Hillgrove Resources Ltd

Company update

15 November 2011

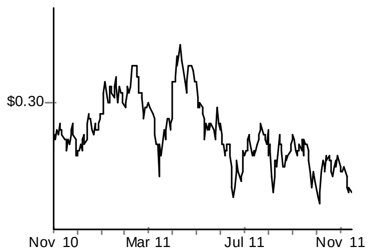
$0.22

BUY

James Brennan-Chong
03 9640 3893
james.brennan-chong@wilsonhtm.com.au

Cameron Judd
03 9640 3864
Cameron.judd@wilsonhtm.com.au

Price Performance



Security/Capital Details

ASX Code	HGO
Market Cap	$173 M
Issued Shares (dil)	806.0 M
Avg Mth T'over	39.81 M
12 Mth High – Low	$0.36 - $0.21

Key Data/Ratios – FY 2012

EBITDA / Sales	-318.2%
EBIT / Sales	-341.2%
Debt / Equity	26.1%
Interest Cover	-4.5 x
ROE	-2.1%
EPS Growth	70.5%
DCF	$0.46
12 Mth Price Target	$0.55

Important Disclosure
Wilson HTM Corporate Finance Ltd acted as Joint Lead Manager and Underwriter for the placement announced by Hillgrove Resources Limited in October 2010 and earned fees for acting in this capacity.

Recommendation

Following a delay to first production, an unexpected claim from a contractor and a lower than forecast cash balance for the quarter ended October, we see HGO's projected cash position as thin. We model the issuance of $20m in additional debt to provide a conservative cash buffer of one-month for potential unforeseen ramp up delays. We see multiple options available to HGO, including additional debt, adopting a gold loan as well as issuing further equity. At this stage, we do not see an equity raising as a foregone conclusion. BUY retained. Valuation and target price have reduced 6.5% to $0.46/sh and $0.55/sh. respectively.

Key Points

Commissioning on going, three weeks behind schedule.

- A delay to the energisation of the Kanmantoo plant has resulted in a three-week delay to first revenue, now expected in mid to late December.
- The ball mill has been successfully rotation tested and water is flowing through the plant. On going works include; instrumentation installation and completion of the thickener. With construction essentially complete, the risks rest predominantly with commissioning and ramp up. However, given the plant is second hand, a risk of further delays is somewhat mitigated.
- Mining activities have been on going and stockpiles are in excess of 300kt, exceeding the regular capacity of the ROM pad. The stockpile is equivalent to approximately six weeks of mill feed. We see this as reducing mining risk during the ramp up period.
- The mining rate during the October quarter is understood to be higher than forecast and this has in part led to a significant build up of stockpiles.

Cash flows to be watched closely

- HGO is forecasting an October cash balance of $24m. This is below our expectations and has been led by a higher than anticipated mining rate in the October quarter.
- Mining activities continue at a cost of $2-2.5m per week with overhead and exploration costs running at $1m per week, resulting in a monthly cash burn of ~$10m.
- In addition, HGO has been presented with an unexpected claim from a contractor for $10m. The timing and size of this claim remains unknown.
- December will be a critical month and we see an increasing likelihood for further funding. Possible funding scenarios include debt with associated hedging (likely gold hedging), a gold loan or an equity raising.
- At this stage, and just prior to first production, we see additional debt financing as the preferred scenario. Our revised base case assumes the issuance of an additional $20m in debt.
- However, issuing additional equity cannot be ruled out. Raising $20m @ $0.198/sh (10% discount) would reduce our valuation to $0.42/sh.
- We see HGO returning to the market for further funding when the Pinjam Paki (exploration licence) is granted for the Birdshead project in Indonesia. The timing of the permitting remains unknown.

Year to Jan	NPAT (Rep) $M	NPAT (PSig) $M	EPS (PSig) c	EPS Growth %	PER x	CFPS c	P/CF x	DPS c	Div Yld %	Franking %
2011a	-13.4	-13.4	-1.7	16.2	-13.0	-5.0	-4.3	0.0	0.0	0
2012e	-4.0	-4.0	-0.5	70.5	-43.9	-0.7	-29.9	0.0	0.0	0
2013e	29.3	29.3	3.6	842.9	5.9	6.1	3.5	0.0	0.0	
2014e	52.6	52.6	6.5	79.1	3.3	11.2	1.9	0.0	0.0	

Commissioning delays and cost overrun comparison

	HGO	OZL
Mine	Kanmantoo	Prominent Hill
Status	Commissioning	Operating
Operation	Open cut	Open-cut
Capacity	2.4mtpa	10mtpa
Initial capital estimate	$124m	$1,080m
Overrun	~$10m	$70m
Revised estimate	$134m	$1150m
Overrun	8.1%	6.5%
Cause	Unexpected claim	Delay to electrical and small-bore piping works
Production delay	1 month	3 months
First production	Dec-11	Feb-09

Source: HGO, OZL

Commissioning and production from the Kanmantoo mine is one month behind schedule due to a delay in the energisation of the plant. OzMinerals' Prominent Hill mine, also in South Australia, experienced a delayed to first production by three months. Moreover, cost overruns at Kanmantoo of ~$10m represent an 8.1% increase to the capital spend to completion from the Final Investment Decision (FID). OzMinerals experienced a similar 6.5% or $70m increase in capital costs just prior to first production.

However, we note that the size and complexity of the Prominent Hill operation is significantly greater than that of Kanmantoo, such that we would not anticipate a similar length delay to first production.

From an operational and processing perspective, we see the Kanmantoo mill as somewhat derisked moving into first production relative to Prominent Hill as the Pillara Mill is a second hand plant that has to date successfully been re-erected at the Kanmantoo site.

Although unfortunate, we see the delay as only a short term set back and our stance on the longer-term outlook remains unchanged and intact.

Relative capital intensities

	HGO	OZL	SFR	CGG	EXS
	Kanmantoo	Prominent Hill	De Grussa	Jabal Sayid	CCP
Capital $m	134	1150	384	305	200
Nameplate pdn Kt Cu	20	100	65	57	25
Capital intensity $/t	6,700	10,445	5,908	5,351	8,000

Source: Company reports

Relative to other copper projects and developments, HGO has a relative low capital intensity, and this is despite the +$10m capital over run.

Cash flows to be watched closely

Cash flows are expected to remain tight ahead of first forecast revenue in mid to late December.

Costs are expected to remain relatively inflexible over the coming months, with site costs of $8-10m per month with an additional $1m per month for overheads and exploration costs.

HGO's net cash position for the quarter ended 31 October 2011 is expected to be approximately ~$24m. Cash burn during the quarter is expected to be higher than our forecast, led by a higher than expected mining rate. This has led in part to the large build up of stockpiles to 300kt, equivalent to 6 weeks of mill feed.

We estimate that every month of lost production will result in an additional ~$10m of working capital. This is in addition to the ~$10m unexpected claim from the contractor. No timing has been given as to the timing of the payment and we understand discussions with the contractor are on going.

The month of December will be particularly critical and we see it as increasingly likely that additional funding will be required to maintain a sufficient cash balance.

With first revenue not expected until mid to late December, HGO's cash balance is projected to reduce to $4m at the end of December, due to $10m per month of working capital (November & December), this does not include payment for the $10m unexpected claim.

Every month delay costs HGO ~$10m of additional working capital

Forecast near term cash flows prior to first revenue in mid to late December

	Cash flows	Cash balance
HGO forecast cash balance 31 October		$24m
Working capital - November	-$10m	
Working capital - December	-$10m	
Forecast 31 December cash balance prior to first sales, operating expenses and payment for the unexpected claim		$4m

Source: HGO, Wilson HTM

Possible funding scenarios

In our opinion, HGO would likely pursue debt financing over an equity raising.

Debt financing: Issuing additional debt of $20m would decrease our valuation marginally and increase the gearing ratio to 21%. We see debt funding likely coinciding with gold hedging. Moreover, a gold loan, whereby cash is received upfront in exchange for gold delivered at a later date, remains a further funding option.

We see debt financing as the most likely source of additional funding, this would likely coincide with additional hedging

Impact to gearing from addition debt

	Gearing %
Current $30m	14%
$30m + $20m	21%
$30m +$30m	24%

Source: Wilson HTM

Equity financing: Assumed closing price of $0.22/sh. We have adjusted our modelling to reflect the lower than expected cash balance of $24m for the quarter-ended October.

Impact to valuation from potential equity raising (*pre revised October cash balance*)

Price\Raising	$20m	$30m
0.198 (10% discount)	0.463 (-6.5%)	0.449 (-9.2%)
0.176 (20% discount)	0.465 (-7.8%)	0.440 (-11.0%)

Source: Wilson HTM

Impact to valuation from potential equity raising (*post revised October cash balance*)

Price\Raising	$20m	$30m
0.198 (10% discount)	0.435 (-12.2%)	0.423 (-14.6%)
0.176 (20% discount)	0.429 (-13.4%)	0.414 (-16.2%)

Source: Wilson HTM

Revised base case scenario

Our revised base case scenario following a lower than expected HGO forecast cash balance at the end of the October quarter of $24m, assumes the issuance of an additional $20m of debt. We also assume that the $10m unexpected claim is paid before 31 January 2012. Our gearing forecast has increased to 21% and our valuation and target price have reduced 6.5% to $0.46/sh and $0.55/sh respectively. Our forecast cash balance at 31 January 2012 is revised to $15m.

The issuance of further debt will likely require additional hedging.

Bear case scenario

Our bear case scenario assumes;

- No production in the January half year 2012, representing an 8 week delay.
- Payment of the $10m unexpected claim in the January half year.
- $10m of working capital in November, December and January.
- No change to corporate or exploration expenditure.

Should HGO return the market for more capital under this scenario, and issue **160.4m shares @ $0.187/sh (20% discount) to raise $30m**, our valuation **declines by 17% from $0.50/sh to $0.41/sh**.

Hillgrove Resources Ltd (HGO : $0.22)

PRODUCTION

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
Copper In Conc - (kt)	0	0	1.3	16.1	22.0
Gold In Conc - (koz)	0	0	0	10	11
Silver In Conc (koz)	0	0	10	198	226
C1 Cash Cost - (US$/lb)	0.00	0.00	n/a	1.78	1.29

PRICES

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
Gold (US$/oz spot)	994	1250	1617	1900	1783
Silver (US$/oz spot)	15.02	21.65	36.76	41.08	38.75
Copper (US$/lb)	2.46	3.51	4.02	4.10	3.95
AUDUSD (USD)	0.82	0.93	1.02	0.97	0.94

INVESTMENT & VALUATION FUNDAMENTALS

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
EPS Before Abs (c)	-2.0	-1.7	-0.5	3.6	6.5
EPS Growth (%)	N/A	16.2%	70.5%	842.9%	79.1%
PER (x)	**-10.9**	**-13.0**	**-43.9**	**5.9**	**3.3**
CFPS (c)	-1.1	-5.0	-0.7	6.1	11.2
P/CF (x)	**-20.3**	**-4.3**	**-29.9**	**3.5**	**1.9**
EV/EBITDA (x)	-4.6	-2.6	-31.9	2.5	0.8
DPS (c)	0.0	0.0	0.0	0.0	0.0
Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Franking (%)	0%	0%	0%		

DCF VALUATION @ 11.1 % / 10 %

Yr Ending Jan	A$m (11.1 %)	A$ps (11.1 %)	A$m (10 %)	A$ps (10 %)
Kanmantoo - Open Cut	393.1	0.49	410.6	0.51
Corporate Items	-29.9	-0.04	-31.2	-0.04
Interests In Other Entities	3.7	0.00	3.67	0.00
Exploration/Development	19.3	0.02	19.2	0.02
Cash collateralised bond	7.5	0.01	7.5	0.01
Franking Credits	30.9	0.04	32.4	0.04
Hedge Book	-18.4	-0.02	-18.8	-0.02
Net (Debt)/Cash	-35.0	-0.04	-35.0	-0.04
Additional Capital - Dilution	0.8	0.00	0.8	0.00
Total Valuation	371.9	0.46	389.1	0.48

PROFITABILITY RATIOS

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
EBIT / Sales (%)	-710.5%	-670.8%	-341.2%	28.2%	36.0%
ROA (%)	N/A	-19.6%	-3.3%	15.6%	27.0%
ROE (%)	N/A	-7.7%	-2.1%	14.2%	21.2%
ROFE (%)	N/A	-41.2%	-4.8%	20.7%	38.2%

INTERIMS ($m)

Half Yr	Jul 10	Jan 11	Jul 11	Jan 12	Jul 12
Yr Ending Jan	**1H A**	**2H A**	**1H A**	**2H E**	**1H E**
Sales Revenue	1.4	1.7	1.6	0.5	64.1
EBIT	-7.4	-13.9	-2.8	-4.3	15.0
Net Profit	**-2.7**	**-10.7**	**0.5**	**-4.5**	**9.1**
EPS	-0.3	-1.3	0.1	-0.6	1.1

1. Gearing = (Debt + CNotes) / (Debt + Cnotes + Equity)

BALANCE SHEET ($m)

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
Cash	130.4	118.2	15.0	54.9	132.6
Total Assets	211.1	254.4	306.2	346.4	397.7
Debt	2.5	0.0	50.0	47.5	37.5
Total Liabilities	47.3	68.8	114.7	124.7	123.4
Total Shareholders Equity	163.5	185.3	191.4	221.5	274.2
Total Funds Employed	35.9	67.4	226.6	214.2	179.2

LIQUIDITY & LEVERAGE RATIOS

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
Debt / Equity (%)	1.5%	0.0%	26.1%	21.4%	13.7%
Gearing (%) [1]	1.5%	0.0%	20.7%	17.6%	12.0%
Interest Cover (x)	-0.8	-17.9	3.4	12.0	139.2
Debt / CashFlow (x)	-0.3	0.0	-8.6	1.0	0.4
(Debt+CNotes)/ CashFlow	-0.1	0.0	-11.2	0.8	0.4

PROFIT & LOSS ($m)

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
Sales Revenue	1.4	3.2	2.1	162.2	208.7
EBITDA	-9.8	-20.9	-6.5	66.8	104.0
Depn and Amortisation	0.4	0.4	0.5	21.1	28.8
EBIT	**-10.2**	**-21.3**	**-7.0**	**45.7**	**75.2**
Net Interest Expense	12.2	1.2	-2.1	3.8	0.5
Pre-tax Profit	**-22.4**	**-22.5**	**-5.0**	**41.9**	**74.6**
Tax	-6.4	-9.1	-1.0	12.6	22.0
Tax rate (%)	28.5%	40.6%	19.8%	30.0%	29.5%
Minorities / pref divs	0.0	0.0	0.0	0.0	0.0
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0
Net Profit	**-16.0**	**-13.4**	**-4.0**	**29.3**	**52.6**
Abnormals	71.6	0.0	0.0	0.0	0.0
Reported Net Profit	55.6	-13.4	-4.0	29.3	52.6

CASHFLOW ($m)

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
Operating Cash Flow	-8.5	-40.4	-5.8	49.5	90.1
Capital Expenditure	-7.2	-44.2	-141.6	-2.4	-2.5
Expln, Develop, Evaln	-4.4	-8.4	-5.4	-5.4	0.0
Asset Sales/Acquisitions	165.6	12.0	0.2	0.0	0.0
Other	0.0	-0.6	0.0	0.0	0.0
Investing Cash Flow	154.0	-41.1	-146.9	-7.8	-2.5
Share Issues/(Buybacks)	32.8	83.9	0.0	0.8	0.0
Debt Drawndown (Repay)	-47.3	-2.5	50.0	-2.5	-10.0
Dividends Paid	-8.3	0.0	0.0	0.0	0.0
Other Fin. Flows	0.0	-12.7	-0.2	0.0	0.0
Financing Cash Flow	-22.8	68.7	49.8	-1.7	-10.0
Cash Increase (Decrease)	122.7	-12.8	-102.9	40.0	77.6

EARNINGS SENSITIVITIES - % CHANGE

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
+/-10% US$ Copper Price	0.0%	0.0%	0.0%	33.9%	25.8%
+/-10% US$ Gold Price	0.0%	0.0%	0.0%	4.0%	2.3%
+/- 1c Movement US$/A$	0.0%	0.0%	0.0%	3.7%	2.8%
+/-10% US$ Silver Price	0.0%	0.0%	0.0%	1.6%	1.7%

Recommendation Structure

BUY: Total return +10% or more over a 12 month period
HOLD: Total return expected to be between +10% to -10% over a 12-month period
SELL: Total return expected to be -10% or more over a 12 month period
TOTAL RETURN OR TSR = capital growth in share price + expected dividend yield in that period

Other definitions

CS Coverage Suspended. Wilson HTM Ltd has suspended coverage of this company.
NR Not Rated. The recommendation has been suspended temporarily. Such suspension is in line with Wilson HTM Investment Group Ltd policies in circumstances where Wilson HTM Corporate Finance Ltd is acting in an advisory capacity in a merger or strategic transaction involving the company and in certain other situations.

Disclaimer

Whilst Wilson HTM Ltd believes the information contained in this communication is based on reliable information, no warranty is given as to its accuracy and persons relying on this information do so at their own risk. To the extent permitted by law Wilson HTM Ltd disclaims all liability to any person relying on the information contained in this communication in respect of any loss or damage (including consequential loss or damage) however caused, which may be suffered or arise directly or indirectly in respect of such information. Any projections contained in this communication are estimates only. Such projections are subject to market influences and contingent upon matters outside the control of Wilson HTM Ltd and therefore may not be realised in the future.

The advice contained in this document is general advice. It has been prepared without taking account of any person's objectives, financial situation or needs and because of that, any person should, before acting on the advice, consider the appropriateness of the advice, having regard to the client's objectives, financial situation and needs. Those acting upon such information without first consulting one of Wilson HTM Ltd investment advisors do so entirely at their own risk. This report does not constitute an offer or invitation to purchase any securities and should not be relied upon in connection with any contract or commitment whatsoever. If the advice relates to the acquisition, or possible acquisition, of a particular financial product – the client should obtain a Product Disclosure Statement relating to the product and consider the Statement before making any decision about whether to acquire the product. This communication is not to be disclosed in whole or part or used by any other party without Wilson HTM Ltd's prior written consent.

Disclosure of Interest. Hillgrove Resources Ltd

The Directors of Wilson HTM Ltd advise that at the date of this report they and their associates have relevant interests in Hillgrove Resources Ltd. They also advise that Wilson HTM Ltd and Wilson HTM Corporate Finance Ltd A.B.N. 65 057 547 323 and their associates have received and may receive commissions or fees from Hillgrove Resources Ltd in relation to advice or dealings in securities. Some or all of Wilson HTM Ltd authorised representatives may be remunerated wholly or partly by way of commission.

In producing research reports, members of Wilson HTM Ltd Research may attend site visits and other meetings hosted by the issuers the subject of its research reports. In some instances the costs of such site visits or meetings may be met in part or in whole by the issuers concerned if Wilson HTM Ltd considers it is appropriate and reasonable in the specific circumstances relating to the site visit or meeting.

Regulatory Disclosures

Wilson HTM Corporate Finance Ltd acted as Joint Lead Manager and Underwriter for the placement announced by Hillgrove Resources Limited in October 2010 and earned fees for acting in this capacity.

Wilson HTM Investment Group Ltd and its related bodies corporate trades or may trade as principal in the securities that are subject of the research report.

Wilson HTM Corporate Finance Ltd has received compensation for corporate advisory services from this company, its subsidiaries or affiliates during the previous 12 months.

BRISBANE
Ph: 07 3212 1333
Fax: 07 3212 1399

SYDNEY
Ph: 02 8247 6600
Fax: 02 8247 6601

MELBOURNE
Ph: 03 9640 3888
Fax: 03 9640 3800

GOLD COAST
Ph: 07 5509 5500
Fax: 07 5509 5599

DALBY
Ph: 07 4660 8000
Fax: 07 4660 4169

HERVEY BAY
Ph: 07 4197 1600
Fax: 07 4197 1699

Our web site: www.wilsonhtm.com.au