



# Hillgrove Resources Limited (HGO)

## May Production Update Following Poor April Quarterly Production

### BUY

Risk: HIGH RISK

#### Key Information

Price (\$)	0.16
Target Price (\$)	0.46
Market Cap (\$M)	127.0
GICS Sector	Materials
52 week Hi-Lo (\$)	0.30 - 0.16
Daily Vol (M, mth avg)	2.2
Weight of S&P 200 Index (%)	0.0
Cash (\$M)	17.9
Debt (\$M)	65.1
Gearing [ND/(ND+E)] (%)	18.3
Forecast Total Return (%)	187.5

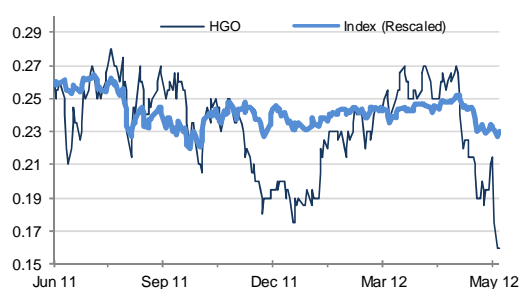
#### Investment Fundamentals

YE 31 Jan	FY12E	FY13E	FY14E	FY15E
Sales (\$M)	5.2	123.9	150.4	155.0
EBITDA (\$M)	-2.6	37.8	72.6	77.2
Margin (%)	-49.7	30.5	48.3	49.8
NPAT (\$M)	-5.7	10.2	33.0	38.4
EPS (cps)	-0.7	1.3	4.2	4.8
EPS Growth (%)	n.a	n.a	224.1	16.2
DPS (cps)	0.0	0.0	1.0	1.5
Franking (%)	n.a	n.a	100.0	100.0

#### Ratio Analysis

YE 31 Jan	FY12E	FY13E	FY14E	FY15E
PE (x)	n.a	12.5	3.8	3.3
Yield (%)	0.0	0.0	6.3	9.4

#### HGO vs S&P/ASX Market Index



#### Performance

	1 Mth	3 Mth	12 Mth
Absolute (HGO) (%)	-33.3	-37.3	-38.5
Rel to Market (%)	-25.3	-32.1	-26.7

#### Major Shareholders

	%
Freemont Commodities LLC	7.0
Westpac Banking Corporation	5.0
Wilson HTM Investments	4.7
AMP Ltd.	2.3

#### Directors and Management

Hon. Dean Brown	Non-Executive Chairman
Drew Simonsen	Managing Director
Ronald Belz	Non-Executive Director
John Gooding	Non-Executive Director
John Quirke	Non-Executive Director
Edwin Zemancheff	Non-Executive Director
Douglas Snedden	Non-Executive Director
Russell Middleton	CFO & Company Secretary

#### Event

We look at the May 2012 production summary at HGO's Kanmantoo Copper-Gold Project.

#### Highlights

- Moving forward from crushing plant problems:** HGO announced in March that it had a failure of the crown gear in the secondary cone crusher at its Kanmantoo operation, South Australia. Problems were also experienced due to excessive maintenance on the fixed jaw crusher. Sourcing critical spares took HGO longer than expected and it purchased a Lippmann 3252 mobile crushing plant in mid-March with greater size-handling and throughput capacity than the current fixed jaw crusher. The crusher averaged 79% of nameplate capacity (200,000t/m) during the April 2012 quarter and then reached 103% of nameplate capacity in May 2012.
- Improvements in May:** The improvement in the crushing circuit has led to improvements in the tonnes of ore milled at the plant which increased from 81% of nameplate capacity (200,000t/m) in the April quarter to 98% of nameplate capacity in May 2012. Milled copper grade of 0.63% was below plan during the April quarter due to greater than expected mine dilution. In May, milled copper grade was back in line with the mine plan at 0.73%. Copper recoveries continued to improve throughout the quarter from an average of 81.7% for February to 91.3% for April and 91.9% for May.
- Lower than plan production:** Total metal production for the April quarter was 2,681t of copper, 1,275oz of gold and 22,507oz of silver, which was below plan as a result of the lower feed grades and lower plant throughputs caused by the crushing circuit problems mentioned above.
- Bird's Head Copper-Gold project, West Papua, Indonesia:** Drill testing of the West Delta target area commenced mid-March. Drilling is targeting a modelled porphyry copper-gold-molybdenum system centred on the Green Cliffs area.
- Sumba Gold Project, Indonesia:** The April quarter was focused on preparation for, and recommencement of, drilling at the Karipi Prospect, ongoing trenching and mapping in the Masu area, and ongoing trenching and mapping in the Pelitalira prospect.

#### Recommendation

The May 2012 production update has provided a sigh of relief for us and re-instilled our confidence in HGO and our previous price target. We believe management did a good job of quickly arranging for a mobile crusher to minimise delays caused by the crushing circuit and we hence **rate HGO as a BUY with a price target of \$0.46.**

## Financial Summary

### Assumptions

Y/E 31st January	2012F	2013F	2014F	2015F	2016F
Copper Price (US\$/tonne)	8,137	8,734	8,294	7,855	7,497
A\$:US\$	1.01	0.96	0.94	0.92	0.92
End Issued Capital (m)	793.70	793.70	793.70	793.70	793.70
Share Price	\$0.16				

### Production

Y/E 31st January	2012F	2013F	2014F	2015F	2016F
<b>Kanmantoo</b>					
Tonnes Mined (kt)	0.100	2.000	2.400	2.400	2.400
Grade					
Copper (%)	0.760	0.860	0.820	0.890	0.950
Gold (g/t)	0.120	0.130	0.210	0.250	0.260
Silver (g/t)	3.220	3.010	3.440	3.480	3.220
Production					
Copper (t)	590	13,348	16,351	17,747	18,943
Gold (oz)	159	3,435	8,138	9,688	10,075
Silver (oz)	4,726	88,364	145,422	147,113	136,122
<b>Concentrate Production (t)</b>	<b>2,184</b>	<b>49,437</b>	<b>60,558</b>	<b>65,728</b>	<b>70,159</b>

### Profit and Loss (A\$m)

Y/E 31st January	2012F	2013F	2014F	2015F	2016F
Revenue (Net of Royalties)	5.16	123.93	150.36	154.96	156.35
<b>Costs</b>					
Mining	6.51	57.35	48.98	48.36	25.11
Processing	0.76	18.26	18.19	18.19	18.19
SG&A	0.14	3.40	3.36	3.36	3.36
Concentrate Offtake	0.31	7.10	7.25	7.86	5.60
EBITDA	-2.56	37.82	72.59	77.18	104.09
Depn. & Amort.	0.95	19.06	22.88	22.88	22.88
Interest Costs	1.13	0.70	-0.30	-2.50	-7.20
H/O Corporate Costs	3.50	3.50	3.50	3.50	3.50
Pre-Tax	-8.14	14.56	46.52	53.31	84.91
Tax	-2.44	4.37	13.49	14.93	23.78
NPAT	-5.70	10.19	33.03	38.39	61.14

### Cash Flow (A\$m)

Year ending 30 June	2012F	2013F	2014F	2015F	2016F
Gross Cash Flow	-2.56	37.82	72.59	77.18	104.09
Net Interest	-1.13	-0.70	0.30	2.50	7.20
Income Taxes Paid	2.44	-4.37	-13.49	-14.93	-23.78
Net Operating Cashflow s	-5.25	28.75	55.40	60.76	83.51
Maintenance Capex	-4.00	-4.00	-4.00	-4.00	-4.00
Build Capex	-129.40	0.00	0.00	0.00	0.00
Loan Repayments	0.00	0.00	0.00	0.00	-30.00
Exploration & Evaluation	-2.50	-2.50	-2.50	-2.50	-2.50
Free Cash Flow	-141.15	22.25	48.90	54.26	47.01

### Balance Sheet (A\$m)

Y/E 31st January	2012F	2013F	2014F	2015F	2016F
Cash & Equivalents	34.50	56.75	105.66	159.92	206.93
Total Current Assets	39.40	61.85	111.66	167.43	214.93
Property / Plant / Equip.	125.00	105.94	83.06	60.18	37.31
Other non-current assets	105.00	105.00	105.00	105.00	105.00
Total Assets	269.40	272.79	299.72	332.61	357.24
Total Current Liabilities	20.00	21.08	22.22	23.42	24.68
Borrowings	53.00	39.50	26.00	12.50	0.00
Other non-current liabilities	1.00	1.00	1.00	1.00	1.00
Total Non Current Liabilities	54.00	40.50	27.00	13.50	1.00
Total Shareholders Equity	215.40	232.29	272.72	319.11	356.24
NTA/Share	\$0.27	\$0.29	\$0.34	\$0.40	\$0.45

### Per Share Ratios

Y/E 31st January	2012F	2013F	2014F	2015F	2016F
EPS (c)	-0.7	1.28	4.16	4.84	7.70
PE Ratio	-22.3x	12.5x	3.8x	3.3x	2.1x
DPS (c)	0.0c	0.0c	1.0c	1.5c	2.0c
Dividend Yield (%)	n.a.	n.a.	6.3%	9.4%	12.5%
Payout Ratio (%)	n.a.	n.a.	24.0%	31.0%	26.0%
Franking (%)	n.a.	n.a.	100%	100%	100%
CFPS (c)	-0.2c	2.36c	4.54c	4.82c	6.51c
CF P/E	-99.9x	6.8x	3.5x	3.3x	2.5x

### Divisional EBITDA (A\$m)

Y/E 31st January	2012F	2013F	2014F	2015F	2016F
Kanmantoo	-2.56	37.82	72.59	77.18	104.09

### Operating Ratios (%)

Y/E 31st January	2012F	2013F	2014F	2015F	2016F
Op EBIT Margin	-49.7%	30.5%	48.3%	49.8%	66.6%
Interest Cover - EBIT					
Tax Rate	30.0%	30.0%	29.0%	28.0%	28.0%
ROA	-2.1%	3.7%	11.0%	11.5%	17.1%
ROE	-2.6%	4.4%	12.1%	12.0%	17.2%

### Balance Sheet Analysis

Y/E 31st January	2012F	2013F	2014F	2015F	2016F
Net Debt / (Cash) \$M	18.50	-17.25	-79.66	-147.42	-206.93
Net Debt / Equity	9%	-7%	-29%	-46%	-58%
Debt / Equity	25%	17%	10%	4%	0%
Net Debt / Net Debt + Equity	-9%	7%	23%	32%	37%
D & A / PPE	1%	18%	28%	38%	61%
Current Ratio	197%	293%	503%	715%	871%

### Growth

Y/E 31st January	2012F	2013F	2014F	2015F	2016F
Sales Growth	n.a.	2302%	21%	3%	1%
EBITDA	n.a.	n.a.	92%	6%	35%
NPAT	n.a.	n.a.	224%	16%	59%
EPS	n.a.	n.a.	224%	16%	59%

### Valn. (10% real post tax)

Consensus Gold Price	Reserves		Resources	
	Base	Base	Upside	Upside
Y/E 31st January	A\$m	c/share	A\$m	c/share
Kanmantoo	249.60	\$0.31	370.80	\$0.47
Regional Sth Aust	25.00	\$0.03	25.00	\$0.03
Indonesia	30.00	\$0.04	30.00	\$0.04
Net Debt/Cash	-18.50	-\$0.02	-18.50	-\$0.02
Corporate	-24.00	-\$0.03	-44.00	-\$0.06
Total Valn.	262.10	\$0.33	363.30	\$0.46

\* Net Debt as of 31st July 2011

## Moving forward from Crushing Problems

Management responded swiftly to a secondary crusher failure in mid-March 2012 and decided to install a mobile crushing plant.

Tonnes crushed went from 142,000t in Mar'12 to 161,000t in Apr'12 and to 207,000t in May'12.

Ore milled reached 91% of nameplate capacity of 200,000t in May'12

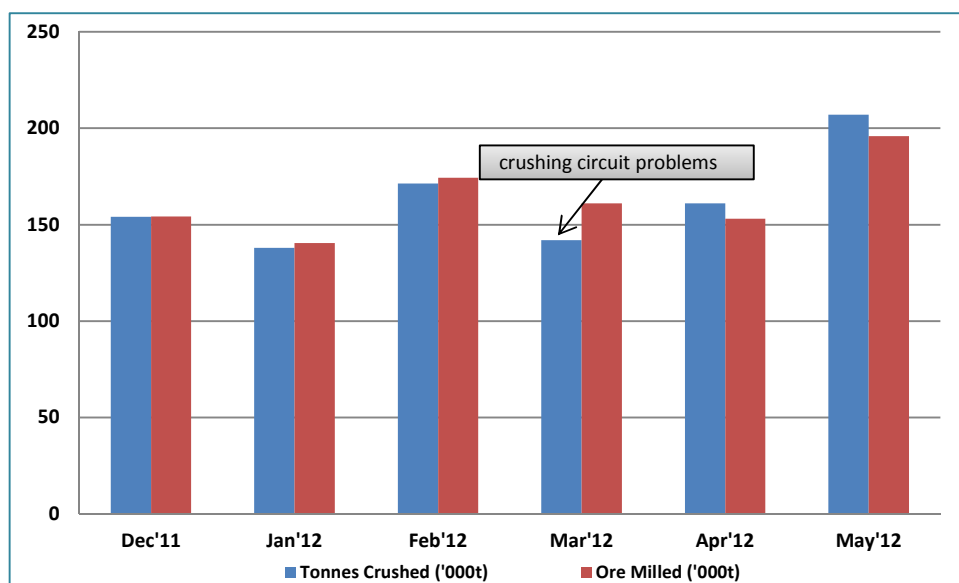
HGO announced in mid-March that it experienced a failure of the crown gear in the secondary cone crusher at its Kanmantoo operation, which was a rather rare occurrence. Problems were also experienced due to excessive maintenance on the fixed jaw crusher.

Sourcing critical spares took HGO longer than expected and management decided to purchase a Lippmann 3252 mobile crushing plant in mid-March with greater size-handling and throughput capacity than the current fixed jaw crusher.

Tonnes crushed went from 171,000t in Feb'2012 to 142,000t in Mar'12 due to the problems mentioned above. The average tonnes crushed during the April 2012 quarter were hence affected and averaged at 79% of nameplate capacity of 200,000t/m. Following deployment of the mobile crusher, tonnes crushed in the month of April increased to 161,000t and further to 207,000t in the month of May (103% of nameplate capacity).

Tonnes of ore milled during the April 2012 quarter were 488,000t which is an average of 81% of nameplate capacity of 200,000t/m. Following full implementation of the mobile crusher, improvements were noted in May with ore milled for the month reaching 196,000t and 98% of nameplate capacity.

Chart 1: Crushing & Milling Profile for HGO ('000t)



Source: Hillgrove Resources & Shaw Stockbroking

We believe management's decision to deploy a mobile crusher was the right thing to do. This decision has enabled HGO to complete ramp-up in the month of May and allay fears surrounding HGO's production ramp-up and associated cash flows. Given HGO's performance in May, we are confident of management's ability to steer the company clear of its ramp-up related teething problems.

## Production

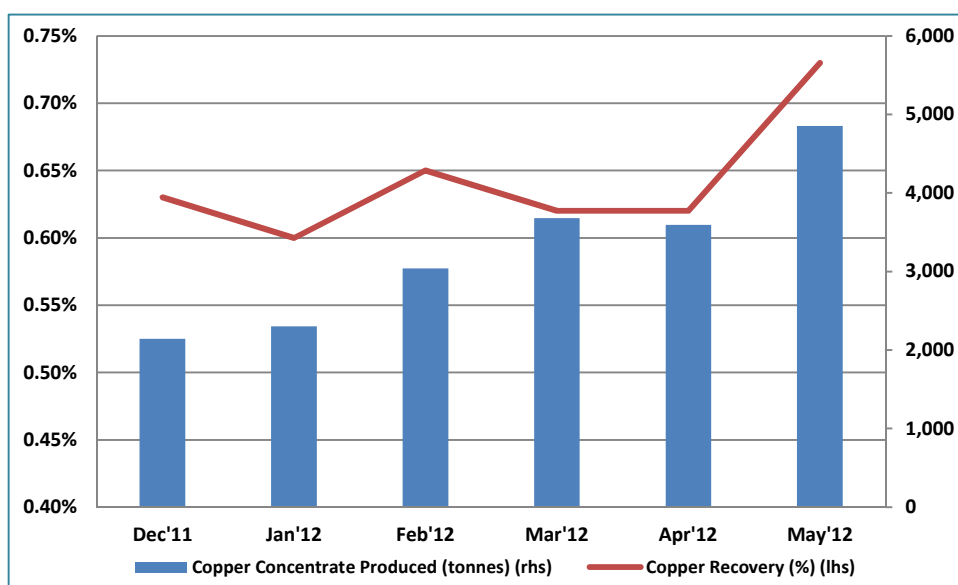
Production was below plan in the quarter ended April 2012 as a result of lower feed grades and lower plant throughputs.

Production in May 2012 was significantly better than the production in April 2012.

In the first complete quarter of operations ending April 2012, the Kanmantoo Copper Mine produced 10,316t of concentrate containing 2,681t of copper, 1,275oz of gold and 22,507oz of silver. This was below plan as a result of the lower feed grades and lower plant throughputs for the quarter caused by the crushing circuit problems mentioned above.

For the month of May 2012, Kanmantoo produced 4,854t of concentrate which was significantly higher than April (3,596t). In terms of contained metals, HGO produced 1,315t of copper (868t in April), 499oz of gold (353oz in April) and 11,252oz of silver (7,402oz in April). This reflected a significant improvement in Kanmantoo's production profile.

Chart 2: Concentrate Production & Copper Recovery Profile for HGO



Source: Hillgrove Resources & Shaw Stockbroking

Milled copper grade of 0.63% was below plan during the April 2012 quarter but was back in line with the mine plan in May.

Milled copper grade of 0.63% was below plan during the April 2012 quarter and was impacted by greater than expected dilution from the mine. In May 2012 however, the milled copper grade was back in line with the mine plan at 0.73%. Recoveries of copper continued to improve throughout the quarter from an average of 81.7% for February to 91.3% for April and 91.9% for May, 2012.

The first shipment of 4,890 tonnes left Kanmantoo on 7<sup>th</sup> March 2012 and the second shipment of 5,163 tonnes departed on 28<sup>th</sup> April 2012. The next shipment of approximately 10,000 tonnes is planned for June 2012.

## Shaw Commentary

Despite problems with the crushing circuit in the 4<sup>th</sup> month of ramp-up, HGO was able to complete ramp-up within the time frame guided by management (4 to 6 months).

Expected ramp-up period for the Kanmantoo Copper Mine was guided by management to be between 4 and 6 months. With problems occurring with the crusher circuit in mid-March (4<sup>th</sup> month of ramp-up) there was some nervousness in the market with regard to whether management would be able to ramp-up to full production within given guidance and whether HGO would be faced with any cash flow constraints in case of a delay in ramp-up. We believe that management was quick on its feet when faced with problems relating to the crushing circuit which has enabled HGO to complete ramp-up to full production in May 2012 (6<sup>th</sup> month of ramp-up). This has provided a sigh of relief for us and the market while re-instilling our confidence in HGO and its management.

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## Rating Classification

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Buy	Expected to outperform the overall market
Hold	Expected to perform in line with the overall market
Sell	Expected to underperform the overall market
Not Rated	Shaw has issued a factual note on the company but does not have a recommendation

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## Risk Rating

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High	Higher risk than the overall market – investors should be aware this stock may be speculative
Medium	Risk broadly in line with the overall market
Low	Lower risk than the overall market.

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