

Equities

27 January 2011 | 13 pages

Resource Generation (RES.AX)

Site Visit Confirms Progress

- SA site visit** — We recently spent two days in South Africa visiting Resource Generation. We left impressed with the scale of the proposed 6Mtpa (Stage 1) Boikarabelo mine. Based on the current reserve of 745Mt, Boikarabelo will be in operation for many years and may even match the scale of the nearby 50Mtpa (ROM) Grootegeluk mine owned by Exxaro. To us, RES stands out amongst ASX peers for value, scale and progress to development.
- Timeline for development** — With 2 off-take deals signed (CESC and Bhushan), we believe construction must commence by the end of 2011. Still required are the Mining Right, Water Licence and go-ahead for rail. On rail, we understand that tenure over the 36km link to the main line is very close. We believe all major approvals will likely be won within the next ~6 months.
- Comparative value** — There are many emerging coal producers on the ASX and by our calculation, RES is the least expensive of 35 companies we have identified. On an EV/t basis, RES trades on just US\$0.02/t whereas ASX listed peers with South African projects range from US\$0.05-0.61/t.
- Cash of A\$37m is good for now** — RES is debt free and has A\$37m cash following the equity raising in Nov 2010. As we expect construction to begin towards the end of 2011, we anticipate a major raising in the 3Q 2011. Company guidance is for capex of A\$552m, the majority of which will be debt funded in our view. We adjust our 2013 estimates to reflect our assumption of higher debt.
- Valuation & Recommendation** — We continue to rate RES Buy/Speculative risk with an A\$0.95 target price. In our view, RES is undervalued versus peers on almost every measure despite its large reserve and advanced stage of planning. We expect the stock to re-rate as rail and mining approvals are won and believe RES is within ~6 months of this point. Our DCF based target uses a WACC of 15% and implies a return of 55%.

- Company Update
- Estimate Change

Buy/Speculative	1S
Price (27 Jan 11)	A\$0.62
Target price	A\$0.95
Expected share price return	54.5%
Expected dividend yield	0.0%
Expected total return	54.5%
Market Cap	A\$150M US\$150M

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



RES.AU revisions (Y/E Jun)	2009A	2010A	2011E	2012E	2013E
Sales (A\$m)	0.0	0.0	0.0	0.0	0.0
% revision	0.0%	0.0%	na	na	na
EBIT (A\$m)	-15.5	-4.2	-6.0	-6.0	-6.1
% revision	0.0%	0.0%	0.0%	0.0%	0.0%
Core Net Profit (A\$m)	-15.1	-3.3	-5.9	-5.8	-14.9
% revision	0.0%	0.0%	0.0%	0.0%	4.6%
Core EPS (A¢)	-19.7	-2.1	-3.2	-3.2	-8.1
% revision	0.0%	0.0%	0.0%	0.0%	4.6%
EPS Growth (%)	-164.4	89.5	-56.1	0.5	-154.2
PE Ratio (x)	-3.2	-30.1	-19.3	-19.4	-7.6
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0

Source: Company Reports and dataCentral, CIRA.

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

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Resource Generation (RES.AX)

27 January 2011

Fiscal year end 30-Jun											
Profit & Loss (A\$m)	2009	2010	2011E	2012E	2013E	Per share data	2009	2010	2011E	2012E	2013E
Sales revenue	0.0	0.0	0	0	0	Reported EPS (¢)	-19.7	-2.1	-3.2	-3.2	-8.1
Cost of sales	-0.1	-0.1	na	na	na	Core EPS (¢)	-19.7	-2.1	-3.2	-3.2	-8.1
Gross profit	0.0	-0.1	na	na	na	DPS (¢)	0	0	0	0	0
EBITDA	-15.5	-4.1	-6.0	-6.0	-6.1	CFPS (¢)	-1.5	-0.1	-3.4	-3.4	1.5
Depreciation	-0.1	-0.1	0	0	0	BVPS (¢)	74.2	54.3	48.6	60.5	60.9
Amortisation	0	0	0	0	0	Wtd avg ord shares (m)	77	159	183	183	183
EBIT	-15.5	-4.2	-6.0	-6.0	-6.1	Wtd avg diluted shares (m)	77	159	183	183	183
Net interest	0.4	1.0	0.1	0.2	-8.8						
Earnings before tax	-15.1	-3.3	-5.9	-5.8	-14.9	Valuation ratios	2009	2010	2011E	2012E	2013E
Tax expense	0	0	0	0	0	PE (x)	-3.2	-30.1	-19.3	-19.4	-7.6
Exceptional items post tax	0.0	-0.1	0	0	0	EV/EBIT (x)	-9.5	-34.4	-23.9	-38.4	-71.0
Minority interests	0	0	0	0	0	EV/EBITDA (x)	-9.6	-35.2	-23.9	-38.4	-71.0
Associates	0	0	0	0	0	FCF yield (%)	-3.2	-24.6	-5.4	-181.9	-191.6
Reported net profit	-15.2	-3.4	-5.9	-5.8	-14.9	Dividend yield (%)	0	0	0	0	0
Core NPAT	-15.1	-3.3	-5.9	-5.8	-14.9	Payout ratio (%)	0	0	0	0	0
Half year data (A\$m)	1H10	2H10	1H11E	2H11E	1H12E	Growth rates	2009	2010	2011E	2012E	2013E
Sales revenue	0.0	0.0	0	0	0	Sales revenue (%)	-91.2	35.0	nm	na	na
EBIT	-1.6	-2.6	-3.0	-3.0	-3.0	EBIT (%)	nm	72.7	-42.1	-0.4	-0.4
Core NPAT	-1.0	-2.3	-2.9	-2.9	-2.9	Core NPAT (%)	nm	78.3	-79.1	0.5	nm
Core EPS (¢)	-0.6	-1.4	-1.6	-1.6	-1.6	Core EPS (%)	nm	89.5	-56.1	0.5	nm
Balance Sheet (A\$m)	2009	2010	2011E	2012E	2013E	Operating performance	2009	2010	2011E	2012E	2013E
Cash & cash equiv.	5.1	6.1	8.4	30.2	10.9	Gross margin (%)	-245.0	-240.7	na	na	na
Accounts receivables	0.5	1.7	1.7	1.7	1.7	EBIT margin - Group	na	na	na	na	na
Inventory	0	0	0	0	0						
Net fixed & other tangibles	56.2	84.4	84.4	284.4	504.4	Operating ROA (%)	-27.9	-4.3	-6.3	-2.8	-3.6
Goodwill & intangibles	0	0	0	0	0	Operating ROE (%)	-29.2	-4.6	-6.7	-5.9	-13.4
Financial & other assets	0	0.0	0.0	0.0	0.0	Operating ROIC (%)	-30.7	-6.0	-7.1	-3.3	-1.5
Total assets	61.8	92.2	94.5	316.3	517.0						
Accounts payable	0.6	1.6	1.6	1.6	1.6	Net debt to equity	-8.9	-7.0	-9.5	153.5	349.5
Short-term debt	0	0	0	0	0	Debt to total capital (%)	0.0	0.0	0.0	64.4	78.2
Long-term debt	0	0	0	200.0	400.0	Interest coverage (x)	na	na	na	na	-0.69
Provisions & other liab	4.0	4.1	4.1	4.1	4.1						
Total liabilities	4.6	5.7	5.7	205.7	405.7	Production Volumes	2009	2010	2011E	2012E	2013E
Shareholders' equity	57.2	86.5	88.8	110.6	111.3	Thermal (export) (mt)	0.00	0.00	0.00	0.00	0.00
Minority interests	0.0	0.0	0.0	0.0	0.0	Hard Coking (export) (mt)	0.00	0.00	0.00	0.00	0.00
Total equity	57.2	86.5	88.9	110.6	111.3						
Net debt	-5.1	-6.1	-8.4	169.8	389.1	Operating Metrics	2009	2010	2011E	2012E	2013E
Cashflow (A\$m)	2009	2010	2011E	2012E	2013E	Cash Costs (A\$/t)	0.00	0.00	0.00	0.00	0.00
EBITDA	-15.5	-4.1	-6.0	-6.0	-6.1	Cash Costs (US\$/t)	0.00	0.00	0.00	0.00	0.00
Working capital	0	0	0	0	0	Average Price Received	0.00	0.00	0.00	0.00	0.00
Net interest paid	0.4	1.0	-0.1	-0.2	8.8	Average Price Received	0.00	0.00	0.00	0.00	0.00
Tax paid	0	0	0	0	0						
Other	13.9	3.0	0	0	0.0	Commodity&FX	2009	2010	2011E	2012E	2013E
Operating cashflow	-1.2	-0.1	-6.2	-6.2	2.7	AUDUSD (analyst)	0.74	0.88	0.96	0.92	0.86
Capex	-0.4	-24.2	0	-200.0	-220.0	Hard coking (export) (US\$/t)	260.8	146.0	233.5	212.5	185.0
Net acq/disposals	-2.3	0	0	0	0	Thermal (export) (US\$/t)	98.2	84.1	99.9	107.5	97.5
Exploration exp/Other	-3.9	-4.3	-2.0	-2.0	-2.0						
Investing cashflow	-6.6	-28.5	-2.0	-202.0	-222.0						
Dividends paid	0	0	0	0	0						
Financing cashflow	11.4	29.6	10.5	230.0	200.0						
Net change in cash	3.8	1.0	2.3	21.8	-19.3						
FCF ex acquisits &	-7.8	-28.6	-8.2	-208.2	-219.3						

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Boikarabelo: Large, Low-cost, Long Life

We recently spent two days in South Africa with Resource Generation visiting the site of its proposed thermal coal mine in the Waterberg region. ResGen is planning a multi-stage development beginning with a 12Mtpa ROM open pit operation, which is expandable to as much as 50Mtpa ROM, a similar size to the nearby Grootegeluk mine owned by Exxaro.

We were impressed by the sheer scale of the proposed Boikarabelo mine and the work that has been done to advance the project, particularly with respect to rail. Rail is key to making Boikarabelo a reality and we believe ResGen is close to securing the corridor for the proposed link to Transnet's main line that connects to ports at Richards Bay and Durban.

In our view, ResGen is undervalued on a fundamental basis and versus peers. Few companies under A\$200m market cap can match ResGen's reserve base of 745Mt or the progress it has made in mine planning. We believe the company is overly discounted for South Africa risk and with a 60% discount to NPV and resource multiple of just US0.02/t of resource, ResGen is rapidly emerging as our preferred small ASX coal.

We continue to rate ResGen Buy/Speculative Risk with A\$0.95 target implying a return of 55%.

Figure 1. Transnet main line at proposed link site for RES rail link



Source: Citi Investment Research and Analysis

Short-term Milestones

ResGen is at a very advanced stage of mine and infrastructure planning. We have identified four key hurdles for Stage 1 development:

1. **Acquiring land for the rail corridor**

ResGen has spent several months obtaining or arranging access to freehold land on which to build a rail link from the mine to Transnet's main line. The required length of rail is 36km and RES has secured 5 of the 6 properties required for the rail route. We believe full access is very close and there is some flexibility of the route through the Steenbokpan properties if required.

Land in the area is used to raise game and farms typically have a size of ~2,000Ha. We drove the route of the rail link and confirm that the land is very flat and firm, reasonably well vegetated with mainly low scrub and small trees, and in good condition despite the onset of the wet season.

2. Grant of Mining Right

South African mining law is rigorous and demands fine detail for proposed mines. ResGen is at an advanced stage of mine planning and is awaiting the grant of its Mining Right before it commences any development or requisition of long lead time items.

We sighted these plans and visited the proposed Stage 1 pit area and mine infrastructure area. The terrain for both is very flat, as it is with the rail corridor and the only topography of note is a large east-west trending fault that forms a low ridge on part of the property.

This ridge is the only place where basement is exposed and separates the coal-bearing basin to the north from the south. Coal may be present south of the fault but has not been intersected in deeper drill holes meaning it is not present or is too deep to be commercial at this time.

Figure 2. Site for Boikarabelo mine infrastructure



Source: Citi Investment Research and Analysis

Figure 3. Fault escarpment and existing power infrastructure



Source: Citi Investment Research and Analysis

ResGen is fully BEE compliant and has submitted its mining application to the Minister for a decision. ResGen anticipates 6 months for approval but we think the company could be successful in a shorter period of time.

3. IWULA: Integrated Water Use Licence Application

All water use, including treatment and disposal is governed by the IWULA. ResGen's property extends to the Limpopo River, which forms the border between South Africa and Botswana. The Limpopo floods regularly and ResGen has completed a 5-well hydrological study of the area. It has also identified the 1-in-100 year flood line governing the emplacement of flood levees, which have been designed and planned for.

Test results from the 5 water bores have proven the production capacity of the local aquifer is sufficient for Stage 1 and that there is no connection with the Limpopo River. ResGen is drilling a further 6 bores on its own initiative to support long-term water monitoring of the area.

We anticipate that the IWULA will be awarded by about mid-year 2011.

Figure 4. Test Water Bore



Source: Citi Investment Research and Analysis

Figure 5. Limpopo River in Flood



Source: Citi Investment Research and Analysis

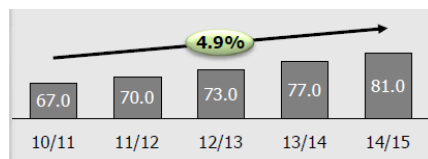
4. NEMA for rail link

Development plans for the 36km rail link to Transnet's main line were submitted in Jan 2011 under the National Environmental Management Act (NEMA). Approvals take place over a fixed 6-month period and therefore a **decision will be made in mid-2011**. Landowners are consulted on the development and as ResGen currently holds ~80% of the proposed rail route, we think the chance of rejection due to landholder objection is small. As noted above, ResGen has some flexibility over the route.

Rail Options

The Boikarabelo mine is not currently linked to Transnet and requires 36km of new rail to tie into the main rail network. An earlier proposal for trucking product coal to a main line load-out in the short-term was scrapped because of the large number of truck movements and potential impact on the environment. Company guidance for capex of A\$552m, which includes an allowance for trucking that we think is ~A\$40m.

Figure 6. Transnet Projected Growth (Mt)



Source: Company Reports

ResGen is responsible for building the rail link and we estimate capital cost of A\$100m. The rail link is budgeted for within total capex of A\$552m. We understand that the link would be sold back to Transnet on a reduced tariff basis.

ResGen has engaged South African engineering consultants RCE to investigate the options available to the company. A chief problem for coal developers in the Waterberg is the constrained nature of the rail in the immediate region. Axle loads north of Ogies are only ~20/t versus 26/t that producers south of the town enjoy.

In addition, the line through Rustenberg was built ~100 years ago and has not been significantly upgraded. The substrate is predominantly clay, which has led to questions of stability of the line under large loads.

RCE has identified a potential 4-stage development:

- Stage 1: 4Mtpa including link to main line.
- Stage 2: 10Mtpa
- Stage 3: 26Mtpa
- Stage 4: 46Mtpa

Coal-fired Power Infrastructure in the Waterberg

Coal-fired power infrastructure in the Waterberg consists of:

- The 4,000MW Matimba plant, which has operated for 28 years
- The 4,800MW Medupi plant, which is under construction
- Coal 3 plant: fully planned to the pre-feasibility stage but no commitment to construction. Capacity of 5,000MW and 15Mtpa feed required.
- The ~50Mtpa Grootegeluk thermal coal mine operated by Exxaro

Each of these power plants consumes or is expected to consume 15Mtpa coal and thus total domestic coal consumption in the region is 45Mtpa. Due to power shortages, South Africa has instigated a programme of bringing old power stations out of mothball and there are several plants in the Witbank region that do not have a secure long-term supply of coal.

We therefore believe that there is more than adequate domestic demand to support a 3Mtpa domestic coal mine operation in the Waterberg. We understand that Eskom has a very complex pricing structure and assume ZAR250/t for domestic off-take.

In terms of power for the Boikarabelo site, ResGen continues its discussions for supply with Eskom. Another option being investigated by the company is its own power supply. We believe that a 25MW power plant would be adequate to supply Stage 1 operation.

For construction, there is existing power to the site, as can be seen in Figure 3. While this would be adequate through the construction phase, additional power to the site is necessary for ongoing operation at 12Mtpa ROM capacity. We estimate that a power plant of this size would cost ~A\$50m.

Figure 7. Matimba Power Station



Source: Citi Investment Research and Analysis

Figure 8. Medupi Power Station under Construction



Source: Citi Investment Research and Analysis

Off-take Recap – the Pressure is on

ResGen has signed two long-term coal off-take agreements with power generators:

1. Integrated Mining (CESC), Aug 2010: 1Mtpa in years 1 to 3 then 2Mtpa for the remaining 17 years
2. Bhushan, Nov 2010: 0.5Mtpa for the first 5 years then a minimum 0.5Mtpa for the remaining 15 years

Both agreements commence late 2013, which bookends the project development timeline. The pressure is on to secure the relevant agreements and begin the construction of Boikarabelo. Given we estimate 20-24 months for the construction of site infrastructure, including a wash plant, construction of the mine needs to commence at the end of 2011 to meet the sales contracts.

This timetable raises the question of funding. Boikarabelo is undoubtedly a large undertaking and company guidance on capex for Stage 1 is A\$552m. RES currently has A\$37m cash on hand and no debt and we think that fund raising needs to take place in the 3Q 2011 in order to secure long lead time items like the wash plant. We also understand that the pre-strip will be brought forward to match completion of the wash plant.

According to the company, a number of South African and European banks are taking an interest in the project and a large part of the capital requirement – at least 60% in our view – is likely to be debt. Our understanding is that one of the interested parties is the Development Bank of Southern Africa, which views the Boikarabelo mine as part of a larger regional development of the Waterberg

The Lephalale region is undergoing strong growth with a large volume of new, high quality housing in evidence. The construction of Medupi and expansion of Grootegeluk has created ~7,000 and 2,000 jobs, respectively, while we think ResGen could add another 800.

We view the two off take agreements and any debt funding package as a strong vote of confidence in the project as both require a degree of due diligence on behalf of the off-takers/funders.

Comparative Value

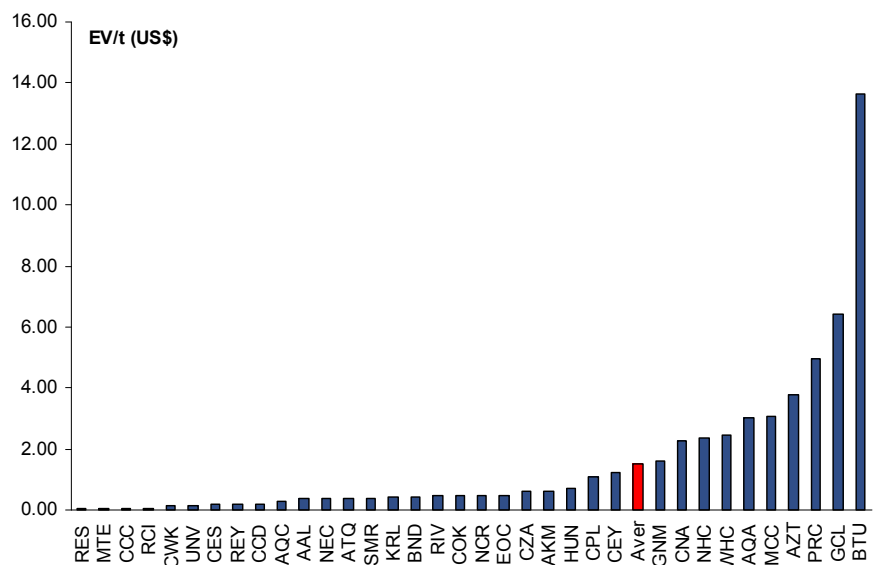
Resource stands out against peers for the sheer size of its reserve, which is currently 745Mt Probable. Given that the reserve is defined on only 35% of the tenements holding the 6.4Bt resource, we believe that ResGen could expand the mineable reserve further.

Although we value ResGen on a DCF basis assuming a WACC of 15%, which results in our 50% risk-weighted target of A\$0.95, we believe it is also worthwhile comparing the company to other coal developers on a \$/t basis. While this multiple has many flaws e.g. it cannot distinguish between coal quality, it is widely used to compare emerging companies.

Figure 9 below shows ResGen's position relative to the ASX coal sector:

- At ~US\$0.02/t, RES has the lowest EV/resource tonne multiple
- Other South Africans include CCC (\$0.05/t), UNV (\$0.13/t) & CZA (\$0.61/t)
- The linear average is US\$1.52/t
- BTU (\$13.64) and AZT (\$3.76/t) have the highest multiples for non-producers

Figure 9. EV/t of Resource, ASX Coal Companies



Source: Company reports, Citi Investment Research and Analysis

Note: We calculate EV for a range of companies based on market cap as at 25 Jan 2011 and cash/debt figures from the most recent financial report.

Resource Generation

Valuation

Our target price of \$0.95/share is set as a 50% risk weighting to our NPV of \$1.90 per share. Our NPV is based on DCF analysis using a 14.5% discount rate and a US\$90/t long term thermal coal price. We believe a 50% risk weighting to our NPV is appropriate given the early stage of the project as well as the infrastructure barriers that need to be overcome.

Risks

We rate RES as a Speculative 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.

Rail: RES's coal assets are located in the Waterberg region of South Africa. The region is not as well serviced by infrastructure as the coal fields of the Witbank are.

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

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

Resource Generation (RES.AX)

Ratings and Target Price History Fundamental Research

Analyst: David Haddad
Covered since September 22 2010

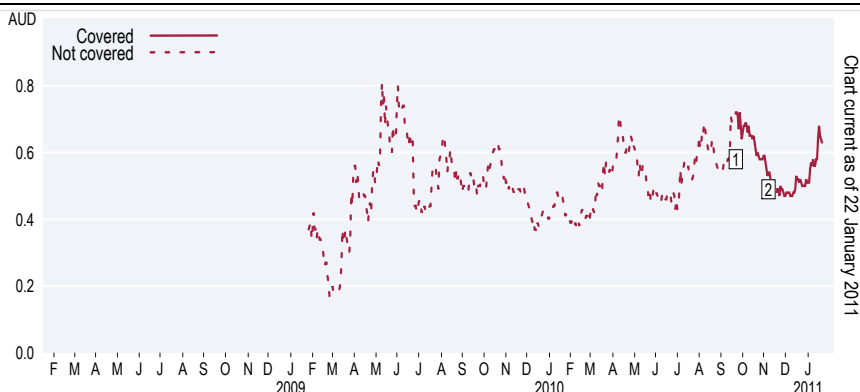


Chart current as of 22 January 2011

Date	Rating	Target Price	Closing Price
1 22-Sep-10	*1S	*1.00	0.72

Date	Rating	Target Price	Closing Price
2 8-Nov-10	1S	*0.95	0.54

* 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: David Haddad
Covered since September 22 2010

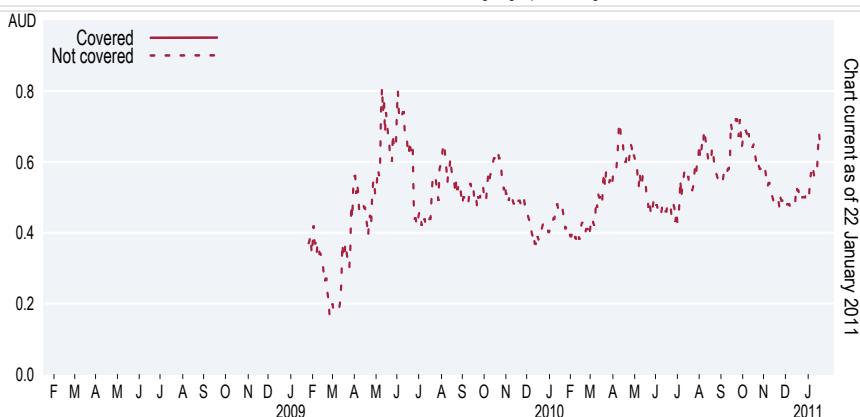


Chart current as of 22 January 2011

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 31 Dec 2010

	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
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