

BUY

HOLD

SELL

ACTION & RECOMMENDATION

We recently attended a site visit to HGO's Kanmantoo operation in South Australia. Pleasingly operating performance has significantly improved in September and October. It is expected that performance will continue to build in the December quarter. HGO indicated the mine was cash flow positive in September and we expect this to continue going forward. We believe the market requires evidence of consistent operating performance before rewarding HGO with a higher share price. We reiterate our Speculative Buy recommendation and have increased our 12 month price target to \$0.24/share.

Operational Momentum Building

What's Changed

- Average mill feed grade in September and October was ~0.8% copper, a significant improvement on the 0.69% achieved in August.
- Copper in concentrate production is approaching 1,500t per month, which is towards the bottom end of the target range for Kanmantoo of 18kt – 20kt on an annualised basis.
- A significantly improved working relationship between HGO and its site contractor Exact. This has coincided with new site managers for both HGO and Exact. Both parties appear more aligned with key KPI's linked to copper production.
- HGO is currently working on a new life of mine plan that is expected to add mine life. A new Reserve/Resource statement is expected early 2013.

Risks & Catalysts

- Main risk is that operating performance at Kanmantoo does not continue to improve. This could be due to lower mill feed grades if the Reserve model is incorrect, or there is a significant equipment failure. In our view, the recent equity raising has provided HGO with sufficient working capital to resolve its operating issues.
- In our view, the market requires evidence that operating performance at Kanmantoo can be consistently achieved. We believe at least two successive quarters of improved operating performance is required before HGO's share price will be meaningfully rewarded.
- The new Reserve/Resource statement expected early 2013 that is expected to add mine life, should act as a share price catalyst.

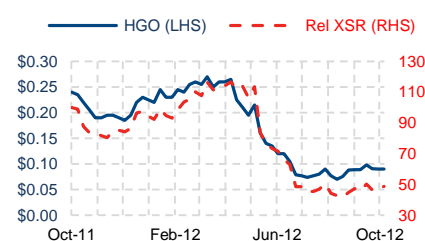
12m Target Price (AUD)	\$0.24
Share Price @ 31-Oct-12 (AUD)	\$0.09
Fcst 12m Capital Return	167.2%
Fcst 12m Dividend Yield	0.0%
12m Total S'holder Return	167.2%

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12m Share Price Performance



	1m	6m	12m
Abs Return	0.0%	-66.0%	-62.5%
Rel Return	3.7%	-46.7%	-38.4%

WHTM Return Re-investment Matrix

Return	High	Cash Generator	Champion
	Low	Challenged	Potential
		Low	High
		Re-investment	

WHTM Risk Assessment

	Low	Med	High	Spec
Share Price Risk				
Business Risk				

Year-end January (AUD)	FY11A	FY12A	FY13E	FY14E	FY15E
Revenue (\$m)	4.2	12.9	111.4	140.1	158.8
EBITDA Margin (%)	-498	-91	19	35	36
NPAT Norm (\$m)	-13.3	-11.6	-9.0	12.4	16.7
Consensus NPAT (\$m)			-1.0	11.0	14.6
EPS Norm (cps)	-2.1	-1.5	-0.9	1.2	1.6
EPS Growth (%)	38	30	36	231	34
P/E Norm (x)	-4.3	-6.1	-9.6	7.3	5.5
EV / EBITDA (x)	-5.2	-9.3	5.2	2.2	1.9
CFM (x)	-1.1	-0.6	15.4	2.3	1.7
DPS (cps)	0.0	0.0	0.0	0.0	0.0
Franking (%)	0	0	0	0	0

Key Changes	12-Oct	After	Var %	
Revenue	FY13	111	111	0.0%
(\$m)	FY14	136	140	3.1%
	FY15	154	159	2.9%
EBITDA:	FY13	19.4	21.2	9.1%
(\$m)	FY14	45.4	49.6	9.4%
	FY15	53.0	57.6	8.6%
EPS:	FY13	-1.1	-0.9	N/A
Norm	FY14	0.9	1.2	31.9%
(cps)	FY15	1.3	1.6	24.6%
Price Target:	0.22	0.24	7.2%	
Rec:	BUY	BUY		

Mkt Cap: \$92m

Enterprise Value: \$110m

Shares: 1,023m

Sold Short: 0.3%

ASX 300 wgt: 0.0%

Median T'over/Day: \$0.1m

Wilson HTM Equities Research – Hillgrove Resources Limited

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PRICE TARGET		
	Valuation	Price Target
Kanmantoo	225.11	0.22
Exploration	67.12	0.07
Hedge Book	8.43	0.01
Other Equity	1.62	0.00
Corporate	-30.10	-0.03
Net (Debt)/Cash	-26.57	-0.03
TOTAL	245.60	0.24

12 Month Price Target 0.24

INTERIMS (\$m)				
Half Yr (AUD)	Jul 11	Jan 12	Jul 12	Jan 13
	1H A	2H A	1H E	2H E
Sales	1.3	11.6	49.7	61.7
EBITDA	-2.5	-9.3	1.5	19.7
EBIT	-2.8	-14.1	-14.8	5.6
Net Profit	-0.3	-11.3	-11.7	2.7
Norm. EPS	0.0	-1.4	-1.4	0.3
EBIT/Sales	-213.6	-121.8	-29.7	9.1
Dividend (c)	0.0	0.0	0.0	0.0
Franking (%)	0.0	0.0	0.0	0.0

FINANCIAL STABILITY			
Year-end January	FY12A	FY13E	FY14E
Net Debt	30.5	17.6	-18.1
Net Debt / Equity (%)	14.5	8.1	<0
Net Debt / EV (%)	27.8	16.1	<0
Current Ratio (x)	9.4	4.6	5.7
Interest Cover (x)	10.4	<0	10.6
Adj. Cash Int. Cover (x)	91.0	1.2	25.1
Debt / CashFlow (x)	0.0	2.8	1.2
Net Debt (cash) / share	0.0	0.0	<0
NTA / share (\$)	0.3	0.2	0.2
Book Value / share (\$)	0.3	0.2	0.2
Payout Ratio (%)	0	0	0
Adj. Payout Ratio (%)	0	0	0

EPS RECONCILIATION (\$m)				
	FY12A		FY13E	
	Rep.	Norm.	Rep.	Norm.
Sales Revenue	13	13	111	111
EBIT	-17.0	-17.0	-9.1	-9.1
Net Profit	-11.6	-11.6	-11.9	-9.0
Notional Earn.	0.0	0.0	0.0	0.0
Pref./Conv. Div.	0.0	0.0	0.0	0.0
Profit for EPS	-11.6	-11.6	-11.9	-9.0
Diluted Shrs(m)	794	794	968	968
Diluted EPS (c)	-1.5	-1.5	-1.2	-0.9

Notes to accounts

All numbers reported using A-IFRS

KEY ASSUMPTIONS								
Year-end January (AUD)	FY10A	FY11A	FY12A	FY13E	FY14E	FY15E	FY16E	FY17E
Copper Price (US\$/lb)		3.94	4.00	3.58	3.74	3.65	3.41	3.22
A\$/US\$		0.99	1.03	1.03	1.03	1.00	0.93	0.87
Copper Production (kt)		0.0	1.3	14.4	17.7	20.2	20.2	20.2
Gold Produced (koz)		0.0	0.4	6.3	7.9	8.9	8.9	8.9
EBITDA Margin (%)		-497.6	-91.1	19.0	35.4	36.3	33.9	31.9
EBIT Margin (%)			-173.4	-8.5	14.0	14.7	12.3	18.5
ROA (%)		-5.2	-3.9	-3.7	4.1	5.3	4.8	6.8
Earnings Sensitivity (% Chg)								
+/- 10% A\$/US\$				0.0	9.7	5.5	18.2	39.2
+/- 10% Copper Price				0.0	11.5	26.6	30.7	51.9

PROFIT & LOSS (\$m)								
Year-end January (AUD)	FY10A	FY11A	FY12A	FY13E	FY14E	FY15E	FY16E	FY17E
Sales Revenue	1.4	4.2	12.9	111.4	140.1	158.8	158.2	160.1
EBITDA	-9.9	-20.9	-11.8	21.2	49.6	57.6	53.7	51.1
Depn & Amort	0.3	0.4	5.2	30.3	30.0	34.2	34.2	21.4
EBIT	-10.2	-21.3	-17.0	-9.1	19.6	23.4	19.5	29.7
Net Interest Expense	12.2	1.2	-1.6	4.7	1.8	-0.4	-2.6	-4.1
Tax	-6.4	-9.2	-3.9	-4.9	5.3	7.1	6.6	10.2
Minorities / pref divs	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net Profit pre Sig. Items	-16.0	-13.3	-11.6	-9.0	12.4	16.7	15.4	23.7
Abn's / Ext's / Signif.	71.5	0.0	0.0	-2.9	0.0	0.0	0.0	0.0
Reported Net Profit	55.5	-13.3	-11.6	-11.9	12.4	16.7	15.4	23.7

CASHFLOW (\$m)								
Year-end January (AUD)	FY10A	FY11A	FY12A	FY13E	FY14E	FY15E	FY16E	FY17E
EBITDA	-9.9	-20.9	-11.8	21.2	49.6	57.6	53.7	51.1
Interest & Tax	-37.3	-8.7	2.4	-5.6	-8.2	-8.3	-6.9	-10.2
W/kg Cap & Other	38.7	-11.1	-12.8	3.1	-0.1	5.9	3.5	5.1
Operating Cash Flow	-8.6	-40.7	-22.2	18.6	41.3	55.1	50.4	46.0
Maintenance Capex	-7.2	-44.2	-121.4	-12.6	-2.0	-2.0	-2.0	-2.0
Free Cash Flow	-15.8	-84.9	-143.6	6.0	39.3	53.1	48.4	44.0
Development Capex	-4.4	-8.2	-10.7	-10.8	-3.6	-3.7	-3.7	-3.7
Dividends Paid	-8.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Invest. / Disposals	165.6	3.2	0.2	0.0	0.0	0.0	0.0	0.0
Other Inv. Flows	0.0	4.5	5.9	0.3	0.0	0.0	0.0	0.0
Cash Flow Pre New Financing	137.2	-85.4	-148.2	-4.6	35.7	49.4	44.7	40.4
Funded by Equity	32.8	75.5	0.0	18.2	0.0	0.0	0.0	0.0
Funded by Debt / Cash	-170.0	9.9	148.2	-13.6	-35.7	-49.4	-44.7	-40.4

BALANCE SHEET SUMMARY (\$m)								
Year-end January (AUD)	FY10A	FY11A	FY12A	FY13E	FY14E	FY15E	FY16E	FY17E
Cash	130.4	118.4	20.7	33.2	39.0	75.0	112.2	152.6
Current Receivables	1.1	1.9	6.4	8.6	9.9	11.0	11.3	11.2
Current Inventories	0.1	0.1	9.3	13.8	13.8	15.9	16.3	16.7
Net PPE	31.9	69.1	229.4	218.4	190.3	158.1	125.9	106.5
Investments	3.5	3.8	4.2	10.5	10.5	10.5	10.5	10.5
Intangibles / Capitalised	44.1	43.3	19.8	30.5	34.1	37.7		
Other	0.0	17.8	10.0	4.6	4.6	4.6	46.0	49.7
Total Assets	211.1	254.4	299.8	319.6	302.2	313.0	322.3	347.3
Current Payables	13.7	8.9	17.2	30.3	30.5	35.1	36.0	36.8
Total Debt	2.5	0.0	51.2	50.8	20.8	7.5	0.0	0.0
Other Liabilities	31.5	59.8	21.3	22.2	22.2	25.1	25.6	26.1
Total Liabilities	47.7	68.7	89.7	103.3	73.5	67.6	61.5	62.8
Minorities / Convertibles	0.0	0.0	0.2	0.2	0.2	0.2	0.2	0.2
Shareholder Equity	163.4	185.3	209.9	216.3	228.7	245.3	260.8	284.5
Total Funds Employed	165.9	185.3	261.1	267.1	249.5	252.8	260.8	284.5



Momentum Building at Kanmantoo Operations

We recently attended a site visit to HGO's Kanmantoo operations in South Australia. Pleasing to us was that operational performance has significantly improved in September and October. The key now is for HGO to build on this base and consistently achieve operating performance. The net result from the site trip is that we are now more confident that our base case scenario for Kanmantoo can be achieved.

The following are key points from our site visit.

TABLE1. THIRD QUARTER PRODUCTION UPDATE

		April Qtr	July Qtr	Oct Qtr to Date*	Indicative Dec Qtr
Total Tonnes Mined	(kt)	3,481	3,417	3,495	
Ore to Long Term Stockpiles	(kt)	298	248	214	
Ore to ROM	(kt)	544	486	554	
ROM Grade	Cu (%)	0.83	0.71	0.81	
Mined Waste	(kt)	2,639	2,683	2,727	
Ore Milled	(kt)	488	572	576	>600
Milled Grade	(%)	0.63	0.67	0.73	+0.75
	Au (%)	0.14	0.13	0.17	
	Ag (%)	2.89	3.43	3.08	
Recovery	Cu (%)	86.80	90.50	91.10	~92.00
	Au (%)	58.00	50.40	55.10	
	Ag (%)	49.70	48.00	60.20	
Cu Concentrate Produced	(t)	10,316	13,280	16,112	
Concentrate Grade	Cu (%)	26.00	26.20	23.60	
	Au (%)	3.90	2.80	3.30	
	Ag (%)	67.80	71.10	66.30	
Contained Metal in Conc.	Cu (t)	2,681	3,473	3,802	4,125 - 4,500
	Au (oz)	1,275	1,216	1,703	
	Ag (oz)	22,507	30,351	34,229	
Annualised Cu Production	Cu(t)	10,724	13,892	15,208	16,500 - 18,000
Total Concentrate Sold	(dry metric t)	8,590	15,462	16,287	

* Mining & Production figures as at 28/10/12 and sales figures as at 29/10/12

Key points to note for Kanmantoo operations from Table 1:

- Average mill feed grade in the October quarter to date is 0.73%, a significant improvement. Importantly the mill feed grade includes an average feed grade in the month of August of 0.69% - treatment of low grade stockpile material that has now been completed.. This implies that the feed grade in the month of September and October has been approaching 0.8%.
- Copper in concentrate production in the October quarter to date is 3,802t. This includes production in the August month of 1,002t, September month of 1,484t and in October of 1,316t.



- Production in August was negatively impacted by the lower feed grade from the stockpile and also re-lining of the mill that meant production was off-line for 8 days.
- Production numbers in the table above are to the 28th of October. There is a further 3 days (or 10%) to complete October. Scheduled maintenance during October also resulted in no production for 4 days.
- Taking into account the additional three days production in October and the scheduled downtime, it appears that site are now achieving production levels close to 1,500t of copper in concentrate a month. This equates to an annualised figure of 18,000t of copper in concentrate.
- HGO expect operations to continue to improve in the December quarter. Indicative estimates are for the mill rate to be greater than 600kt (annualised 2.4Mtpa) and a feed grade of +0.75%. The higher feed grade is also expected to result in a higher recovery rate. Based on these numbers, we estimate copper in concentrate production in the December quarter of 16,500t – 18,000 on an annualised basis.
- HGO management indicated that their target is to achieve a monthly production rate of 1,650t of copper in concentrate, which is approximately 20,000t of copper in concentrate on an annualised basis. This suggests there is possible upside to our forecast for copper production in FY14 (Feb 2013 – Jan 2014) of 17,712t. We prefer to wait for operations to show consistently improved production numbers before we increase our forecasts.

TABLE 2. UNIT PRODUCTION COSTS DECREASING

	April Qtr	July Qtr	Oct Qtr to 30/9/12	YTD (at 30/9/2012)	WHTMe	
					FY13	FY14
US cents per lb						
Mining Costs	132	116	93	114	125	137
Processing Costs	111	88	94	97	86	59
Other Direct Costs	29	22	23	26	23	20
Total Onsite Costs	272	226	210	237	234	216
Transport & Shipping	18	18	15	17	15	15
TC/RC	31	35	34	35	35	35
Precious Metal Credits	-40	-43	-45	-46	-43	-43
Total C1 Operating Costs	281	236	214	243	241	223
Royalties	6	3	4	4	5	6
D&A	135	117	116	121	100	82
Total	422	356	334	368	346	311

Key points to note for cash costs from Table 2:

- C1 cash costs at Kanmantoo are declining. The C1 cash cost in the October quarter (to the end of September) was US\$2.14/lb of copper. We expect a similar cost level for the month of October and the December quarter.
- Comparing to our C1 cash cost forecast for FY13 of US\$2.41/lb indicates that there is potential for our number to reduce.
- HGO expect a new primary crusher to be installed and operational in April 2014. The current crushing circuit (primary and mobile crusher) requires a



significant amount of material double handling. We estimate the cost to be ~\$400k each month. Replacement of the primary crusher will eliminate the double handling cost and is the reason why our processing costs reduces to US\$0.59/lb in FY14 (from US\$0.86/lb in FY13).

- HGO management is confident that further operational improvements can reduce the C1 cash cost to below US\$2/lb of copper. Our long term C1 cash cost is US\$2/lb – US\$2.10/lb.
- We note that the mining cost in table 2 above includes only the cost to move mined ore. The cost to move waste material and lower grade/oxide ore to long term stockpiles is capitalised as is normal accounting practice.
- We estimate that the unit mining cost is approximately \$3.50/t of material moved.

Other key points from our Kanmantoo site trip include:

- HGO advised that the Kanmantoo operation was cash flow positive in the September month, the first time it has been so since May. Importantly HGO expect operations to remain cash flow positive going forward.
- HGO are currently working two mine fronts – the Spitfire deposit and the Kavanagh deposit. It is expected the Spitfire deposit will be depleted by the end of 2012. HGO are currently developing the Emily Star deposit that will ensure two mine fronts are maintained in 2013.
- HGO management are currently working through a new life of mine (LOM) plan for Kanmantoo. This will result in a new Reserve/Resource statement issued early in 2013.
- Whilst it is too early to provide numbers, HGO management did indicate that mine life is likely to increase. The current mine life based on existing Reserves is ~6.5 years based on a processing rate of 2.4Mtpa. It is likely that mine life will be extended to ~7.5 years based on a processing rate of 2.8Mtpa (achieved once the new primary crusher is installed).
- The new LOM plan is likely to include an increase in waste material mined in 2014 and 2015 as a cutback to the open pit is completed. Whilst we have already factored in a higher strip ratio in these years, the actual number when presented could be higher than our current forecast.
- Previously HGO had previously indicated the potential to develop a heap leach project to treat the oxide ore it is currently stockpiling. HGO now advise that it is more likely to treat the oxide material by sulphidising it rather than a heap leach. Whilst still early in planning, the feed to the 2.8Mtpa processing circuit could be 2.4Mtpa of primary ore and 0.4Mtpa of oxide ore. This will help HGO smooth revenue whilst they complete the cut back of the open pit.
- It is expected that the new LOM plan will be submitted to HGO's bank in early November. It will be the basis from which the Kanmantoo bank completion test (BCT) will be measured. Under the current terms the BCT must be achieved by the 30 June 2013. We understand that for the operations to successfully complete the BCT, the new crusher needs to be installed (likely to be April 2013). HGO has previously indicated that the BCT requires 3 months of continuous operation. This does not provide much flexibility should there be a delay in the crusher installation. However, we understand that HGO are currently discussing this issue with their banks and are confident of achieving a positive outcome.



Key points to note regarding HGO's new Site Manager & Contractor:

- The host of the site trip was HGO's new site general manager Steve McClare. Steve has been in the role at site for 8 weeks and in our view has already introduced a more disciplined and focused approach. Steve's target is to normalise the Kanmantoo operations and then optimise.
- Steve has had extensive experience having held various senior operating roles at Mt Isa mines, Normandy/Newmont and more recently Newcrest.
- Steve made the comment that looking back on his 2 months at site, his experience at Kanmantoo has been better than he had first expected. Specifically the plant appears to be robust, there are a number of potential operational gains to be achieved, and the exploration potential of the region is significant.
- Coinciding with Steve starting at HGO, the site contractor Exact also introduced a new site manager. Our view is that the relationship between HGO and Exact has significantly improved. Both parties now appear to be more aligned with KPI's now linked to copper production.



RETURN RE-INVESTMENT MATRIX

Return	High	Cash Generator	Champion
	Low	Challenged	Potential
		Low	High
		Re-investment	

Currently progressing 20ktpa copper mine in South Australia towards Bank Completion test. Project largely de-risked once achieved and should provide consistent returns. We also consider ability to grow organically as likely.

RISK MEASURES

	Low	Med	High	Spec
Share Price Risk				
Business Risk				

Share price risk - Earnings subject to copper price exposure and strength of AUD. Business Risk - Main risk is that project does not deliver forecast copper production profile. Further risk is that exploration potential in South Australia and South-East Asia is not realised.

BUSINESS DESCRIPTION

HGO is an Australian mining company focused on the operation of the Kanmantoo Copper mine in South Australia, and exploration on its Indonesian tenements. In Indonesia, HGO is targeting the discovery of epithermal gold and porphyry copper/gold deposits. The Kanmantoo Copper mine is located less than 55km from Adelaide. Ramp-up of the open pit mine and processing circuit is progressing to an initial throughput of 2.4Mtpa producing ~80kt of concentrate per annum (~20ktpa of copper metal).

INVESTMENT THESIS

HGO recently completed a \$19m raising to provide sufficient working capital to allow the company to address elevated grade dilution and low mining rates at its Kanmantoo mine. In our base case, we operational improvements are achieved and we value the company at \$0.22/sh. The current share price approximately reflects the replacement value of the Kanmantoo mine. Whilst we highlight the near term operating risks, we do see value should these issues be resolved. We rate a Speculative Buy.

REVENUE DRIVERS

- Copper and gold prices
- Improved mining rates and copper feed grades to the mill
- Successful exploration at Kanmantoo and Indonesia

BALANCE SHEET

- Equity: 793.7m FPO
- Options: 38.9m
- Cash: \$14m (31 July 2012)
- Debt: \$53m (31 July 2012)

KEY ASSETS

- *Kanmantoo Copper Mine (South Australia): is an open-cut mine with initial throughput of 2.4Mt pa, producing approximately 80,000t of concentrate, containing about 20,000t of copper metal and 10,000oz of gold with exploration potential for further copper*

RESERVES & RESOURCES

- ? Kanmantoo
 In-situ Resource: 31.2Mt @ 0.82% Copper
 Long term stockpile Resource: 1.6Mt @ 0.37% Copper

BOARD

- Dean Brown (Chairman)
- John Gooding (Non-Executive Director)
- John Quirke (Non-Executive Director)
- Douglas Snedden (Non-Executive Director)
- Edwin Zemancheff (Non-Executive Director)

KEY ISSUES / CATALYSTS

- Mill feed grades achieving 0.8% by end of 2012.
- Bank Completion Test achieved: must be completed by 30 June 2013
- Increased Resource at Kanmantoo to increase mine life towards 10 years.
- Exploration success in Indonesia provides optionality for HGO

MANAGEMENT

- Russell Middleton (Chief Executive Officer)
- Shanthi Smith (Chief Financial Officer and Company Secretary)
- Steven McClare (General Manager (Kanmantoo Copper Mine))

RISK TO VIEW

- Inability to achieve and maintain full production capacity at Kanmantoo.

MISCELLANEOUS AND OTHER

?

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Return Reinvestment Matrix and Risk Measures

Definitions at <http://www.wilsonhtm.com.au/Disclosures>

Recommendation Structure and Other Definitions

Definitions at <http://www.wilsonhtm.com.au/Disclosures>

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