under the radar report

SMALL CAPS

Bi-winning!

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This week's research stock tip is Hillgrove Resources – a small miner that is transforming itself, and its shares are reacting positively.

Making money on stocks is not always about investing in the best and biggest operators around. The biggest money is made when market expectations are changed. We believe this is the case with the mining producer Hillgrove Resources.

We have been achieving good success with our Top Buy recommendations. Three have left the list because of good performance since we started doing them less than two months ago.

This week we add two more hot stocks to the list. You should also check out our "Top Stocks to Buy" on the website. It gives you the stock's investment metrics, as well as "About the company", "Why we like it" and "What's new". You also get pointed to our most recent research on the company.

There are too many passwords in the world, and to make life simpler, we got rid of ours. So please LOGIN online using just your email.

We have made it easier online to search for our company research. Also, download our RESEARCH SUMMARY which is a full listing of all our stocks we have covered, includes the current stock price, our latest comment and recommendation. It's updated weekly.

More reasons to keep flying Under the Radar.

Richard Hemming
Editor

the issue

SMALL TALK

"It's been a year of hard work to make it interesting. We have an executive team of 3 and are a small company with a strong future."

GREG HALL
HILLGROVE RESOURCES
CEO

99% of all financial news relates to the 40 to 50 biggest companies. So what about the rest? They're Under the Radar.

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HILLGROVE RESOURCES

This South Australian copper/gold producer will reap the benefits from a turnaround strategy that is starting to produce dividends.

PATIENCE BEING REWARDED

It is fair to say that investors in Hillgrove Resources have been a patient bunch – it's shares are trading just above their low but have been as high as 36 cents in the past three years, and as high as 52 cents if you go back further.

Then again, so have most investors who have held on to small resource companies. The company's primary asset is the Kanmantoo copper mine, 55 kilometres east of Adelaide, although it also owns gold and copper exploration properties in Indonesia.

But now there are signs of investor interest in Hillgrove because of one factor – cash flow. The economics are straight forward. Hillgrove is ramping up to 20,000 tonnes of copper by fiscal 2014, which based on its current reserves and resources, should be maintained for seven years. It has already spent $156m on its production plant to produce copper/gold concentrate, which was budgeted to cost $130m and it has been rapidly reducing its debt, which now stands at $44.5m.

ADVANTAGEOUS HEDGING

Because it is small and has funding from the bank, it needed to hedge forward the price it receives for copper. This is proving advantageous as copper's spot price is down from US$3.75 a pound early this year to US$3.17. Its copper is hedged at about US$3.60 and its cash cost should come in at about US$2.50 (which is at the high end, according to the company). Converting the tonnages into pounds gives you 44.1m pounds, which means you're looking at US$44m in operating revenues.

Hillgrove is easily repaying its debt. Beyond this, is has operating costs including royalties, capital expenditure, labour costs and interest expenses, but these shouldn't come out to much more than $20m a year. This leaves about $25m a year for shareholders over seven years, which equates to 2.1 cents a share.

BIG YIELD POTENTIAL FROM A MINER!

There will be exploration costs, which ensure the future of the company. So the odds are Hillgrove pays a third in dividends, which delivers a yield of about 8 per cent.

This company might not be big – the 20,000 tonnes of copper a year it intends to produce by about fiscal 2015 is a long way from the 100,000 tonnes plus Oz Minerals should do. But the key is that you aren't paying much for this, with a market cap of just over $100m compared to Oz Mineral's of over $1bn. This is also reflected in its dividend potential.

There is significant operational risk, but many big investors have been buying Hillgrove in the hope that it continues to reduce its costs and ramp up production. The Gary Weiss vehicle Ariadne controls 9.2 per cent and is agitating for a board seat. Other major shareholders include Perennial, Investors Mutual, Colonial First State and Renaissance.

OPERATIONAL RISK

The operational risk is a key reason why this company has had problems ramping up production, and reducing its cash costs. In about six weeks Hillgrove's mine manager Steven McClare (who previously managed Newcrest's Cadia Valley operations) constructed a team which took over the mine's running from contractors.

The team has been processing from low-grade stock piles since the start of August and then re-commenced working on digging beneath the 40 years old Kanmantoo mine pit. The grades are improving, and so are the mine economics.

GOOD TIMES AHEAD

This improvement should continue because Hillgrove has established its shift crews for the mine earlier this month and has ordered larger excavators to further increase mining tonnes early next year. The small executive team of three have institutions with big stakes breathing down their necks. In our opinion the big decisions have been made and the company's execution is proving to be up to the task. What happens with the copper price and exchange rate is anyone's guess. ■

SHARE PRICE **$0.09**

MARKET CAP **$108M**

ASX CODE **HGO**

RADAR RATING **SPEC BUY**

DIVIDEND YIELD **0%**

BULL POINTS

- CASH FLOW POSITIVE
- REDUCING MINE COSTS
- POTENTIAL TO INCREASE MINE LIFE

BEAR POINTS

- COPPER PRICE RISK
- PRODUCTION RISK

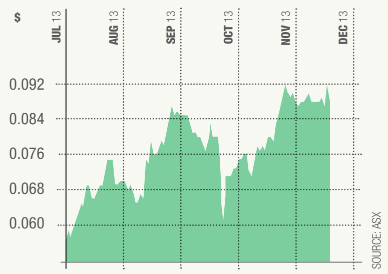
WHY WE LIKE IT

Institutions have been buying into this South Australian copper/gold miner, which is transforming its earnings through a combination of reducing its costs and ramping up production. Its Kanmantoo mine is on track to reach its target of 20,000 tonnes of copper a year in 2014, which is 60% to 70% hedged. We estimate this means about $44m of operating cash flow from 2014, which should translate to about $8.5m of cash for shareholders – implying a yield of over 8%.

WHAT'S NEW?

Hillgrove raised $10.8m in stock at 7c a share in September, $9m of which went to pay out contractors. The company has now replaced these contractors with its own employees. It has been a big learning curve for Hillgrove, whose Kanmantoo copper mine has 157,000 tonnes of copper ore reserves and 128,000 ounces of gold. Its quarterly report, out on Tuesday, indicated production is on a run rate of more than 16,500 tonnes of copper per annum and costs are expected to come down.

HGO - Share Price



RESEARCH TIP UPDATES

We've got some good opportunities to buy some stocks irrationally sold off.

LOGICAMMS (LCM)
MINING SERVICES

Logicamms is well regarded for its control systems engineering, which increases productivity for companies. It also trains people up to use its systems and does more conventional work, like front end engineering design.

The stock has been sold off aggressively since reaching $2.24 on 21 October. It reached this peak after a sharp spike and more recently shareholders have reacted to news that its first half performance might not be as good as expected.

This year broker CCZ expects only 30 per cent of its full year earnings to come in the first half. This half involves heavy investing to cater for the contract pipeline that starts hitting the ground in the second half.

The conventional mining segment is down about 15 per cent on last year. The big business is coming from the tens of billions being spent on liquefied natural gas (LNG). Logicamms is benefiting from capitalising on its relationships with the oil and gas majors and being moved up from a tier 2 or 3 contractor, into the first position. ■

RADAR TAKEOUT: *The company is trading on a PE for fiscal 2015 of about 6.5 times and on a yield of 8 per cent. Over time, this group can justify a PE of more than 10 times. Buy.*

TIP DATE 1: **28 JUNE 12**

TIP PRICE 1: **$1.07**

TIP DATE 2: **11 JULY 13**

TIP PRICE 2: **$1.41**

CURRENT PRICE **$1.52**

RADAR RATING **BUY**

MARKET CAP **$116M**

MAYNE PHARMA (MYX)
SPECIALITY PHARMACEUTICAL

As we have said before, Mayne is a particularly complicated story but one which has so far returned subscribers over 70 per cent this year. We won't say we understand it completely, but the basis of our positive rating was its US acquisition, which keeps performing better than expectations. Last September we said: "Let's hope it continues."

The thing is, it has. It climbed up to the extreme altitudes of 84 cents late last month before coming back quickly to current levels. ■

RADAR TAKEOUT: *We think that a trader somewhere had a change of heart because it didn't make it into an index, but the fact is that it has presented us with what we consider a buying opportunity, and we are upgrading our rating from Hold to Spec Buy. The company is trading on a PE of about 17 times and we think that it is a good company but its high share price is the reason for the "speculative" adverb.*

TIP DATE **24 JAN 2013**

TIP PRICE **$0.33**

CURRENT PRICE **$0.69**

RADAR RATING **SPEC BUY**

MARKET CAP **$386M**

STRIKE ENERGY (STX)
OIL AND GAS PRODUCER

TIP DATE **18 OCTOBER 12**

TIP PRICE **$0.23**

CURRENT PRICE **9.4C**

RADAR RATING **HOLD**

MARKET CAP **$68M**

We rated Strike Energy "Avoid" in the middle of the year because the company desperately needs money.

Luckily for it, it is managing to do some deals, which have kept it afloat. It managed to get cash in from selling asset in the US, and it got funding from Orica, which will pay for some gas even though Strike hasn't found it yet – unusual but this has happened before. Orica could pay up to $52m as Strike achieves appraisal and development milestones. It is not a bad deal, providing them with a source of funding, as long as it gets results.

The Cooper Basin is still bubbling away. STX has started drilling in the Cooper Basin for coal seam gas. The current studies won't prove it's profitability. It needs more work to get to that point.

The stock is on its lows and is not flavour of the month but the company is doing an admirable job keeping the dream alive. ■

RADAR RATING: *The cash in the bank is still tight: it had $9m at September quarter, and it is planning to spend $7m in the December quarter. It could sell its US assets but we don't think it wants to; you need to be patient if you want to keep holding on.*

UNDER THE RADAR DIVERSIFIED SHARE PORTFOLIO

The Idle Speculator delivers a performance review reflects on positive performances by eServGlobal and Melbourne IT and the destruction of value at Elders.

ASX CODE	COMPANY NAME	LAST TRANSACTON DATE	NUMBER HELD	TOTAL COST ($)	PRICE @ 11/06/13 ($)	CURRENT VALUE ($)	SHARES (%)
AQZ	Alliance Aviation Services Limited	09-Apr-13	750	-$1,535	$1.680	$1,260	1.1%
ASB	Austal Limited	17/12/2012	1900	-$1,878	$0.710	$1,349	1.1%
CLV	Clover Corporation Limited	19/06/2012	4000	-$1,548	$0.495	$1,980	1.7%
EGN	Engenco Limited	18/01/2013	12500	-$3,608	$0.165	$2,063	1.8%
ELD	Elders Limited	09-Apr-13	20000	-$2,405	$0.110	$2,200	1.9%
ESV	Eservglobal Limited	07-May-13	4000	-$1,468	$0.700	$2,800	2.4%
MAQ	Macquarie Telecom Group Limited	15/10/2013	200	-$1,648	$8.260	$1,652	1.4%
MLB	Melbourne IT Limited	06-Feb-12	1500	-$2,245	$1.695	$2,543	2.2%
NGF	Norton Gold Fields Limited	14/02/2012	5000	-$1,003	$0.125	$625	0.5%
PRT	Prime Media Group Limited	14/02/2012	3000	-$2,083	$1.020	$3,060	2.6%
RED	Red 5 Limited	20/12/2011	400	-$722	$0.070	$28	0.0%
ARG	Argo Investments Limited	19/06/2012	2000	-$10,531	$7.150	$14,300	12.1%
WHF	Whitefield Limited	06-Nov-12	1500	-$4,573	$4.130	$6,195	5.3%
STW	SPDR S&P/ASX 200 Fund	22/05/2012	500	-$19,794	$51.030	$25,515	21.7%
Shares	56%					$65,569	
Cash	44%					$52,253	
Portfolio	100%			GRAND TOTAL		$117,822	

Please note: The share portion of the portfolio is made up of 70% Market linked shares, and 30% Small cap shares.

PERFORMANCE REVIEW

It is almost exactly two years since we launched Under the Radar Report's diversified share portfolio, and even though we are delivering a positive return, we know we could be doing better. This is particularly so when we look at stocks like Warrnambool Cheese (WCB), BigAir (BGL), Tassal (TGR) and Freedom Foods (FNP) that have performed so well since your editor brought them to your attention, and which as a portfolio managers, we were not smart enough to pick up at the same time.

At the transaction level, we have achieved annualised returns 16.5 per cent, with dividends, but which have suffered a -6.6 per cent annualised drag from the cash held. Our small caps performed adequately until April this year, while the whole portfolio has lagged since the middle of the year after fear of the US Federal Reserve reducing its monetary stimulus or Quantitative Easing cased investors to sell. Such “Taperphobia” took hold briefly.

We have received some feedback that our current cautious policy of remaining only 50 per cent invested represents a major bet against the markets, and that will be a material impediment to the progress of the portfolio and its performance over the short and medium term.

As private investors we are not interested in relative performance, you can’t eat relative performance. Over time, we are looking to make materially more than might be achieved from alternate asset classes, while limiting the risk of losses as best we can while remaining invested.

The 50 per cent that is invested in market-linked instruments and individual stocks is vulnerable to any wider equity market correction. And although we have no insight into the timing of such a change in sentiment, we fear a change may be ahead.

We manage approximately six portfolios for ourselves and family, including the portfolio for Under the Radar subscribers. The relatively high level of cash in the Under the Radar Report portfolio is not unusual in the selection of portfolios we manage. In some cases, the cash may be there for a reason, that is, to meet the costs of everyday living.

If the balance of probability favours an upward move in markets and if the cash was not required for any specific purpose, we can easily re-invest it into stocks. The fact that we are choosing not to re-invest, in large part, is both a reflection and a guide to the level of general overvaluation that we see in equity markets in the UK and Australia.

Another indicator that suggests equity markets are potentially overvalued is that the raising of this cash in the majority of our portfolios has not led to any noticeable underperformance. Hence, the stocks that we are invested in are outperforming the market and ensuring that the portfolio as a whole does not lag the overall market.

Unfortunately, in the main, Under the Radar's portfolio has not benefited from stellar stock picking, and is still suffering the penalties of early investment in turnaround stories which have further to run than we had imagined. These have offset the best performance from the growth stocks we have picked that have caught the market's imagination.

UPDATES

EservGlobal (ESV) is performing well as mobile counters gain favour, and this may be one of the better stocks in that group. We would like to see more transparency about how, where and from whom, the business makes its money. We would not be chasing stock at these levels, but we still like the story very much.

At Melbourne IT (MLB), we look forward to some further news about a replacement chief executive and the capital return or shareholder distribution of the more than $100m that remains on the balance sheet from the sale of the brand protection business earlier this year.

Elders (ELD) announced its results and released its annual report. A week previously it had flagged a headline loss of just over $0.5bn, which reduces net assets to just over $40m, and continues the long and painful story of Elder's demise from its position of pre-eminence in the rural life of the Australian scene. The stock is down 99.6 per cent from its peak five years ago. But it is still alive.

As we have previously remarked, we were pleased to see the back of the automotive parts business, which was apparently sold, although the cash balance that went with the business together with the amount of working capital and investment made in only the past 12 months suggests that essentially they gave business away to the private equity purchasers. It can be argued that Elders now avoids any ongoing liabilities.

In the underlying rural services business, realised prices for cattle, sheep and wool have fallen against the averages achieved in FY12 by 18 per cent, 29 per cent and 6 per cent, respectively. This was a major factor in driving EBIT from the continuing rural services from a positive $18m to a loss of $36m after a $24m charge for the previously announced accounting irregularities in the trading unit.

In an agency business like Elders, changes in the prices of the underlying commodities will tend to have a direct impact on the revenue line which is not offset by any changes to the cost line. This may be a short to medium term future positive, but may not be enough on its own to drag the company out of the mire.

The level of core net debt excluding that secured by customers' receivables (what the company calls "self-liquidating debt") has increased to $109m (from $94m) at the September year end. Modest further reductions in net debt are anticipated, but the problem now is that after the huge write-offs, there is limited shareholder equity on the balance sheet and the hybrid instruments (code ELDPA) stand in the way of an easy resolution. The hybrids are valued at par ($145m) on the balance sheet, but at less than $25m by the market, so there are some net assets available for sharing around, but the hybrids are a Gordian knot that any broader Elders equity capital restructure has to untie. Shareholders therefore should expect a rights issue and ensure that they have funds to participate and do not get involuntarily diluted.

For full disclosure, we recently sold 10 per cent of the Elders position in our SMSF at 14.5 cents. The money was required elsewhere. We do not anticipate any further sales, but this position may change at any time.

TOP BUY RECOMMENDATIONS

As at 20 November 2013

**Return includes dividends and is after brokerage*

NAME	CODE	SECTOR	MARKET CAP $M	NET CASH/ -NET DEBT $M	DIVI-DENDS	ORIGINAL TIP DATE	TIP PRICE $	LAST PRICE $	RETURN *%	COMMENTS
CLOVER CORP	CLV	Biotech	80.9	8.3	Y	12-Jan-12	0.30	0.47	77.5	Some short-term issues have produced a buying opportunity for a long-term performer.
GALE PACIFIC	GAP	Manufact	89.1	-10.0	Y	25-Jul-13	0.31	0.30	1.1	Record FY13 result and gaining offshore contracts. Sun shading has never been this profitable.
INFOMEDIA	IFM	IT	170.0	6.0	Y	13-Jun-13	0.47	0.56	21.4	The car parts catalogue specialist has outstanding fundamentals: PE 16 times; dividend yield of 5.5 per cent; growing at 20 per cent a year.
IMF AUSTRALIA	IMF	Services	263.6	70.0	Y	8-Nov-13	1.71	1.71	-0.3	The litigation funder probably won't be one of the biggest performers, but over time it will be one of the most consistent.
MACQUARIE TELECOM	MAQ	Info Tech	172.6	53.5	Y	20-Oct-11	8.15	8.26	7.2	Now is the time to get back into this IT services firm as it benefits capital spend & contracts
MAXITRANS	MXI	Manufact	216.2	-30.0	Y	2-May-13	1.21	1.17	0.2	Standout FY13 result. This trucking industry supplier is making the right moves and is still cheap.
RECKON	RKN	a/c Software	285.4	-9.2	Y	10-Oct-13	2.17	2.23	2.8	The accounting software specialist is in the fight of its life against Xero. It has a big client base of accountants and strong fundamentals.
SERVCORP	SRV	Services	388.2	96.0	Y	15-Aug-13	3.53	3.95	14.0	Its office services earnings have been under pressure from fast expansion, but are recovering.

NO MORE PASSWORDS!
There are too many passwords in the world, and to make life simpler, we got rid of ours.
So please LOGIN online using just your email. We have a fuller version of this top 10 BUY table online, plus links through to the latest research.

We have also made it easier online to search for our company research. Also, **download our RESEARCH SUMMARY which is a full listing of all our stocks we have covered, includes the current stock price, our latest comment and recommendation.** It's updated weekly.

TOP 10 STOCKS

RADAR TOP 10 STOCKS (AS AT 20 NOVEMBER 2013)

**Return includes dividends and is after brokerage*
Average Return: 155.1%

NAME	CODE	SECTOR	TIP DATE	TIP PRICE $	LAST $	RETURN *%
SILVER CHEF	SIV	Financial services	06-Oct-11	2.69	7.85	211.3
ISS GROUP	ISS	Information Tech	12-Jan-12	0.14	0.32	200.0
FREEDOM FOODS	FNP	Food	04-Apr-13	1.05	3.00	187.6
BIGAIR GROUP	BGL	Telco	26-Jan-12	0.32	0.84	167.2
ESERVGLOBAL	ESV	Information Tech	19-Apr-12	0.28	0.70	150.0
TASSAL	TGR	Food	31-May-12	1.33	3.18	149.3
WARRNAMBOOL CHEESE	WCB	Food	03-May-12	3.83	9.23	146.7
NICK SCALI	NCK	Retail	18-Oct-12	1.40	3.20	137.1
MAYNE PHARMA	MYX	Pharmaceuticals	24-Jan-13	0.33	0.69	107.6
SIRTEX MEDICAL	SRX	Biotech	14-Jun-12	6.28	12.09	94.1
AVERAGE RETURN OF TOP TEN: 155.1%						

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