</i>
Expected share price return	247.8%
Expected dividend yield	0.0%
Expected total return	247.8%
Market Cap	A\$60M
	US\$63M

Price Performance (RIC: RES.AX, BB: RES AU)



RES.AU revisions (Y/E Jun)	2011A	2012A	2013E	2014E	2015E
Sales (A\$m)	0.0	0.0	0.0	0.0	293.2
% revision	0.0%	na	na	na	0.0%
EBIT (A\$m)	-6.3	-1.5	-7.5	-17.6	98.3
% revision	0.0%	0.0%	0.0%	0.0%	0.0%
Core Net Profit (A\$m)	-5.1	0.6	-7.2	-12.1	36.7
% revision	0.0%	0.0%	0.0%	0.0%	2.3%
Core EPS (A¢)	-2.0	0.2	-2.8	-4.7	14.2
% revision	0.0%	0.0%	0.0%	0.0%	2.3%
EPS Growth (%)	4.4	111.3	-1,358.7	-68.3	402.7
PE Ratio (x)	-11.7	103.5	-8.2	-4.9	1.6
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0

Source: Company Reports and dataCentral, Citi Research.

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RES.AX: Fiscal year end 30-Jun						Price:\$0.23; TP:\$0.80; # Shares: 263m; Market Cap: A\$60m; Recomm: Buy/High Risk					
Profit & Loss (A\$m)						Comdty & FX Forecasts					
	2012	2013E	2014E	2015E	2016E	2012	2013E	2014E	2015E	2016E	
Sales revenue	0	0	0	293.2	451.3	Thermal coal price (US\$/t)	108.7	97.8	116.3	124.5	128.3
Cost of sales	-0.1	0	-10.0	-179.3	-294.6	AUDUSD (analyst) (x)	1.03	1.00	0.92	0.90	0.90
EBITDA	-1.4	-7.5	-7.6	113.3	182.5	ZARUSD (analyst)	7.9	8.5	8.9	9.3	9.6
Depreciation/Amortization	-0.1	0	-10.0	-15.0	-47.7	Long Term Forecasts					
EBIT	-1.5	-7.5	-17.6	98.3	134.8	Thermal Coal (US\$/t)					na
Net interest	2.1	0.3	-5.9	-14.3	-12.3	AUDUSD average					0.90
Earnings before tax	0.6	-7.2	-23.5	84.0	122.5	Production Volumes	2012	2013E	2014E	2015E	2016E
Tax Recurring	0.0	0	0	-25.2	-36.7	Thermal coal (mt) (mt)	0.0	0.0	0.0	4.0	6.0
Exceptional/Other	0	0	11.4	-22.1	-44.7	Production Costs	2012	2013E	2014E	2015E	2016E
Reported net profit	0.6	-7.2	-12.1	36.7	41.0	Cash Costs (US\$/t)	0.0	0.0	0.0	41.1	41.2
Core NPAT	0.6	-7.2	-12.1	36.7	41.0						
Balance Sheet (A\$m)	2012	2013E	2014E	2015E	2016E						
Cash & cash equiv.	12.1	652.3	298.6	382.2	486.2						
Net fixed & other tangibles	127.2	377.2	717.2	756.8	716.2						
Total assets	140.5	1030.7	1017.0	1140.1	1203.6						
Short-term debt	0.8	0.8	0.8	0.8	0.8						
Long-term debt	0	450.0	450.0	450.0	450.0						
Total liabilities	7.2	457.2	457.2	457.2	457.2						
Shareholders' equity	133.3	573.5	559.8	682.9	746.4						
Total equity	133.3	573.5	559.8	682.9	746.4						
Net debt	-11.4	-201.6	152.2	68.6	-35.5						
Cashflow (A\$m)	2012	2013E	2014E	2015E	2016E						
Operating cashflow	-1.2	-7.8	-1.7	140.2	213.2						
Capex	-2.4	-250.0	-350.0	-54.6	-7.2						
Net acq/disposals	0	0	0	0	0						
Exploration exp/Other	-7.4	-2.0	-2.0	-2.0	-2.0						
FCF ex acqns & explor exp	-11.1	-259.8	-353.7	83.6	204.0						
Net change in cash	-13.2	640.2	-353.7	83.6	104.0						
Per share data	2012	2013E	2014E	2015E	2016E						
Reported EPS (¢)	0.2	-2.8	-4.7	14.2	15.9	Reserves & Resources	Reserves	Resource			
Core EPS (¢)	0.2	-2.8	-4.7	14.2	15.9		Amount	Grd.()	Amount	Grd.()	
DPS (¢)	0	0	0	0	0	Total Coal (mt)	458.1		2,357.4		
CFPS (¢)	-0.5	-3.0	-0.7	54.4	82.7						
BVPS (¢)	51.7	222.4	217.0	264.8	289.4						
Wtd avg ord shares (m)	258	258	258	258	258						
Wtd avg diluted shares (m)	258	258	258	258	258						
Valuation ratios	2012	2013E	2014E	2015E	2016E	Valuation					
PE (x)	nm	-8.2	-4.9	1.6	1.4	WACC (%)					14.0
EV/EBIT (x)	-28.0	6.1	-2.0	1.7	0.6	NPV Valuation			US\$M	A\$/sh.	
EV/EBITDA (x)	-30.2	6.1	-4.7	1.5	0.4	Boikarebelo			223.4	0.94	
FCF yield (%)	-6.2	nm	nm	nm	nm	Exploration & Other			0.0	0.00	
Dividend yield (%)	0	0	0	0	0	Corporate Costs			-40.3	-0.17	
Payout ratio (%)	0	0	0	0	0	Net (debt) / cash			10.2	0.04	
Operating performance	2012	2013E	2014E	2015E	2016E	Total			193.3	0.82	
EBITDA margin (%)	na	na	na	38.6	40.4						
Operating ROE (%)	0.4	-2.0	-2.1	5.9	5.7						
Operating ROIC (%)	-1.3	-3.0	-3.2	9.9	13.4						
Net debt to equity (%)	-8.5	-35.1	27.2	10.0	-4.8						
Debt to total capital (%)	0.6	44.0	44.6	39.8	37.7						

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A refresh on the project

The recent announcement from RES stating it has signed a 10-year take-or-pay deal with rail provider Transnet moves the Boikarabelo project a step closer to delivery. Whilst the next major milestone in the evolution of the project, an offtake arrangement with Eskom is yet to be completed; the provision of rail access now allows the banks who would look to finance RES to complete their due diligence, which we believe will likely be completed around September/October. After the debt and equity funding is in place, construction could start as early as the end of this year or early 2013. RES has made significant progress on the project and now has received:

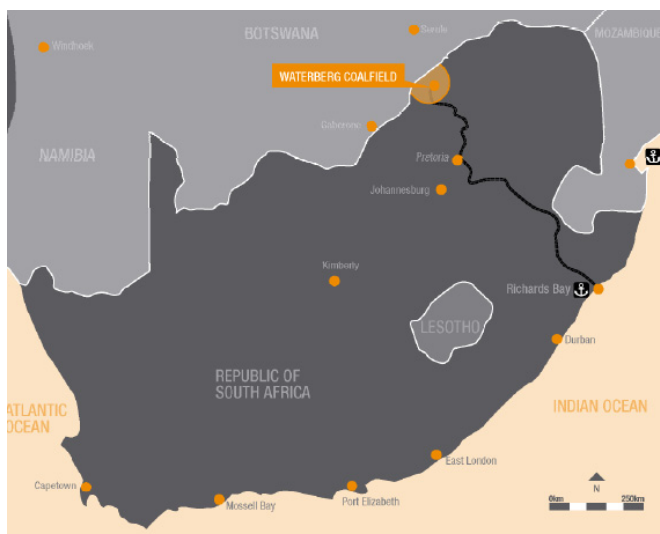
- Mining rights
- Water license
- Development consent
- Rail agreement

Given the progress that RES has achieved to date, we have dusted off our model and take a fresh look at the project and update our assumptions and valuation.

The Boikarabelo project is a c6.4bnt coal resource (745mt of reserve) located in the Waterberg region of South Africa.

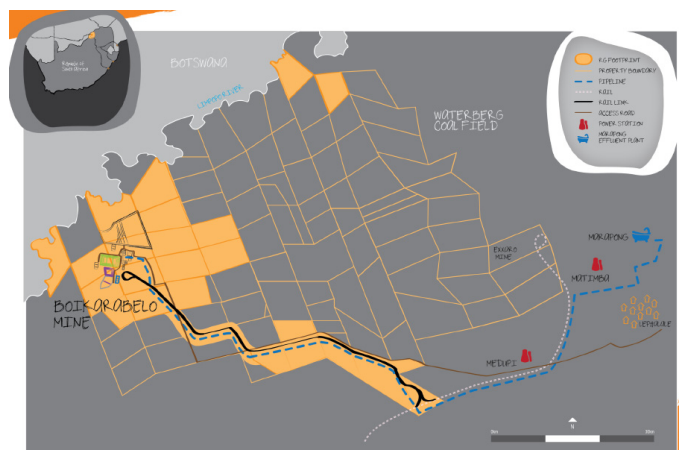
- Stage 1: 14mt of RoM coal delivering 3mt of export and 3mt of domestic coal.
- Stage 2: 50mt of Rom coal delivering 6mt of export and 6mt of domestic coal.

Figure 1. Location of assets



Source: Company reports

Figure 2. Location of coal fields



Source: Company reports

The company has provided relatively clear guidance to the market in terms of the main operational metrics it believes the project will operate to. The table below highlights the key operational assumptions that the company expects alongside our modeling assumptions. As the table indicates, we have been very conservative with our assumptions which we believe is a fair caution given the challenging operational environment in South Africa.

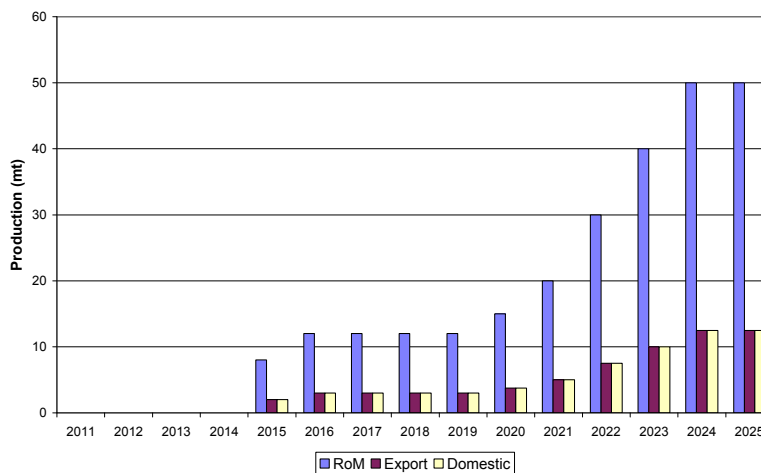
Figure 3. Assumptions – Stage 1

	Citi Assumptions	Company Guidance
Capital Cost	A\$750m	A\$620m
ROM Coal production	First Production start 2015 Phase 1: 12mt RoM (2016 full capacity)	First Production end 2014 Phase 1: 14mt RoM (2015 full capacity)
Yield	43%	43%
Coal split	50% Thermal export 50% Domestic	50% Thermal export 50% Domestic
Mine Cash cost	ZAR190/t Comprised of ZAR140/t mine and ZAR50/t plant & SGA	N/A
Transport Cost - export	ZAR 300/t Comprised of ZAR260/t rail and ZAR40/t port and handling	N/A
Long term export coal price	\$95/t	N/A
Long term domestic coal price	ZAR 250/t	N/A

Source: Company reports, Citi Research

The charts below look at our production assumptions and growth profile for RES.

Figure 4. Coal production and growth profile for RES



Source: Citi Research estimates

Our updated model results in slightly higher earnings forecasts for FY15E+.

Valuation

Our base case NPV for RES is based upon Stage 1 only and assumes an equal blend of export versus domestic coal exports. We use a 14% discount rate to take into account the early stage of the project as well as the sovereign risk. Whilst the discount rate is high, it's not dissimilar to rates we use for other non-producing African mining companies. Our assumption of the long term coal price that RES receive is \$95/t for its export coal and ZAR250/t for domestic coal (both real 2012 figures).

Figure 5. Resource Generation NPV – Base case

WACC	14%	A\$	Ownership	A\$/share
Boikarebelo		335	74.0%	0.94
Corporate Costs		-45		-0.17
Cash/(Net Debt)		11		0.04
Total		302		0.82

Source: Citi Research

Our base case of just Stage 1 delivers an NPV of \$0.82/share

If we assume the development of Stage 2, the NPV would jump to \$2.07/share on an un-risked basis delivering the overall project (Stage 1 & 2) and IRR of 24%.

Figure 6. Resource Generation NPV – Stage 2 scenario

WACC	14.0%	A\$	Ownership	A\$/share
Boikarebelo		783	74.0%	2.20
Corporate Costs		-45		-0.17
Cash/(Net Debt)		11		0.04
Total		749		2.07

Source: Citi Research

Resource Generation

Company description

RES is a 'concept coal' company with assets in the Waterberg region of South Africa. The main development is the Boikarebelo project. It has 3Bt of coal resources and 745Mt of reserves. RES initially plans an open pit producing c6Mtpa of washed coal with a 50:50 split between domestic and export.

Investment strategy

We rate RES shares as Buy/High Risk. RES is very high risk but potentially a highly rewarding prospect. The company has a huge resource position in the mainly untapped Waterbank coal region of South Africa. Its resource base, build out of domestic South African power capacity and demand for coal from emerging markets such as India is likely to see RES evolve into a 6mtpa coal producer.

Valuation

Our target price of \$0.80/share is set to our NPV for just stage one of the project. Our NPV is based on DCF analysis using a 14% discount rate and a US\$95/t long term thermal coal price. We believe a 14% discount rate in our NPV is appropriate given the early stage of the project.

Risks

We rate RES High Risk given the non producing nature of its assets. Key risks to achieving our target price are as follows:

Commodity price: Coal prices have become more volatile over the past 5 years as the historically bulk traded market has moved to a more terminal market approach. At the same time China has been swinging from importers to exporters to importers of coal which has had a significant effect on the supply-demand balance of the seaborne market. Given the big coal resources that China has, there is always the risk that it could increase domestic production and turn again to a net exporter of coal, having a negative influence on the coal price.

Political Risk: South Africa has had a revolution in its minerals industry in the past decade with the implementation of Black Economic Empowerment.

If the impact on the company from any of these factors proves to be greater than we anticipate, the stock will likely have difficulty achieving our target price. However, should they be less than anticipated, the stock could trade above our target price.

Appendix A-1

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Resource Generation (RES.AX)

Ratings and Target Price History Fundamental Research

Analyst: Craig Sainsbury
Covered since February 9 2012



	Date	Rating	Target Price	Closing Price
1	22-Sep-10	*1S	*1.00	0.72
2	8-Nov-10	1S	*0.95	0.54
3	31-Mar-11	1S	*1.40	0.93

	Date	Rating	Target Price	Closing Price
4	6-Jul-11	1S	*1.50	0.80
5	25-Jul-11	1S	*1.45	0.70
6	7-Oct-11	Stock rating system changed		

	Date	Rating	Target Price	Closing Price
7	7-Oct-11	*1H	1.45	0.40
8	11-Jan-12	1H	*1.40	0.44
9	10-Jul-12	1H	*0.60	0.30

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Resource Generation (RES.AX)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Craig Sainsbury
Covered since February 9 2012



	Date	Rating	Target Price	Closing Price
1	15-May-11	*ADD MP	-	0.85

	Date	Rating	Target Price	Closing Price
2	9-Feb-12	*REM MP	-	0.42

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 1 Jul 2012

Citi Research Global Fundamental Coverage

% of companies in each rating category that are investment banking clients

12 Month Rating			Relative Rating		
Buy	Hold	Sell	Buy	Hold	Sell
53%	37%	10%	10%	80%	10%
44%	43%	40%	48%	43%	45%

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