

BUY

HOLD

SELL

ACTION & RECOMMENDATION

HGO's interim financials were better than expected, but this was due mainly to favourable accounting treatment of the settlement with Exact. Importantly HGO advised that the transition to owner operator is ahead of schedule. FY14 production guidance maintained (16.5kt-18kt) and FY15 production to be in excess of 20kt of copper (WHTMe: 20.9kt). With improved production expected and a capital intensive period now behind them, we expect HGO to start to accumulate cash. Despite HGO's improving outlook, we maintain our SPECULATIVE BUY recommendation until consistent production performance is achieved. Our 12-month price target is \$0.16.

FY15 Production Guidance +20kt of Copper**What's Changed**

- HGO's FY14 interim EBITDA result of \$22m was 40% higher than the previous half. It was also higher than our estimate of \$16m. This was due mainly to the accounting treatment of the settlement agreed with the mining services contractor (Exact).
- We calculate the settlement with the mining services contractor to be ~\$17m to HGO's credit. This is reflected in the lower trade payables balance of \$25m (FY13: \$40m). Included in the outstanding trade payable figure is a total of \$9.9m that HGO will pay to Exact.
- At 31 July 2013, HGO's cash balance was \$17m and outstanding debt was \$48m.
- HGO has now completed a capital intensive period. With improved production expected in the 2H-FY14, we expect cash to start to accumulate. We forecast cash balance at end of FY14 of \$27m.
- HGO advised that it had completed the transition to owner operator ahead of the original 6 week schedule. Mining at Kanmantoo is operating at steady state with targeted processing throughput achieved. Ore exposure in the pit is increasing with a corresponding increase in process grade expected for the remainder of this quarter.
- HGO production guidance for FY15 is in excess of 20kt of copper in concentrate (WHTMe: 20.9kt).** FY14 production guidance is 16.5kt – 18kt copper in concentrate (WHTMe: 17.2kt).

Risks & Catalysts

- Risk: Production and cost performance in FY14.
- Catalyst: Evidence of improved operating and cost performance.

Year-end January (AUD)	FY12A	FY13A	FY14E	FY15E	FY16E
Revenue (\$m)	11.6	115.4	124.7	155.9	150.1
EBITDA Margin (%)	-76	15	39	38	35
NPAT Norm (\$m)	-8.7	-10.6	8.8	14.4	14.4
Consensus NPAT (\$m)			6.9	6.9	9.8
EPS Norm (cps)	-1.1	-1.0	0.9	1.3	1.3
EPS Growth (%)	35	5	183	55	0
P/E Norm (x)	-7.1	-7.4	9.0	5.8	5.8
EV / EBITDA (x)	-12.6	6.6	2.3	1.9	2.1
CFM (x)	-3.6	2.8	3.2	1.6	1.7
DPS (cps)	0.0	0.0	0.0	0.0	0.0
Franking (%)	0	0	0	0	0

Mkt Cap: \$81m Enterprise Value: \$112m Shares: 1,024m Sold Short: 0.2%

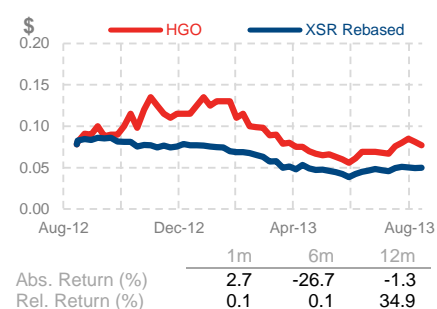
12m Target Price (AUD)	\$0.16
Share Price @ 13-Sep-13 (AUD)	\$0.08
Fcst 12m Capital Return	107.8%
Fcst 12m Dividend Yield	0.0%
12m Total S'holder Return	107.8%

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12m Share Price Performance**WHTM Return Re-investment Matrix**

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

WHTM Risk Assessment

Share Price Risk	Re-Investment			
	Low	Med	High	Spec
Share Price Risk				
Business Risk				

Key Changes	21-Aug	After	Var %
Revenue FY14	128	125	-2.2%
(\$m) FY15	156	156	0.0%
FY16	150	150	0.0%
EBITDA: FY14	42.8	48.2	12.7%
(\$m) FY15	57.6	58.7	2.0%
FY16	52.1	53.2	2.1%
EPS: FY14	0.8	0.9	6.5%
Norm FY15	1.3	1.3	0.0%
(cps) FY16	1.3	1.3	1.0%
Price Target:	0.17	0.16	-5.9%
Rec:	BUY	BUY	

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	229.48	0.21
Exploration	10.00	0.01
Hedge Book	2.83	0.00
Other Equity	0.17	0.00
Corporate	-33.42	-0.03
Net (Debt)/Cash	-31.03	-0.03
TOTAL	178.03	0.16

12 Month Price Target **0.16**

INTERIMS (\$m)

Half Yr (AUD)	Jul 12	Jan 13	Jul 13	Jan 14
	1H A	2H A	1H E	2H E
Sales	49.7	65.7	49.7	75.0
EBITDA	1.5	15.6	21.7	26.5
EBIT	-14.8	5.3	9.3	9.4
Net Profit	-12.5	1.8	4.0	4.7
Norm. EPS	-1.4	0.2	0.4	0.5
EBIT/Sales	-29.7	8.1	18.7	12.5
Dividend (c)	0.0	0.0	0.0	0.0
Franking (%)	0.0	0.0	0.0	0.0

FINANCIAL STABILITY

Year-end January	FY13A	FY14E	FY15E
Net Debt	22.9	13.8	-36.2
Net Debt / Equity (%)	10.4	6.0	<0
Net Debt / EV (%)	20.4	12.4	<0
Current Ratio (x)	4.4	7.6	7.1
Interest Cover (x)	<0	3.3	7.9
Adj. Cash Int. Cover (x)	5.2	6.3	19.7
Debt / CashFlow (x)	1.8	2.0	0.8
Net Debt (cash) / share	0.0	0.0	<0
NTA / share (\$)	0.2	0.2	0.2
Book Value / share (\$)	0.2	0.2	0.2
Payout Ratio (%)	0	0	0
Adj. Payout Ratio (%)	0	0	0

EPS RECONCILIATION (\$m)

	FY13A		FY14E	
	Rep.	Norm.	Rep.	Norm.
Sales Revenue	115	115	125	125
EBIT	-11.0	-9.4	18.7	18.7
Net Profit	-11.8	-10.6	8.8	8.8
Notional Earn.	0.0	0.0	0.0	0.0
Prof./Conv. Div.	0.0	0.0	0.0	0.0
Profit for EPS	-11.8	-10.6	8.8	8.8
Diluted Shrs(m)	1,023	1,023	1,024	1,024
Diluted EPS (c)	-1.2	-1.0	0.9	0.9

RETURNS

	FY13A	FY14E	FY15E	FY16E
ROE (%)	-4.9	3.9	6.0	5.5
ROIC (%)	-2.7	5.3	7.1	6.8
Incremental ROE	-11.1	183.0	35.4	-0.1
Incremental ROIC	3.7	871.5	-25.1	9.3

KEY ASSUMPTIONS

Year-end January (AUD)	FY12A	FY13A	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E
Copper Price (US\$/lb)	4.00	3.60	3.39	3.48	3.40	3.30	3.20	3.05
A\$/US\$	1.03	1.04	0.97	0.96	0.93	0.89	0.84	0.81
Copper Production (kt)	1.3	13.7	17.2	20.9	19.8	19.6	19.6	18.3
Gold Produced (koz)	0.4	6.5	6.1	5.6	5.6	5.6	5.6	5.6
EBITDA Margin (%)	-76.2	14.8	38.7	37.7	35.4	33.6	29.7	24.5
EBIT Margin (%)	-143.4	-8.9	15.0	15.1	13.2	19.8	16.2	11.0
ROA (%)	-2.9	-3.5	2.8	4.5	4.6	6.6	5.4	3.7
Earnings Sensitivity (% Chg)								
+/- 10% A\$/US\$	0.0	0.0	23.5	31.6	45.6	55.5	69.8	100.9
+/- 10% Copper Price	0.0	0.0	20.2	23.4	35.7	48.0	59.5	85.4

PROFIT & LOSS (\$m)

Year-end January (AUD)	FY12A	FY13A	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E
Sales Revenue	11.6	115.4	124.7	155.9	150.1	149.5	152.2	142.0
EBITDA	-8.9	17.1	48.2	58.7	53.2	50.2	45.2	34.8
Depn & Amort	5.2	26.5	29.6	35.2	33.4	20.6	20.6	19.2
EBIT	-14.0	-9.4	18.7	23.5	19.7	29.6	24.6	15.6
Net Interest Expense	-1.6	5.7	5.6	3.0	-0.8	-2.0	-3.1	-4.1
Tax	-3.9	-4.5	4.3	6.2	6.2	9.5	8.3	5.9
Minorities / pref divs	0.2	0.0	0.0	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	-8.7	-10.6	8.8	14.4	14.4	22.1	19.4	13.8
Abn's / Ext's / Signif.	0.0	-1.2	0.0	0.0	0.0	0.0	0.0	0.0
Reported Net Profit	-8.7	-11.8	8.8	14.4	14.4	22.1	19.4	13.8

CASHFLOW (\$m)

Year-end January (AUD)	FY12A	FY13A	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E
EBITDA	-8.9	17.1	48.2	58.7	53.2	50.2	45.2	34.8
Interest & Tax	2.4	-4.0	-6.7	-10.1	-7.3	-10.3	-9.1	-6.7
Working Cap / Other	-15.8	15.3	-16.2	0.8	2.1	3.2	4.0	5.4
Operating Cash Flow	-22.2	28.4	25.3	49.4	48.0	43.1	40.2	33.5
Maintenance Capex	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Free Cash Flow	-22.2	28.4	25.3	49.4	48.0	43.1	40.2	33.5
Dividends Paid	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Development Capex	-132.1	-46.7	-16.1	-6.1	-5.5	-7.4	-4.4	-6.2
Invest. / Disposals	0.2	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Other Inv. Flows	5.9	1.1	0.0	0.0	0.0	0.0	0.0	0.0
Cash Flow Pre Financing	-148.2	-17.3	9.3	43.2	42.5	35.7	35.7	27.3
Funded by Equity	0.0	17.8	0.0	6.8	0.0	0.0	0.0	0.0
Funded by Debt	51.1	6.2	-10.0	-14.9	-20.0	0.0	0.0	0.0
Funded by Cash	97.1	-6.7	0.7	-35.1	-22.5	-35.7	-35.7	-27.3

BALANCE SHEET SUMMARY (\$m)

Year-end January (AUD)	FY12A	FY13A	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E
Cash	20.7	27.4	26.7	61.8	84.3	120.0	155.8	183.0
Current Receivables	6.4	6.4	4.2	4.3	4.2	4.2	4.3	3.9
Current Inventories	9.3	19.7	19.6	19.4	19.6	20.1	20.7	20.8
Net PPE	229.4	233.2	209.8	180.7	152.2	138.6	121.9	108.4
Investments	4.2	5.3	7.9	7.9	7.9	7.9	7.9	7.9
Intangibles / Capitalised	19.8	28.1	31.5	31.5				
Other	10.0	15.9	12.9	12.9	44.9	45.4	45.9	46.4
Total Assets	299.8	336.0	312.6	318.5	313.3	336.2	356.4	370.4
Current Payables	17.2	40.0	19.6	19.4	19.6	20.1	20.7	20.8
Total Debt	51.2	50.3	40.6	25.7	5.7	5.7	5.7	5.7
Other Liabilities	21.3	25.1	21.2	21.1	21.2	21.5	21.8	21.9
Total Liabilities	89.7	115.4	81.3	66.2	46.5	47.3	48.1	48.4
Minorities / Convertibles	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Shareholder Equity	210.1	220.6	231.3	252.4	266.8	288.9	308.3	322.1
Total Funds Employed	261.3	270.9	271.8	278.1	272.5	294.6	314.0	327.7



FY14 INTERIM FINANCIALS SUMMARY

Yr End Jan (A\$m)	1H-FY13 Act	2H-FY13 Act	FY13 Act	1H-FY14 Act	% Diff pcp	% Diff prev. half	1H-FY14 WHTMe	% Diff
Copper Prod (kt)	6.15	7.59	13.74	7.04	14%	-7%	7.04	0%
Copper Price (US\$/lb)	3.67	3.54	3.60	3.42	-7%	-3%	3.42	0%
A\$/US\$	1.03	1.04	1.04	1.02	-2%	-2%	1.02	0%
Revenue (incl. TC/RC)	50.3	65.5	115.8	54.2	8%	-17%	56.8	5%
Cost of Sales	48.8	50.0	98.7	32.5	-33%	-35%	41.1	27%
EBITDA	1.5	15.6	17.1	21.7	1348%	40%	15.7	-28%
EBITDA Margin	3%	24%	15%	40%			28%	-31%
EBIT	-14.8	5.3	-9.4	9.3		74%	3.9	-58%
NPAT	-14.7	2.9	-11.8	4.0		40%	1.9	-53%
Op. Cash Flow	1.0	27.4	28.4	6.1	496%	-78%	1.4	-77%
Investing Cash Flow	-14.5	-31.2	-45.7	-14.0	-3%	-55%	-5.6	-60%
Financing Cash Flow	19.7	4.3	24.0	-2.4	-112%	-157%	-8.9	265%
Cash Balance	26.9	27.4	27.4	17.1	-37%	-38%	14.4	-16%

Source: WHTM Research, HGO

Income Statement

- Interim revenue after TC/RC's of ~\$5m was \$54.2m. We calculate that this revenue number included a hedge profit of ~\$4m.
- Cost of sales was \$33m, which included direct cost of production of \$24m, implying a cost of production of \$1.56/lb. This was lower than our estimate of \$37m based on a unit cost of \$2.38/lb (excl. precious metals credit and TC/RC's). The difference is due to the treatment of the settlement agreement with Exact. Following the agreement, which we calculated was a credit to HGO of \$17m, the company restated their C1 costs for the previous 12 months ie. US\$2.41/lb. However, for accounting purposes this amount was written back over a shorter 6 month period, hence the lower production cost reported.
- EBITDA for the period was \$22m, a 40% increase on the previous half. This was larger than our estimate of \$16m mainly for the reasons explained above.
- Reported NPAT was \$4m (WHTMe: \$2m).
- As expected no interim dividend was paid.

Balance Sheet

- As at 31 July 2013 HGO's cash balance was \$17m (FY13: \$27m) and interest bearing debt was \$48m (FY13: \$50m).
- HGO's gearing level is 12% (net debt/(net debt + equity)) (FY13: 9%)
- Working capital at the end of the period was \$19m (FY13: \$14m). The increase is due to the reduction in trade payables resulting from the settlement with the mining services contractor.
- Trade payables at the end of the period was \$25m (FY13: \$40m). The difference is due mainly to the settlement with the mining services contractor that we calculate was a credit to HGO of ~\$17m. Included in the \$25m trade payable is an amount of \$9.9m still owed to the mining contractor. HGO will make a payment of \$5m on September 16 with the remaining amount to be paid over time.
- Net assets and total equity increased by \$6m during the half to \$227m



Cash Flow

- Free cash flow after capital expenditure for the interim period was negative \$8m (FY13: -\$18m).
- Capital expenditure in the period included \$3m for exploration activity in Indonesia, \$3.3m to install the new crusher and \$8.1m for other including capitalisation of waste material for the Kanmantoo tailings dam.
- We expect HGO has now passed a capital intensive period and we expect cash to start accumulating in the 2H-FY14.
- Financing cash outflow was \$2m for the period, due mainly to a repayment of \$2m towards the outstanding Gold Loan.

SUMMARY CHANGES TO HGO MODEL

YE 31 Jan A\$m	FY14e			FY15e			FY16e		
	New	Old	% Change	New	Old	% Change	New	Old	% Change
Pricing									
Copper US\$/lb	3.39	3.39	0.0%	3.48	3.48	0.0%	3.40	3.40	0.0%
Gold US\$/oz	1387	1387	0.0%	1338	1338	0.0%	1338	1338	0.0%
A\$/US\$	0.97	0.97	0.0%	0.96	0.96	0.0%	0.93	0.93	0.0%
Production									
Copper kt	17.2	17.2	0.0%	20.9	20.9	0.0%	19.8	19.8	0.0%
Gold koz	6.3	6.3	0.0%	5.6	5.6	0.0%	5.6	5.6	0.0%
Financials									
Revenue A\$m	129	132	-1.9%	155	155	0.0%	151	151	0.0%
EB ITDA A\$m	48	43	12.7%	59	58	2.0%	53	52	2.1%
D&A A\$m	30	29	2.0%	35	35	0.0%	33	33	0.0%
EBIT A\$m	19	14	34.9%	24	22	5.0%	20	19	6.0%
NPAT A\$m	9	8	6.6%	14	14	0.1%	14	14	1.1%
EPS A\$/sh	0.01	0.01	6.5%	0.01	0.01	0.0%	0.01	0.01	1.0%

Source: WHTM Research

- We have updated our model to include the interim financials.
- We have not changed production or commodity pricing assumptions.
- The lower cost of production in FY14, and therefore the higher EBITDA, is due mainly to the write back of the settlement with the mining services contractor as explained above.
- We have slightly lowered corporate costs in FY15 and FY16.



RETURN RE-INVESTMENT MATRIX

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

Currently progressing a 20 ktpa copper mine in South Australia. Project largely de-risked 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 55 km from Adelaide. Ramp-up of the open pit mine and processing circuit is progressing to an initial throughput of 2.8 Mtpa producing ~80 kt of concentrate per annum (~20 ktpa of copper metal).

INVESTMENT THESIS

HGO 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, operational improvements are achieved and we value the company at \$0.20/sh. The current share price approximately reflects the replacement value of the Kanmantoo mine. While we highlight the near-term operating risks, we do see value should these issues be resolved. We rate it 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: 1,022.8m
- Options: 50m
- Cash: \$17m (31-Jul-13)
- Debt: \$48m (31-Jul-13)

KEY ASSETS

Kanmantoo copper mine (South Australia): an open-cut mine with throughput of 2.8 Mtpa, producing approximately 80,000 tonnes of concentrate, containing about 20,000 tonnes of copper metal and 10,000 ounces of gold with exploration potential for further copper.

RESERVES & RESOURCES

- Kanmantoo:
- In-situ Resource: 31.2 Mt @ 0.82% Copper
- Long-term stockpile Resource: 1.6 Mt @ 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 April 2013
- Increased Resource at Kanmantoo to increase mine life towards 10 years
- Exploration success in Indonesia provides optionality for HGO

MANAGEMENT

- Mr Greg Hall (Managing Director)
- Russell Middleton (Chief Financial Officer)
- Shanthi Smith (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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