

Hillgrove Resources (HGO)

Quarterly, April 2013 – improvements will be seen later

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Three Key Points

- We have been projecting that the April quarterly would show little improvement, while July would be better and the final 2 quarters will be good. This report is consistent with our theme.
- Copper produced was 3,590t, v. 3,595t in the January quarter. However, C1 cash costs were much higher than expected, at \$3.15/lb,. The higher cash costs are due to the change over to the new crusher, with extra costs, while there was no crusher in line, being expensed.
- Our valuation is reduced as we now use the grades in the Mine Plan of 20 February, 2013, which are lower than Reserve grades.

Kanmantoo : getting better

April Quarterly - synopsis

- 689kt of ore as mined, compared with 639kt in the previous quarter and 552kt in the quarter before that, and an objective of 700kt each quarter.
- The grade mined was 0.67% Cu, which compares with 0.85% Cu in Reserves. However, the area that was mined was a low grade area and the result was consistent with expected for that area.
- The volume of ore processed was 708kt. The new, larger crusher was brought in line on 11 April, so the volume of ore processed was much more than expected.
- However the grade of ore processed was only 0.57% Cu, so copper produced was 3,590t, compared with 3,595t in the prior quarter, and 3,994t to quarter before.
- The lower grade was because 138kt of low grade material was processed due to timing of material movement.
- The reported cash cost was US\$ 3.15/lb, which compares with \$2.81/lb in our model (adjusted) and \$2.25 to \$2.50/lb guided for the current financial year.
- The costs were higher due to the change-over to the new crusher; there was 4 weeks from when the old crusher was taken out of line and the new crusher was brought in line. During this time, extra costs were incurred for rock breaking and extra mobile crushing.

Projections

- The results are all consistent with guidance which is for 18kt – 20kt of Cu at \$2.25 - \$2.50/lb.
- With the new crusher in line, we expect that more than 700kt will be able to be processed each quarter.
- Mining performance is expected to improve with a more powerful excavator now operating.
- Our valuation was been reduced to 18.5c, following the most recent mine plan, which has lower grades for material not in reserves.

Investment Recommendation

- Our valuation is 2.8x the current share price, so we retain a Strong Buy recommendation

Recommendation

Strong Buy

Previous Recommendation	Strong Buy
Risk Rating	Medium
Current Share Price	\$0.07
12 Month Price Target	\$0.19 (from \$0.24)
Price Target Methodology	DCF
Total Return (Capital + Yield)	184.9%
NAV / Share	\$0.19 (from \$0.24)
Market capitalisation	\$66m
Liquidity – Daily Value	\$0.2m

EPS Changes & PhillipCapital vs. Consensus

Y/e Jan (\$m)	2014F	2015F	2016F
Previous EPS (cps)	2.3	3.3	3.8
Change in EPS (%)	-66.0	-20.2	-37.4
Consensus EPS (cps)	-2.3	2.3	3.3
PhillipCapital vs Consensus (%)	0.0	0.0	0.0

Financial Forecasts & Valuation Metrics

Y/e Jan (\$m)	2013A	2014F	2015F	2016F
Revenue	117	153	190	193
NPAT	-22.3	7.9	27.2	24.3
EPS (cps)	-2.4	0.8	2.7	2.4
EPS Growth	-3%	132%	242%	-11%
DPS (c)	0.0	0.0	0.0	0.0
EV / EBITDA (x)	46.5	1.6	0.2	na
PER (x)	-2.7	8.4	2.4	2.7
Dividend Yield	0.0%	0.0%	0.0%	0.0%
Gearing	10%	5%	-19%	-38%
Interest Cover (x)	na	3.4	17.2	31.9

Source: PhillipCapital estimates

HGO share price performance



Source: PhillipCapital estimates

Hillgrove : Quarterly Report, April 2013

Our thesis re-stated and tested

We have been projecting

- The April quarterly to be consistent with previous quarters;
- an improved result in the July quarterly; and
- good results for the final 2 quarterly reports

We have been stating, since soon after the management was changed, that the operational turn-around will take some time to be seen as the required steps are implemented.

We expected that the April quarter would be consistent with the previous quarters. However, the April quarter was better than expected in terms of volume processed. However the cost penalty brought to the cash costs due to the change-over was greater than we expected.

We expected that the July quarter would show some improvement, but that it would take until the October quarter to see the full benefit.

The evidence to date is consistent with our thesis.

Why we expect operations to improve

The keys to improved performance are :

- Improved mining rate
- Improved grade of ore mined; and
- Increased processing rate.

Improved mining rate

The planned mining rate is 700kt a quarter. The April quarter was the best so far, with 689kt.

However, one of the excavators has been replaced with a more powerful machine, but the same sized bucket, so that greater breaking power is able to be applied. The net result is that the more powerful (300 series) excavator is able to load a truck in 135 seconds compared with 255 seconds previously.

This was implemented during the quarter, so we are confident that the planned rate, of 2.8Mt/tyr can be achieved and probably exceeded (though not by enough to change our model assumptions).

Improved mined grade (short term)

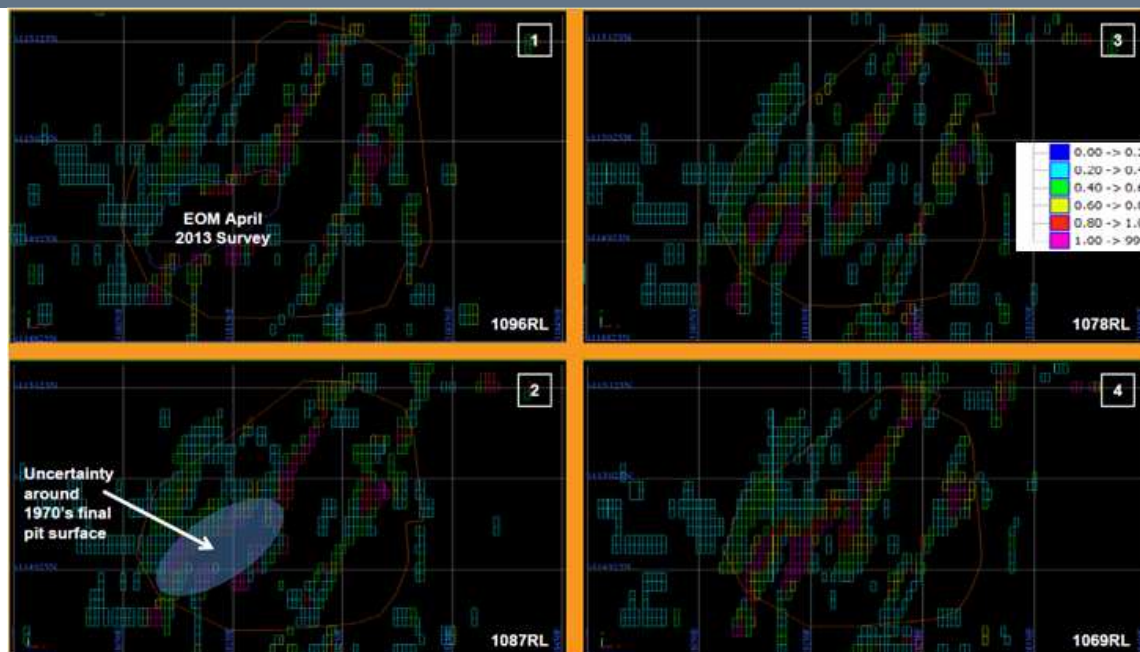
Figure 1 shows successive benches at Kanmantoo, with the operations currently at the 1,096 level (ie. 1,096m above sea level). Each bench is 9m, so the next level is 1,087m above sea level.

The mining rate was about where it needs to be.

It will improve with depth as the ore-body thickens

Grades also improve with depth

Figure 1 : Mining plan, successive benches



Source : HGO presentation, 31 May 2013

Figure 1 shows that as the mine gets deeper, the grades improve.

Figure 1 also shows that significant parts of the current level are either low grade (in light blue), or with no assessable grade (no colour at all).

This gives us confidence that ore grades will improve.

Increased processing rate

The new crusher was brought on line on 11 April.

The new crusher was brought in line on 11 April. The new crusher has 1,220mm jaws, compared with 900mm for the retired crusher, as well as greater power,.

This means that there will be less down-time.

We expect higher throughput rates

The new crusher is expected to achieve the planned rate of 2.8Mt/yr from 60% up-time. If the crusher is able to achieve 75%, which is more like an industry average, up-time, then it will be able process 3.5Mt/yr. However, we do not know the potential of the processing circuit if it is not constrained.

Though we do not know the real capacity of the balance of the processing circuit

Guided Costs

HGO are guiding, for FY14 :

- 18 – 20kt of copper in concentrate, at
- Average cash costs of \$2.25 - \$2.50/lb

The cash cost for the April quarter was \$3.15/lb.

This means that HGO expect to achieve cash costs closer to \$2.00/lb.

Guidance is for 18kt – 20kt of copper at \$2.25 - \$1.50/lb

We project 18.7kt of copper at a cash costs of \$2.24/lb, assuming AUD-USD is 1.000 for the balance of the year.

Revised Valuation

Figure 2 summarises the May 2012 revised Resource statement, while Figure 3 shows the more current mine plan

Figure 2 : May 2012 Resource statement, Kanmantoo

Resources	Copper			Gold		Silver	
In Situ							
Measured	4.2 Mt	0.85 %	36 kt	0.13g/t	17.6 koz	2.36g/t	319 koz
Indicated	20.5 Mt	0.87 %	178 kt	0.16g/t	105.5 koz	2.34g/t	1,542 koz
Inferred	6.5 Mt	0.66 %	43 kt	0.15g/t	31.4 koz	1.73g/t	362 koz
Long Term stockpiles							
Measured	1.1 Mt	0.46 %	5 kt		0.0 koz		0 koz
Indicated	0.5 Mt	0.18 %	1 kt		0.0 koz		0 koz
	32.8 Mt	0.80 %	263 kt	0.15g/t	154.4 koz	2.22g/t	2,223 koz

Source : HGO ASX announcement, May 2012

Figure 3 : February 2013 Mine Plan

			<u>contained</u>	<u>recoverable</u>	<u>recovery</u>
Proved and Probable Reserves	12.0 Mt	0.85 %	102 kt	94 kt	92 %
Measured & Indicated Resources	5.0 Mt	0.70 %	35 kt	31 kt	88 %
Inferred Resources	4.0 Mt	0.60 %	24 kt	20 kt	85 %
Low grade stockpiles	1.6 Mt	0.40 %	6 kt	5 kt	75 %
Exploration Target #1	2.0 - 3.0 Mt	0.6% - 0.8%	12 kt	11 kt	88 %
Exploration Target #2	5.0 - 7.0 Mt	0.7% - 0.8%	35 kt	31 kt	88 %
TOTAL			214 kt	191 kt	

Source : HGO ASX announcement, 20 February 2013

Due to the revised mine plan, our valuation has been reduced from 23.7c/share to 18.5c/share

Figure 3 shows that while the reserve grade is 0.85% Cu, the grade of the other material is lower than we had expected.

Figure 3 also shows that the expected recovery for the reserve material is 92%, compared with 94% in the feasibility studies. It also shows lower recoveries for lower grade material.

Combined, these factors have reduced our valuation, from 23.7c /share to 18.5c/share .

Cash

The total cash cost for the quarter was \$3.20/lb (\$3.15/lb C1 plus 5c/lb royalties). Revenue was \$3.62/lb, with the hedges in place adding to \$3.57/lb market average.

This gives a net margin of 42c/lb, or \$A 893/t by 3,590t, or net cash of \$3.2m.

The Annual Report, for the period ending 31 January 2013, showed cash of \$27.4m and total debt of \$53m for net debt of \$25.6m.

The quarterly report showed net debt of \$32.5m.

Part of the increase was due to the payment of creditors, as payables as at 31 January were \$40m.

There were also capital and corporate costs incurred.

We project that HGO will generate net cash each quarter from now on and will be net cash in about 12 months (ie still net debt at 31 January, but with cash level higher than debt levels by April).

Conclusions

Figure 4 shows PhillipCapital's operational and financial projections for HGO. We expect that more high grade resources will be developed over time, which will extend mine life and raise eps by reducing the depreciation charge.

Figure 4 : PhillipCapital projections for HGO

		2013	2014	2015	2016	2017	2018	2019	2020
Ore Processed	000t	2,303	2,808	2,940	2,940	2,940	2,940	2,940	2,940
Copper produced	tonnes	13,743	18,724	23,012	23,012	23,012	18,111	17,332	14,994
Gold produced	ounces	6,569	6,288	9,321	9,321	9,321	8,508	8,508	8,508
Silver produced	ounces	121,656	137,423	157,467	157,467	157,467	109,580	109,574	109,574
Copper Revenue	AUD m	106	129	165	167	177	149	141	119
Cu TC / RC	AUD m	(10)	(13)	(17)	(18)	(19)	(16)	(15)	(13)
By-products, net	AUD m	12	9	13	13	14	14	13	13
Net Cash costs	US c/lb	258	216	190	189	184	218	227	254
Cash Costs	AUD m	(85)	(93)	(105)	(113)	(117)	(116)	(115)	(109)
Royalties	AUD m	(1)	(2)	(2)	(2)	(4)	(7)	(7)	(6)
Corporate		(11)	(4)	(4)	(4)	(4)	(4)	(4)	(4)
Dep'cn & Amort'sn	AUD m	(26)	(29)	(31)	(31)	(31)	(31)	(31)	(8)
E B I T	AUD m	(7)	(6)	(3)	(1)	(0)	0	0	0
Tax Expense	AUD m	9	(5)	(13)	(12)	(11)	(3)	(1)	(3)
N P A T	AUD m	(12)	11	31	28	27	6	1	6
e p s.		(1.3c)	1.1 c	3.0 c	2.8 c	2.6 c	0.6 c	0.1 c	0.6 c
Project Cap.Ex	AUD m	63	12	0	0	0	0	0	0
Sus. Cap. Ex	AUD m	0	2	3	3	3	3	3	3
Net Cashflow	AUD m	(65)	1	28	55	55	65	43	33

Source : PhillipCapital

Our revised valuation is 18.5c, about 2.8x the current share price.

HGO is now generating net cash.

We retain a Strong Buy recommendation

HGO's net debt levels increased during the quarter. Most of the increase was due to payment of creditors.

We expect HGO to generate net cash from now on.

Our valuation is now 2.8x the current share price.

We retain a Strong Buy recommendation

PhillipCapital Australia

Hillgrove Resources Limited (HGO)

Year ended January	2012	2013	2014	2015	2016	2017	2018	
Section 1 - P&L								
Sales revenue	\$A m	12	115	138	178	180	191	163
Interest revenue	\$A m	3.1	0.8	0.0	0.6	2.5	3.9	4.0
Other revenue	\$A m	0.0	0.4	13.2	11.7	10.1	0.0	0.0
Total Revenue	\$A m	15	117	151	190	193	195	167

Cost of Goods Sold	\$A m	(8)	(85)	(93)	(105)	(113)	(117)	(116)
Corporate Costs	\$A m	(10.1)	(10.6)	(4.0)	(4.0)	(4.0)	(4.0)	(4.0)
Royalties	\$A m	(0.1)	(1.4)	(1.8)	(2.4)	(2.4)	(4.0)	(7.2)
Exploration Expense	\$A m	(2.4)	(7.3)	(1.0)	(1.0)	(1.0)	(1.0)	0.0
Other Operating Expenses	\$A m	(0.2)	(0.1)	0.0	0.0	0.0	0.0	0.0
Total Operating Expenses	\$A m	(21)	(104)	(100)	(112)	(121)	(126)	(128)

EBITDA	\$A m	(6.1)	12.4	51	78	72	69	39
Dep'n & Amort'n	\$A m	(5.2)	(26.5)	(29.2)	(30.6)	(30.6)	(30.6)	(30.6)
EBIT	\$A m	(11.3)	(14.1)	21.7	47.0	41.6	38.1	8.6
Interest Expense	\$A m	(1.2)	(6.5)	(5.5)	(2.5)	(1.2)	(0.2)	0.0
Other	\$A m							
Pre-Tax Profit	\$A m	(12.5)	(20.6)	16.2	44.5	40.4	37.9	8.6
Tax Expense	\$A m	3.9	8.8	(4.9)	(13.4)	(12.1)	(11.4)	(2.6)
NPAT	\$A m	(8.6)	(11.8)	11.4	31.2	28.3	26.5	6.0
Reported NPAT	\$A m	(8.5)	(11.8)	11.4	31.2	28.3	26.5	6.0

Section 2 - Key Data

Ordinary shares - year end	m	793.6	1,022.8	1,022.8	1,022.8	1,022.8	1,022.8	1,022.8
Fully diluted shares on issue	m	793.6	1,022.8	1,022.8	1,022.8	1,022.8	1,022.8	1,022.8
Weighted # shares	m	793.6	924.9	1,022.8	1,022.8	1,022.8	1,022.8	1,022.8
Earnings per Share		(1.0c)	(1.0c)	1.1 c	3.0 c	2.8 c	2.6 c	0.6 c
Dividends Per Share	0.0 c	0.0 c	0.0 c	0.0 c	0.0 c	0.0 c	0.0 c	0.0 c

Section 3 - Balance Sheet

Cash	\$A m	21	27	15	66	116	177	220
Receivables	\$A m	6.4	6.4	17.8	21.8	21.9	23.1	18.8
Other	\$A m	14.6	25.0	5.3	5.3	5.3	5.3	5.3
CURRENT ASSETS	\$A m	42	59	39	93	143	206	244

Receivables	\$A m	0.0	0.0	0.0	0.0	0.0	0.0	0.0
P, P & E	\$A m	229	233	207	180	152	125	98
Mining Properties / Exploration	\$A m	19.7	27.4	28.4	29.4	30.4	31.4	31.4
Other	\$A m	8.8	16.5	0.0	0.0	0.0	0.0	0.0
NON-CURRENT ASSETS	\$A m	258	277	236	209	183	156	129
TOTAL ASSETS	\$A m	300	336	274	302	326	362	373

Payables	\$A m	16.0	40.0	15.0	16.8	18.1	18.9	19.1
Debt	\$A m	14.4	29.5	12.4	12.0	3.4	0.0	0.0
Other	\$A m	1.6	6.2	6.2	6.2	6.2	6.2	6.2
CURRENT LIABILITIES	\$A m	32	76	34	35	28	25	25

Long Term Debt	\$A m	35.9	20.8	15.4	3.4	0.0	0.0	0.0
Deferred Tax Liability	\$A m	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	\$A m	12.4	9.0	0.0	0.0	0.0	0.0	0.0

Provisions	\$A m	9.3	9.8	0.0	0.0	0.0	0.0	0.0
NON-CURRENT LIABILITIES	\$A m	58	40	15	3	0	0	0
TOTAL LIABILITIES	\$A m	90	115	49	38	28	25	25
NET ASSETS	\$A m	210	221	225	263	299	337	348

Accumulated Profit (Loss)	\$A m	35	24	35	66	94	121	127
Reserves	\$A m	(3)	1	(6)	1	8	19	25
Contributed Equity	\$A m	178	197	197	197	197	197	197
Minority Interest	\$A m	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Total Equity	\$A m	210	221	225	263	299	337	348

Section 4 - Cashflow

Net Cashflow from operations	\$A m	(69.4)	(2.9)	21.6	51.3	51.2	61.3	39.2
Hedging	\$A m	0.0	4.8	13.2	11.7	10.1	0.0	0.0
Interest Paid	\$A m	(1.9)	5.7	5.5	1.9	(1.3)	(3.7)	(4.0)
Taxes Paid	\$A m	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in Working Capital	\$A m	(2.8)	24.0	(13.6)	5.8	1.3	2.1	(4.1)
Other	\$A m							
OPERATING CASHFLOW	\$A m	(74.1)	31.7	26.7	70.7	61.4	59.6	31.1

Exploration Expenditures	\$A m	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	0.0
Maintenance Capex	\$A m	0.0	(2.4)	(3.2)	(3.2)	(3.2)	(3.2)	(3.2)
Expansion Capex	\$A m	(63.3)	(12.3)	0.0	0.0	0.0	0.0	0.0
PPE Acquisitions (Total Capex)	\$A m	(64.3)	(15.7)	(4.2)	(4.2)	(4.2)	(4.2)	(3.2)
PPE Divestments	\$A m	0.0	0.0	0.0	0.0	0.0	0.0	0.0
INVESTING CASHFLOW	\$A m	(64.3)	(15.7)	(4.2)	(4.2)	(4.2)	(4.2)	(3.2)

Change in Equity	\$A m	0.0	17.7	0.0	0.0	0.0	0.0	0.0
Dividends Paid	\$A m	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in Debt	\$A m	50.3	0.0	(22.4)	(12.4)	(12.0)	(3.4)	0.0
Other	\$A m							
FINANCING CASHFLOW	\$A m	50.3	17.7	(22.4)	(12.4)	(12.0)	(3.4)	0.0

Free Cashflow	\$A m	(138.4)	16.0	22.5	66.5	57.2	55.4	27.9
Net Cashflow	\$A m	(88.1)	33.7	0.1	54.1	45.1	52.0	27.9

Commodity price assumptions

Year ended January	2013	2014	2015	2016	2017	2018
AUD-USD	1.037	1.032	0.988	0.913	0.863	0.830
Copper	US\$ /t	7,951	7,353	7,165	6,614	6,614
Gold	US\$ /oz	1,669	1,414	1,350	1,300	1,300
Silver	US\$ /oz	31.2	24.4	22.9	22.1	22.1

Mine Production

Year ended January	2013	2014	2015	2016	2017	2018
Ore processed '000 t	2,303	2,808	2,940	2,940	2,940	2,940
Copper grade	0.67 %	0.73 %	0.85 %	0.85 %	0.85 %	0.70 %
copper recovery	90 %	91 %	92 %	92 %	92 %	88 %
Gold grade	0.16g/t	0.12g/t	0.16g/t	0.16g/t	0.16g/t	0.15g/t
gold recovery	55 %	58 %	60 %	60 %	60 %	60 %
Silver grade	3.0g/t	2.7g/t	2.5g/t	2.5g/t	2.5g/t	1.7g/t
silver recovery	55 %	57 %	67 %	67 %	67 %	67 %

Attributable production

Copper '000 t	13,743	18,724	23,012	23,012	23,012	18,111
Gold oz	6,569	6,288	9,321	9,321	9,321	8,508
Silver '000 oz	122	137	157	157	157	110

Resources and Resources

Resources, March 2012	Copper	Gold	Silver				
In Situ							
Measured	4.2	0.85 %	36 kt	0.13g/t	18 koz	2.4g/t	319 koz
Indicated	20.5	0.87 %	178 kt	0.16g/t	105 koz	2.3g/t	1,542 koz
Inferred	6.5	0.66 %	43 kt	0.15g/t	31 koz	1.7g/t	362 koz
Long Term stockpiles							
Measured	1.1	0.46 %	5 kt		0 koz		0 koz
Indicated	0.5	0.18 %	1 kt		0 koz		0 koz
TOTAL	32.8	0.80 %	263 kt	0.15g/t	154 koz	2.2g/t	2,223 koz

Reserves, April 2010

Reserves, April 2010	Copper	Gold	Silver				
Proved	2.3	0.87 %	20 kt	0.13g/t	10 koz	3.2g/t	237 koz
Probable	12.5	0.84 %	105 kt	0.18g/t	72 koz	3.1g/t	1,246 koz
TOTAL	14.8	0.84 %	125 kt	0.17g/t	82 koz	3.1g/t	1,483 koz

Asset based Valuation

discount rate = 12.0 %	risking	100%	Product	per share	41426.9454
Kanmantoo Reserves	100 %	\$ 138m	\$ 138m	13.3 c	15.3 c
fanking credits	60 %	\$ 0m	\$ 0m	0.0 c	0.0 c
Kanmantoo M & I Resources	85 %	\$ 31m	\$ 27m	2.6 c	3.0 c
fanking credits	51 %	\$ 0m	\$ 0m	0.0 c	0.0 c
Kanmantoo Stockpiles + Inferred	70 %	\$ 4m	\$ 3m	0.3 c	0.3 c
fanking credits	42 %	\$ 0m	\$ 0m	0.0 c	0.0 c
Corporate	100 %	(\$27m)	(\$27m)	(2.6c)	(2.5c)
Exploration - Sumba	100 %	(\$3m)	\$ 0m	0.0 c	0.0 c
Exploration - Bird's Head	100 %	(\$3m)	\$ 0m	0.0 c	0.0 c
Exploration - other	100 %	\$ 0m	\$ 0m	0.0 c	0.0 c
Hedging	100 %	\$ 30m	\$ 30m	2.9 c	2.7 c
Cash / debt	100 %	(\$30m)	(\$30m)	(2.9c)	(2.0c)
Equity raising	100 %	\$ 15m	\$ 15m	1.4 c	(0.5c)
Options	100 %	\$ 0m	\$ 0m	0.0 c	2.1 c
TOTAL		\$ 155m	\$ 155m	15.0 c	18.5 c
Shares on issue		793.6m	FPO shares	88.5m	options
		228.9m	Issued	10.7m	exercised

Assumed Cash Costs, US c/lb

Year ended January	2012	2013	2014	2015	2016	2017
Waste	107	109	82	76	81	80
Mining	33	45	30	23	22	21
Processing	64	73	62	52	48	45
Site Admin	18	23	17	15	13	13
Transport	15	15	16	16	16	15
TC/RC	32	34	32	34		

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