

# Resource Generation (RES.AX)

## Green Signal for Rail – Full Steam Ahead

- Company Update
- Target Price Change
- Estimate Change

- **Maintain Buy** — The recent approval of a 10-year offtake agreement with Transnet moves the development of the Boikarabelo project closer to fruition. We have reviewed our model in light of the agreement and current coal prices and now believe that it is prudent to only assume value for the Stage 1 project for which we derive an NPV of \$0.60/share. Consequently we have reduced our target price to \$0.60/share and retain our Buy/High risk recommendation on the stock.
- **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). Whilst no negotiations have been reached with Eskom for domestic offtake yet, we believe that this will be likely in due course. Thus we see Stage 1 of the Boikarabelo project delivering 3mt of domestic and 3mt of export coal from 2015 onwards at a capital cost of c\$800m (higher than company guidance) with a mine cost including washing of ZAR190/t and a rail & port cost of ZAR290/t. On those metrics we estimate Stage 1 delivers an NPV of \$0.60 per share and a post tax IRR of 19.7%.
- **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. On our assumptions the project delivers an IRR of 24% and an NPV of \$2.06 per share. We see stage 2 as a long term potential upside rather than core value for RES.
- **Funding** — We anticipate that funding will be split equally between debt and equity with a total funding package of c\$900m. An equity raising of c\$450m will be challenging in the current environment and thus some form of cornerstone partner in either the equity or the assets is likely needed to ensure financing, in our view.
- **Steps to delivery** — Now that the rail has been signed off, banks can complete their due diligence. We would expect funding to occur around October/November, markets permitting. Thus construction could start as early December this year, but more than likely early 2013. On that timeframe first coal would be expected end of 2014 to early 2015 and full production levels hit in 2H15.

<b>Buy/High Risk</b>	<b>1H</b>
Price (09 Jul 12)	A\$0.30
Target price	A\$0.60
	<i>from A\$1.40</i>
Expected share price return	103.4%
Expected dividend yield	0.0%
<b>Expected total return</b>	<b>103.4%</b>
Market Cap	A\$78M
	US\$79M

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



RES.AU revisions (Y/E Jun)	2010A	2011A	2012E	2013E	2014E
Sales (A\$m)	0.0	0.0	0.0	0.0	0.0
% revision	0.0%	0.0%	na	na	-100.0%
EBIT (A\$m)	-4.2	-6.3	-5.8	-7.5	-17.6
% revision	0.0%	0.0%	0.0%	1.0%	-163.0%
Core Net Profit (A\$m)	-3.3	-5.1	-5.2	-7.3	-12.3
% revision	0.0%	0.0%	0.0%	-2.3%	-247.2%
Core EPS (A¢)	-2.1	-2.0	-2.0	-2.8	-4.8
% revision	0.0%	0.0%	0.0%	-2.3%	-247.2%
EPS Growth (%)	89.5	4.4	-3.1	-40.5	-67.2
PE Ratio (x)	-14.6	-15.3	-14.8	-10.5	-6.3
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0

Source: Company Reports and dataCentral, Citi Research.

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### See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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RES.AX: Fiscal year end 30-Jun						Price:\$0.30; TP:\$0.60; # Shares: 263m; Market Cap: A\$79m; Recomm: Buy/High Risk					
Profit & Loss (A\$m)						Comdty & FX Forecasts					
	2011	2012E	2013E	2014E	2015E	2011	2012E	2013E	2014E	2015E	
Sales revenue	0.0	0	0	0	293.2	Thermal coal price (US\$/t)	109.5	108.7	97.8	116.3	124.5
Cost of sales	-0.1	0	0	-10.0	-179.3	AUDUSD (analyst) (x)	0.99	1.03	1.00	0.92	0.90
<b>EBITDA</b>	<b>-6.2</b>	<b>-5.8</b>	<b>-7.5</b>	<b>-7.6</b>	<b>113.3</b>	ZARUSD (analyst)	7.3	7.9	8.5	8.9	9.3
Depreciation/Amortization	-0.1	0	0	-10.0	-15.0	<b>Long Term Forecasts</b>					
<b>EBIT</b>	<b>-6.3</b>	<b>-5.8</b>	<b>-7.5</b>	<b>-17.6</b>	<b>98.3</b>	Thermal Coal (US\$/t)					105.0
Net interest	1.2	0.6	0.2	-6.0	-15.6	AUDUSD average					0.80
<b>Earnings before tax</b>	<b>-5.1</b>	<b>-5.2</b>	<b>-7.3</b>	<b>-23.6</b>	<b>82.7</b>	<b>Production Volumes</b>					
Tax Recurring	0.0	0	0	0	-24.8	2011	2012E	2013E	2014E	2015E	
Exceptional/Other	0	0	0	11.4	-22.1	Thermal coal (mt) (mt)	0.0	0.0	0.0	0.0	4.0
<b>Reported net profit</b>	<b>-5.1</b>	<b>-5.2</b>	<b>-7.3</b>	<b>-12.3</b>	<b>35.8</b>	<b>Production Costs</b>					
Core NPAT	-5.1	-5.2	-7.3	-12.3	35.8	2011	2012E	2013E	2014E	2015E	
<b>Balance Sheet (A\$m)</b>	<b>2011</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>	<b>2015E</b>	Cash Costs (US\$/t)	0.0	0.0	0.0	0.0	41.1
Cash & cash equiv.	25.3	6.3	646.0	241.7	275.7						
Net fixed & other tangibles	113.2	112.2	362.2	752.2	841.8						
<b>Total assets</b>	<b>139.5</b>	<b>119.5</b>	<b>1009.1</b>	<b>994.8</b>	<b>1118.4</b>						
Short-term debt	0	0	0	0	0						
Long-term debt	0.9	0.9	450.9	450.9	450.9						
<b>Total liabilities</b>	<b>5.4</b>	<b>5.4</b>	<b>455.4</b>	<b>455.4</b>	<b>455.4</b>						
Shareholders' equity	134.1	114.1	553.7	539.4	663.0						
<b>Total equity</b>	<b>134.2</b>	<b>114.1</b>	<b>553.7</b>	<b>539.4</b>	<b>663.0</b>						
<b>Net debt</b>	<b>-24.4</b>	<b>-5.4</b>	<b>-195.0</b>	<b>209.3</b>	<b>175.2</b>						
<b>Cashflow (A\$m)</b>											
<b>Operating cashflow</b>	<b>-2.2</b>	<b>-6.5</b>	<b>-7.7</b>	<b>-1.6</b>	<b>141.3</b>						
Capex	-12.0	-10.0	-250.0	-400.0	-104.6						
Net acq/disposals	-0.7	-0.7	-0.7	-0.7	-0.7						
Exploration exp/Other	-6.8	-1.8	-2.0	-2.0	-2.0						
<b>FCF ex acqns &amp; explor exp</b>	<b>-21.7</b>	<b>-19.0</b>	<b>-260.4</b>	<b>-404.3</b>	<b>34.0</b>						
<b>Net change in cash</b>	<b>19.2</b>	<b>-19.0</b>	<b>639.6</b>	<b>-404.3</b>	<b>34.0</b>						
<b>Per share data</b>											
Reported EPS (¢)	-2.0	-2.0	-2.8	-4.8	13.9						
Core EPS (¢)	-2.0	-2.0	-2.8	-4.8	13.9						
DPS (¢)	0	0	0	0	0						
CFPS (¢)	-0.8	-2.5	-3.0	-0.6	54.8						
BVPS (¢)	52.0	44.2	214.7	209.2	257.1						
Wtd avg ord shares (m)	258	258	258	258	258						
Wtd avg diluted shares (m)	258	258	258	258	258						
<b>Valuation ratios</b>											
PE (x)	-15.3	-14.8	-10.5	-6.3	2.2						
EV/EBIT (x)	-10.1	-10.9	2.8	-4.9	2.8						
EV/EBITDA (x)	-10.3	-10.9	2.8	-11.3	2.4						
FCF yield (%)	-18.3	-21.3	nm	nm	47.5						
Dividend yield (%)	0	0	0	0	0						
Payout ratio (%)	0	0	0	0	0						
<b>Operating performance</b>	<b>2011</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>	<b>2015E</b>						
EBITDA margin (%)	nm	na	na	na	38.6						
Operating ROE (%)	-4.6	-4.2	-2.2	-2.2	6.0						
Operating ROIC (%)	-6.4	-5.2	-3.2	-3.2	9.2						
Net debt to equity (%)	-18.2	-4.7	-35.2	38.8	26.4						
Debt to total capital (%)	0.7	0.8	44.9	45.5	40.5						
<b>Reserves &amp; Resources</b>											
						<b>Reserves</b>	<b>Resource</b>				
						Amount	Grd.()	Amount	Grd.()		
						458.1		2,357.4			
<b>Valuation</b>											
WACC (%)						14.0					
<b>NPV Valuation</b>											
Boikarebelo						US\$m	A\$/sh.				
Exploration & Other						138.3	0.66				
Corporate Costs						0.0	0.00				
Net (debt) / cash						-15.8	-0.08				
<b>Total</b>						4.3	0.02				
						<b>126.8</b>	<b>0.60</b>				

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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:

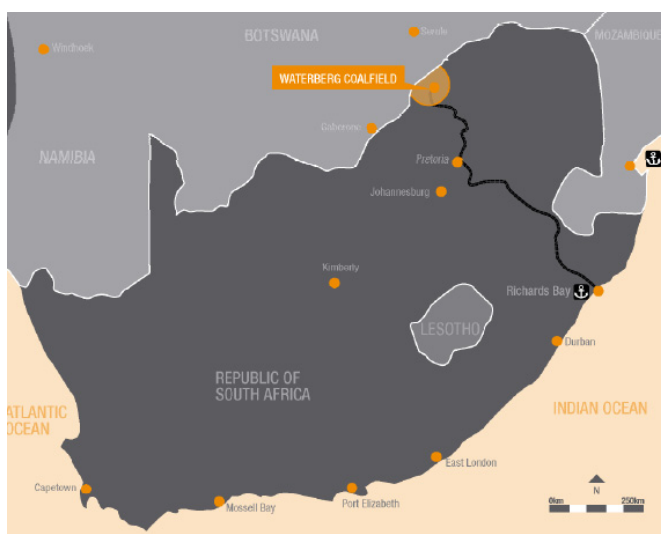
- Mining rights
- Water license
- Development consent
- Rail agreement

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.

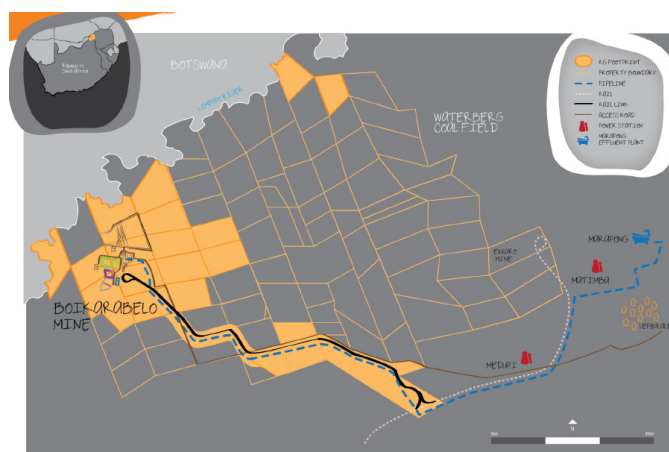
- Stage 1: 14mt of RoM coal delivering 3mt of export and 3mt of domestic coal.
- Stage 2: 50mt of Rom coal delivering 6mt of export and 6mt of domestic coal.

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 overly conservative in terms of our assumptions which we believe is a fair caution given the challenging operational environment in South Africa.

**Figure 3. Assumptions – Stage 1**

	<b>Citi Assumptions</b>	<b>Company Guidance</b>
Capital Cost	A\$850m	A\$750m
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

From a production perspective we have a slower ramp-up than RES assumes. Whilst RES may well hit its milestones, we have seen numerous mines around the world miss its ramp-up schedules over the past decade and law of averages leads us to believe that RES could succumb to some slippage as well. We have pushed back our assumed start date which has resulted in a decrease to our 2014 earnings profile for RES.

Stage 2 is likely to be developed from internal cash flows post the commencement of the Stage 1 operation. As we discuss later in the report, we do not include Stage 2 in our base case valuation given the uncertainties over long term domestic offtake, export coal prices and the dependency on Stage 2 from Stage 1 funding. However the table below profiles our assumptions for Stage 2 in our stretch case scenario.

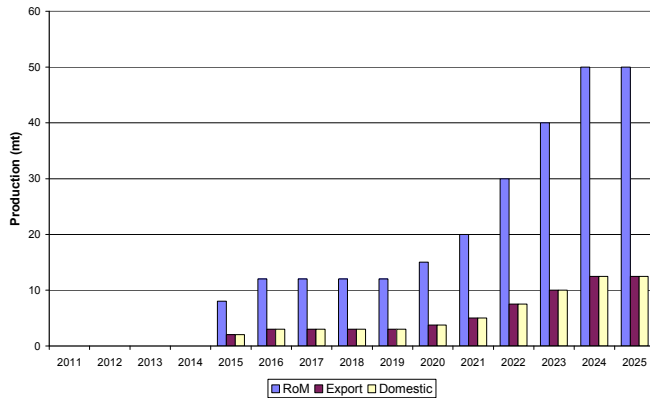
**Figure 4. Assumptions – Stage 2**

	<b>Citi Assumptions</b>	<b>Company Guidance</b>
Capital Cost	A\$800m	n/a
ROM Coal production	First Production 2021 Phase 2: 50mt (2025 full capacity)	First Production 2020 Phase 1: 50mt (2023 full capacity)
Yield	50%	50%
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

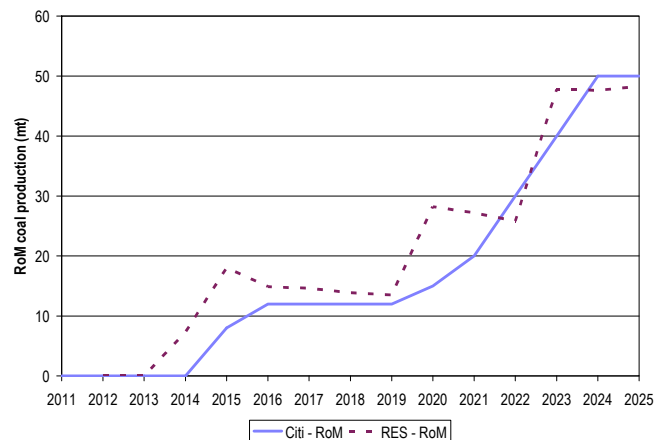
The charts below look at our production assumptions versus the ramp-up timeframe from RES.

Figure 5. Coal production (Stage 1 & 2) – Citi assumptions



Source: Citi Research

Figure 6. Coal production – Citi vs RES profile



Source: Company reports, Citi Research

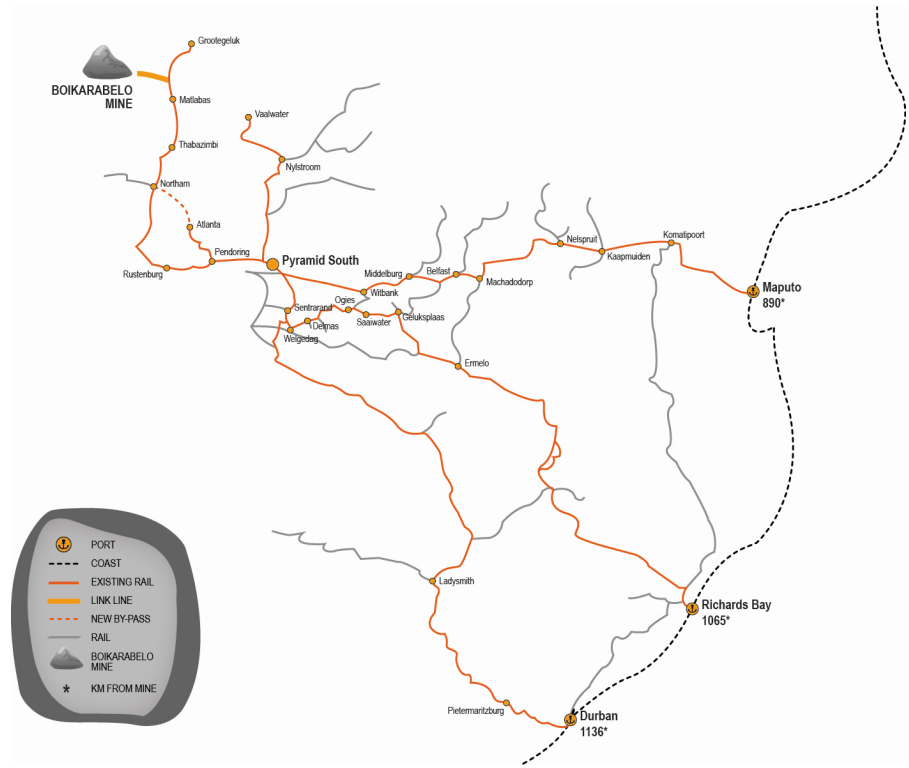
## Rail Approval

In late June RES announced that it had secured a 10-year take-or-pay contract with Transnet to haul up to 6mtpa of coal. Whilst the initial contract is for 10 years, we believe that once in production, RES could look to extend this timeframe for a longer tenure, or have a rolling 10-year contract with Transnet. RES released the following terms for the contract:

- The initial term is for 10 years with provision to extend for a further 10 years.
- The contract allows for 4 million tonnes in the first year, 5 million tonnes in the second year and 6 million tonnes per annum thereafter. Should Eskom elect to contract directly with TFR (which is Eskom's intention) for the proposed domestic purchases (currently under negotiation), the take-or-pay quantities in the contract will reduce to export tonnage only.
- The contract specifies an indicative tariff for the current year. The actual tariff will be determined annually by negotiation

We believe that as yet there is no stipulation in the contract as to which port the coal will be delivered to with Transnet likely preferring Richards Bay and RES preferring either Durban or RBCT (Durban would be a cheaper port for RES to access).

Figure 7. Regional rail links to port



Source: Company reports

Again whilst there has been no disclosure on the cost of rail, our analysis indicates that the cost would be in the vicinity of ZAR260/t for the rail. Given the haulage distances are around 1000km the cost is around ZAR0.26/t/km or cUS\$0.04/t/km which is on par with prices paid in Australia.

However given that disparity in pricing power parity between the regions ('The Economist' estimated the level at 0.6 in 2011), and the oligopolistic nature of rail in South Africa, there is the potential for the coal tariff to possibly come down in the long run if there was to be any form of economic reform in South Africa.

To put the sensitivity on rail into context, every ZAR10/t saving on the rail would lift our NPV of Stage 1 by \$0.06/share (or 9%).

The rail link will still require RES to build a 36km spur line from the mine to main line with the capex for this already included in the overall capital estimate.

### Still no deal with Eskom

Dealing with Transnet and Eskom has been the ultimate chicken and egg scenario. Before signing the offtake agreement Eskom wanted to see that RES were able to deliver coal to them along the Transnet chain; and before committing tonnage Transnet wanted to see domestic offtake agreements.

The deal with Transnet has been done and now hopefully a deal with Eskom will follow which will commit the domestic component of coal production from Boikarabelo.

However we understand an offtake from Eskom is not critical for the viability of the project nor is it (or likely to be) a condition from the banks for funding. If Eskom were to delay/decline purchasing the 3mtpa of domestic coal production from Stage 1 of the project, that coal could be directed into the export market given the 6mtpa of capacity that Transnet has provided. If the coal were diverted into the export market it would need to be washed which would reduce the overall yield from the plant. If all of the initial 14mt of RoM coal were to be washed, we believe that the yield would fall to around 30-35% which would equate to c4.5mtpa of export coal being available.

As we discuss in the valuation section, the project still delivers viable economic returns on a no-Eskom basis. Thus we do not believe that the lack of Eskom offtake would jeopardise funding and thus development of the project.

## 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 8. Resource Generation NPV – Base case**

WACC	14.0%	A\$m	Ownership	A\$m Equity	A\$/share
Boikarebelo		234	74.0%	187	0.66
Corporate Costs		-20			-0.08
Cash/(Net Debt)		5			0.02
Total		219			0.60

Source: Citi Research

Our base case of just Stage 1 delivers an NPV of \$0.60/share and an IRR of 20.2%.

If we assume that no contracts are signed with Eskom and coal production falls to 4.5mt of export coal, our NPV would fall to \$0.34/share as the table below demonstrates. The IRR under this scenario would fall to 15.3%.

**Figure 9. Resource Generation NPV – No domestic contracts scenario**

WACC	14.0%	A\$m	Ownership	A\$m Equity	A\$/share
Boikarebelo		140	74.0%	187	0.40
Corporate Costs		-20			-0.08
Cash/(Net Debt)		5			0.02
Total		126			0.34

Source: Citi Research

If we assume the development of Stage 2, the NPV would jump to \$2.15/share on an un-risked basis delivering the overall project (Stage 1 & 2) and IRR of 24.6%.

**Figure 10. Resource Generation NPV – Stage 2 scenario**

WACC	14.0%	A\$	Ownership	A\$ Equity	A\$/share
Boikarebelo		783	74.0%	579	2.20
Corporate Costs		-20			-0.08
Cash/(Net Debt)		5			0.02
Total		768			2.15

Source: Citi Research

### NPV Sensitivity

Our commodities team explicit coal price forecasts extend out to 2020 and are considerably higher than current spot prices as the table below shows

**Figure 11. Citi coal price forecasts**

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Coal price (US\$/t)	109	98	116	125	128	127	134	141	135

Source: Citi Research

To show the sensitivity of the project to coal price assumptions we have looked at what the NPV and IRR of the project would be if we assumed long term commodity price assumptions from today onwards. In the scenario we have assumed that domestic coal prices stay at a 2012 real price of ZAR250/t.

**Figure 12. NPV**

	Export coal price (US\$/t)			
	80	90	100	110
Stage 1	-0.65	-0.24	0.2	0.64
Stage 1 - export only	-1.52	-0.91	-0.3	0.31
Stage 2	-0.6	0.28	1.16	2.04

Source: Citi Research

**Figure 13. IRR**

	Export coal price (US\$/t)			
	80	90	100	110
Stage 1	7%	12%	16%	20%
Stage 1 - export only	n/a	2%	11%	18%
Stage 2	10%	16%	21%	25%

Source: Citi Research

If contracts are settled with Eskom, domestic coal sales will represent a significant portion of group NPV on our forecasts. The table below looks at the NPV of the project if we keep our export coal prices stable on the base case (as per Figure 11) and shift our domestic coal prices by ZAR10/t.

**Figure 14. NPV**

	Domestic coal price (ZAR\$/t)			
	150	200	250	300
Stage 1	0.02	0.31	0.6	0.89
Stage 2	0.8	1.43	2.06	2.69

Source: Citi Research

**Figure 15. IRR**

	Domestic coal price (ZAR\$/t)			
	150	200	250	300
Stage 1	14%	17%	20%	22%
Stage 2	18%	22%	24%	27%

Source: Citi Research



## Funding – is it possible?

RES is going to require in the vicinity of \$800-\$900m of financing to fund the development of the project. The slightly large figure than our capex provides for contingencies as well as working capital etc.

Looking at historic transactions of similar nature in the mining space we believe that funding would likely come from half bank debt and half equity. Thus at the upper end of the funding range, the equity/debt component would be c\$450m each. We do not see significant risk on the debt tranche of the funding given the cash flows that the project will generate.

However a \$450m equity raising on a company with a sub \$100m market cap may prove to be a challenge. We believe that cornerstone partners would need to take up to 50% of the equity component, thus leaving around \$200-225m to be raised on market. Given that RES has not locked in all of the coal, a cornerstone stake with coal offtake is a possibility.

The Indian power company CESC (on the register at 11% through its vehicle Integrated Coal Mining) already provide a strong cornerstone partner that may look to increase its stake through the equity raising, in our view.

Other funding options could focus on a sell down of the underlying assets. This practice is common in Australia with many of the recent coal mines such as Narrabri and Maules Creek seeing pattern take up to 30% stake in the project as prices significantly beyond the equity value at that time.

The recent example is the sale of 10% stake in Maules Creek to J-Power for \$370m. This was a 70% premium to our NPV on the asset at the time. If RES were to sell a 10% stake in Boikarabelo (keeps its ownership at c64% after BEE participation) then we think it could raise in the order of \$50m if only Stage 1 was assumed or c\$130m with Stage 2. Any asset sale would reduce the size and risk surrounding any on market equity raising. However given that RES owns 74% of the project now, a sale of an asset stake looks to be an option of last resort.

The charts below shows RES cash generation under Stage 1.

**Figure 16. RES cashflow generation – Stage 1 only (US\$m)**

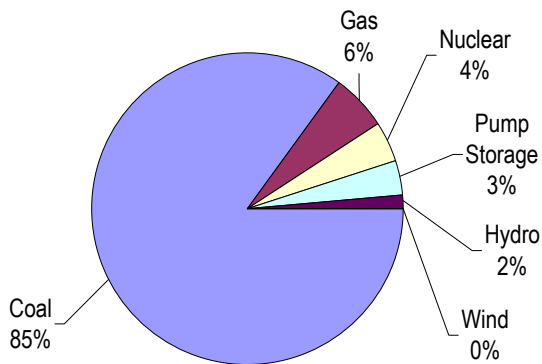
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Op Cash Flow	-2	-6	-8	4	151	225	231	228	220	211
Capex	-12	-10	-250	-400	-105	-7	-7	-8	-8	-9
Free Cash Flow	-22	-19	-260	-398	44	215	220	218	209	200

Source: Citi Research

## Eskom's long term need for coal

Whilst Eskom has yet to sign an offtake agreement, we believe that is a function of bureaucracy rather than demand requirements. In a recent presentation Eskom highlighted that it plans to add over 10,000MW's of coal fired capacity to the grid by FY19. At an 80% capacity utilization rate, that additional tonnage would require c30mtpa of coal. That's on top of the existing c40,000MW of power in the country, so the additional coal requirements are substantial.

Figure 17. Eskom power split 2011



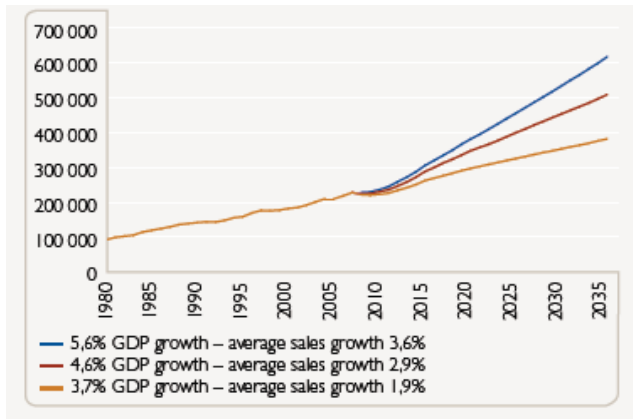
Source: Eskom

Figure 18. Eskom power additions

Project	Projections								Total
	11/12 FY	12/13 FY	13/14 FY	14/15 FY	15/16 FY	16/17 FY	17/18 FY	18/19 FY	
Grootvlei (return to service)	160	30							190
Komati (return to service)	225	200							425
Arnot capacity upgrade (coal fired)		30							30
Medupi (coal fired)			794	794	1588	794	794		4764
Kusile (coal fired)				800	800	800	800	1600	4800
Inqula (pumped storage)				1332					1332
Sere wind farm (renewable)			100						100
<b>TOTAL (MWs)</b>	<b>385</b>	<b>260</b>	<b>894</b>	<b>3387</b>	<b>2388</b>	<b>1594</b>	<b>1594</b>	<b>1600</b>	<b>11641</b>

Source: Eskom

Figure 19. Eskom electricity sales forecast



Source: Company reports

Figure 20. South Africa power capacity - 2009

Type	Number	Net max capacity
Coal-fired	13 stations	34 294 MW
Gas/liquid fuel turbine	4 stations	2 409 MW
Hydroelectric	6 stations	600 MW
Pumped storage	2 stations	1 400 MW
Nuclear	1 station	1 800 MW
Wind energy	1 station	3 MW
<b>TOTAL</b>	<b>27 stations</b>	<b>40 503 MW</b>

Source: Company reports

Our domestic coal price is effectively ZAR250/t or US\$25/t which is a fraction of our long term export price of US\$95/t. On an export parity price (export less freight) our long term price of US\$95/t would derive a domestic price of cUS\$60/t (i.e less c\$30/t of freight and port handling).

### Earnings revision

In our updated model, we have also lowered our earnings forecasts to reflect new coal prices as well as the evolution of the project now that mining licence, water rights and rail approval has been received.

## 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 \$0.60/share is set at our NPV of \$0.60 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

\* 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

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##### Data current as of 1 Jul 2012

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

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