

BUY

HOLD

SELL

ACTION & RECOMMENDATION

We retain our BUY rating on Hillgrove Resources. Following the strong performance in October, the trend has continued – Hillgrove has provided updated guidance for the current quarter (end 31-Jan-14) of 5.4-5.6 kt of contained copper (around 22 ktpa). In our view, this should give investors additional confidence in the year that lies ahead as the Kavanagh pit has started to demonstrate its potential. Further, additional hedging by Hillgrove for the next six months of copper production is value-add, based on our forecasts. We continue to view Hillgrove as undervalued by the market. Our share price target of \$0.123 presents a 12-month total shareholder return of 33%.

A happy new year**What's Changed**

- **Production:** Hillgrove has provided updated guidance for the Jan-14 quarter that's in line with our expectations. Quarterly contained copper production is to be 5.4-5.6 kt (WHTMe 5.5 kt) – annualised production of around 22 ktpa places the Kanmantoo operation well above the long-targeted 20 ktpa rate.
- **Costs:** C1 costs for the quarter have been reiterated to be in the low A\$2.00s/lb (WHTMe: A\$2.05/lb), assisting in free cash flow generation (WHTMe FY14 A\$28m free cash flow). These costs are well below the previous quarter average (US\$2.80/lb).
- **Hedging:** Hillgrove has executed additional hedging contracts for the first half of FY15 to deliver 2,280 Mt of copper at a weighted average price of A\$8,291/Mt. We now forecast more than 90% of payable production is hedged in 1HFY15, at an average price of A\$8,105/t (versus WHTMe for 1HFY15 of A\$8,038/t LME copper).
- **New excavators:** Hillgrove has purchased two new Liebherr 9350 300 tonne excavators, with the first excavator on site – as previously mentioned by the company on the recent site visit.

Risks & Catalysts

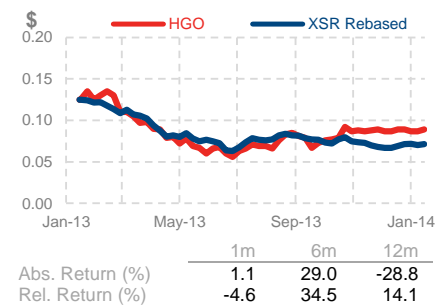
- **Key risks around HGO:** 1) consistency in delivering feed to the mill of around 0.80% copper, 2) operational risk at the mine, especially while it is operating a single open pit with single lane ramp, and 3) sustained weakness in the copper price.
- **Catalysts:** 1) Jan-14 quarterly report which may demonstrate higher production levels; and 2) production guidance for the year to Jan-15. Extra catalysts are an improved copper market or weaker AUD.

Year-end January (AUD)	FY12A	FY13A	FY14E	FY15E	FY16E
Revenue (\$m)	11.6	115.4	138.8	179.2	171.1
EBITDA Margin (%)	-18	12	27	25	22
NPAT Norm (\$m)	-4.1	-10.2	5.2	12.7	11.2
Consensus NPAT (\$m)			6.7	11.8	11.1
EPS Norm (cps)	-0.7	-1.2	0.5	1.2	1.1
EPS Growth (%)		-84	140	147	-12
P/E Norm (x)	-13.9	-7.6	19.0	7.7	8.8
EV / EBITDA (x)	-60.4	9.2	3.5	2.9	3.3
CFM (x)	-4.5	4.3	3.7	2.9	3.2
DPS (cps)	0.0	0.0	0.0	0.0	0.0
Franking (%)	0	0	0	0	0
Mkt Cap: \$105m	Enterprise Value: \$128m	Shares: 1,179m	Sold Short: 0.0%		

12m Target Price (AUD)	\$0.12
Share Price @ 20-Jan-14 (AUD)	\$0.09
Fcst 12m Capital Return	32.6%
Fcst 12m Dividend Yield	0.0%
12m Total S'holder Return	32.6%

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

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

WHTM Risk Assessment

Share Price Risk	Low	Med	High	Spec
	Share Price Risk			
Business Risk				

Key Changes	14-Jan	After	Var %
Revenue FY14	139	139	0.1%
(\$m) FY15	178	179	0.9%
FY16	171	171	0.0%
EBITDA: FY14	36.9	37.0	0.2%
(\$m) FY15	42.8	44.1	3.2%
FY16	38.4	38.4	0.0%
EPS: FY14	0.5	0.5	1.1%
Norm FY15	1.1	1.2	8.3%
(cps) FY16	1.1	1.1	0.3%
Price Target:	0.12	0.12	-0.1%
Rec:	BUY	BUY	
ASX 300 wgt: 0.0%	Median T'over/Day: \$0.1m		

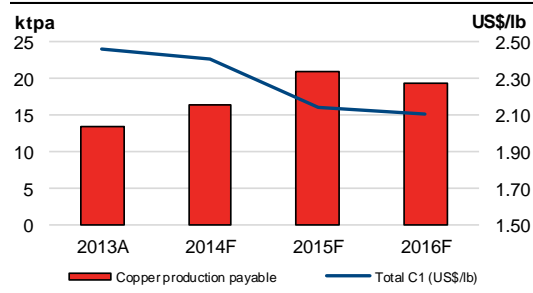
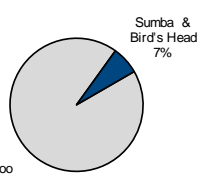
Wilson HTM Equities Research – Hillgrove Resources Limited

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TABLE 1: FINANCIAL SUMMARY

Capital profile				Jan year end								
				2013A	2014F	2015F	2016F	2017F				
Number of shares (m)	1,179			NPAT Reported (A\$m)	-118	7.5	12.7	112	8.4			
Market capitalisation (A\$m)	111			NPAT Normalised (A\$m)	-10.2	5.2	12.7	112	8.4			
Enterprise value (A\$m)	127			EPS (A¢)	-1.1	0.5	1.2	1.1	0.8			
Enterprise value (US\$m)	116			CFPS (A¢)	-0.6	0.8	3.5	4.3	3.8			
				DPS (A¢)	0.0	0.0	0.0	0.0	0.0			
				P/E (x)	nm	19.2	7.8	8.8	11.7			
				P/CF (x)	-14.9	11.4	2.7	2.2	2.5			
				EV/EBITDA (x)	9.6	3.4	2.1	1.3	0.4			
				EPS Growth	118%	-145%	147%	-12%	-24%			
				Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%			
Resources				Assumptions FY								
	Mt	%	Cont Cu	2013A	2014F	2015F	2016F	2017F				
Resources, incl stockpiles (Mt)	313	@ 0.77%	242 kt	AUD/USD	1.04	0.97	0.91	0.90	0.87			
Reserves, incl stockpiles (Mt)	22.1	@ 0.77%	157 kt	Copper price (US\$/lb)	3.70	3.62	3.31	3.25	3.28			
EV/t Resource (A\$/t)	A\$522.3	US\$480.5		Gold price (US\$/oz)	1669	1412	1269	1281	1250			
EV/t Reserve (A\$/t)	A\$808.0			Silver price (US\$/oz)	31.13	23.87	20.38	21.00	20.50			
VALUATION				Total Coal Sales (100%)								
Description	A\$m	A\$ps		2013A	2014F	2015F	2016F	2017F				
Kanmantoo	166	0.14		Copper production payable	13.3	16.3	21.0	19.3	18.1			
Sumba & Bird's Head	12	0.01		Gold production payable	4.7	4.0	5.6	9.6	9.8			
Total Operations	178	0.15		Cu. Equiv production payable (kt)	14.2	17.0	22.0	21.0	19.8			
Net (debt) / cash	-16	-0.01		Cash costs @ Kanmantoo				2013A	2014F	2015F	2016F	2017F
Corporate overheads (incl WC)	-17	-0.01		Total C1 (US\$/lb)	2.46	2.41	2.14	2.10	2.15			
Franking Credits	0	0.00		Royalties (US\$/lb)	0.05	0.05	0.06	0.07	0.07			
Listed investments	0	0.00		Admin (US\$/lb)	0.28	0.20	0.10	0.11	0.12			
Exploration	0	0.00		EBITDA costs (US\$/lb)	2.79	2.66	2.31	2.28	2.34			
Total Valuation	145	0.123		Sustaining capex (US\$/lb)	0.14	0.08	0.04	0.04	0.04			
Premium (Discount)		0.00		All in cash costs (US\$/lb)	2.93	2.74	2.35	2.32	2.38			
Target Price		0.123		D&A (US\$/lb)	0.90	0.66	0.57	0.63	0.69			
P/NPV		0.76		EBIT costs (US\$/lb)	3.69	3.32	2.88	2.91	3.03			
Operations NPV split				Margin analysis								
				2013A	2014F	2015F	2016F	2017F				
				EBITDA (US\$/lb)	0.90	0.96	1.00	0.98	0.94			
				All-in cash cost margin (US\$/lb)	0.76	0.88	0.96	0.93	0.90			
				EBIT (US\$/lb)	0.00	0.30	0.43	0.35	0.26			
				Profit and Loss (\$m)				2013A	2014F	2015F	2016F	2017F
				Revenue	116	139	179	171	167			
				Costs	103	102	135	133	134			
				EBITDA	14	37	44	38	33			
				Depreciation & amortisation	26	24	24	24	24			
				EBIT	-13	13	20	14	9			
				Interest income	1	0	1	2	3			
				Interest expense	7	6	3	0	0			
				MRRT	0	0	0	0	0			
				Pre tax profit	-18	8	18	16	12			
				Tax expense (benefit)	-8	3	5	5	4			
				NPAT - underlying	-10	5	13	11	8			
				Significant items	2	-2	0	0	0			
				NPAT - reported	-12	7	13	11	8			
Sensitivity (A\$ps/A\$m)				Profitability analysis								
	NPV (\$ps)	2015F	2016F	2013A	2014F	2015F	2016F	2017F				
Base Case NPV / NPAT	0.123	12.7	11.2	EBIT margin	-	10%	11%	8%	5%			
Copper price +10% increase	+0.04	+4.4	+10.0	EBITDA margin	12%	27%	25%	22%	20%			
Copper price +10% increase	+33%	+39%	+118%	Effective tax rate	44%	35%	30%	30%	30%			
AUD +10% increase	-0.04	-4.5	57.9	ROA - EBIT / (total assets - cash)	-4%	4%	7%	6%	4%			
AUD +10% increase	-31%	-41%	87%	ROE - NPAT / equity	-5%	2%	5%	4%	3%			
AUD +1¢ increase	0.00	-0.5	6.6	Cashflow				2013A	2014F	2015F	2016F	2017F
AUD +1¢ increase	-4%	-5%	10%	EBITDA	14	37	44	38	33			
				Operating cashflow	28	31	38	34	32			
				Sustaining Capex	-4	-3	-2	-2	-2			
				Free cashflow	24	28	36	32	30			
				Growth Capex	-34	-23	-3	9	7			
				Investing cashflow	-46	-35	-5	7	5			
				Financing cashflow	24	2	-31	-11	0			
				Net Change in cash	7	-1	3	30	37			
Production and costs				Balance Sheet Analysis								
ktpa				2013F	2014F	2015F	2016F	2017F				
				Debt	50	42	11	0	0			
				Equity	221	239	253	264	272			
				Assets	336	342	312	298	301			
				Cash	27	26	29	60	96			
				Net debt	23	16	-18	-60	-96			
				Gearing - net debt/equity	10%	7%	-7%	-23%	-35%			
				Gearing - net debt/ (net debt + equity)	9%	6%	-8%	-29%	-55%			
				Net debt / EBITDA	16	0.4	-0.4	-1.6	-2.9			
				EBIT / net interest	-2.2	2.4	10.4	-9.1	-2.9			
				EBITDA / net interest	2.4	6.7	22.7	-24.3	-10.6			



Source: Wilson HTM, HGO



PRICE TARGET		
	Val. A\$m	Val. A\$ps
Kanmantoo	166.089	0.141
Sumba & Bird's Head	12.000	0.010
Total Operations	178.089	0.151
Net (debt) / Cash	-15.843	-0.013
Corporate Overheads	-16.923	-0.014
Franking Credits	0.000	0.000
Listed Investments	0.000	0.000
Exploration	0.000	0.000
Total Valuation	145.323	0.123
Premium (Discount)		0.000
Target Price		0.123

INTERIMS (\$m)				
Half Yr (AUD)	Jul 12	Jan 13	Jul 13	Jan 14
	1H A	2H A	1H E	2H E
Sales	50.1	65.2	58.6	80.2
EBITDA	3.2	10.7	18.7	18.3
EBIT	-13.1	0.5	6.3	7.1
Net Profit	-11.7	1.5	1.7	3.4
Norm. EPS	-1.4	0.2	0.2	0.3
EBIT/Sales	-26.1	0.7	10.7	8.9
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	15.8	-17.9
Net Debt / Equity (%)	9.9	6.6	<0
Net Debt / EV (%)	17.9	12.4	<0
Current Ratio (x)	4.6	5.7	10.5
Interest Cover (x)	<0	2.4	10.4
Adj. Cash Int. Cover (x)	3.8	6.6	22.6
Debt / Cash Flow (x)	1.8	1.6	1.1
Net Debt (cash) / share	0.0	0.0	<0
NTA / share (\$)	0.3	0.2	0.2
Book Value / share (\$)	0.3	0.2	0.3
Payout Ratio (%)	0	0	0
Adj. Payout Ratio (%)	0	0	0

EPS RECONCILIATION (\$m)				
	FY13A		FY14E	
	Rep.	Norm.	Rep.	Norm.
Sales Revenue	115	115	139	139
EBIT	-11.1	-12.6	11.1	13.4
Net Profit	-8.7	-10.2	2.8	5.2
Notional Earn.	0.0	0.0	0.0	0.0
Pref. / Conv.	0.0	0.0	0.0	0.0
Profit for EPS	-8.7	-10.2	2.8	5.2
Diluted Shrs (m)	834	834	1,052	1,052
Diluted EPS (c)	-1.0	-1.2	0.3	0.5

RETURNS				
	FY13A	FY14E	FY15E	FY16E
ROE (%)	-4.6	2.2	5.2	4.3
ROIC (%)	-3.6	3.7	5.8	4.6
Incremental ROE	-58.5	107.4	68.7	-12.4
Incremental ROIC	-52.5	245.0	-50.4	16.0

KEY ASSUMPTIONS								
Year-end January (AUD)	FY12A	FY13A	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E
AUD/USD	1.0330	1.0359	0.9684	0.9075	0.8950	0.8727	0.8450	0.8173
Copper price (US\$/lb)	4.09	3.70	3.33	3.33	3.40	3.30	3.20	3.08
Copper price (US\$/t)	9,027	8,150	7,332	7,330	7,495	7,275	7,054	6,789
Gold price (US\$/oz)	1,572	1,669	1,412	1,269	1,281	1,250	1,241	1,217
Silver price (US\$/oz)	35.3	31.1	23.9	20.4	21.0	20.5	20.7	20.2
Copper Prod Payable (kt)	1.4	13.3	16.3	21.0	19.3	18.1	18.1	18.1
Gold Prod Payable (koz)	0.0	4.7	4.0	5.6	9.6	9.8	9.8	9.8
Cu. Equiv Prod Payable (kt)	0.0	14.2	17.0	22.0	21.0	19.8	19.8	19.8

PROFIT & LOSS (\$m)								
Year-end January (AUD)	FY12A	FY13A	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E
Sales Revenue	11.6	115.4	138.8	179.2	171.1	166.9	168.1	167.5
EBITDA	-2.1	13.9	37.0	44.1	38.4	33.0	24.4	20.1
Depn & Amort	5.2	26.5	23.6	24.0	24.0	24.0	24.0	24.0
EBIT	-7.3	-12.6	13.4	20.1	14.4	9.0	0.4	-3.9
Net Interest Expense	-1.2	5.7	5.5	1.9	-1.6	-3.1	-4.3	-5.1
Tax	-2.0	-8.1	2.7	5.5	4.8	3.6	1.4	0.4
Minorities / Pref. Divs	0.0	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	-4.1	-10.2	5.2	12.7	11.2	8.4	3.3	0.8
Abns / Exts / Signif.	4.4	1.6	-2.3	0.0	0.0	0.0	0.0	0.0
Reported Net Profit	0.3	-8.7	2.8	12.7	11.2	8.4	3.3	0.8

CASHFLOW (\$m)								
Year-end January (AUD)	FY12A	FY13A	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E
EBITDA	-2.1	13.9	37.0	44.1	38.4	33.0	24.4	20.1
Interest & Tax	2.8	-3.1	-4.7	-5.6	-3.9	-0.8	2.0	4.3
Working Cap / Other	-20.1	17.6	-0.9	0.0	0.0	0.0	0.0	0.0
Operating Cash Flow	-19.5	28.4	31.3	38.5	34.5	32.2	26.4	24.4
Maintenance Capex	-4.0	-4.0	-3.0	-2.0	-2.0	-2.0	-2.0	-2.0
Free Cash Flow	-23.5	24.4	28.3	36.5	32.5	30.2	24.4	22.4
Dividends Paid	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Development Capex	-128.1	-34.1	-22.9	-2.7	9.3	6.6	-2.0	-5.0
Invest. / Disposals	0.0	0.3	0.1	0.0	0.0	0.0	0.0	0.0
Other Inv. Flows	14.4	-81.4	-9.0	0.0	0.0	0.0	0.0	0.0
Cash Flow Pre-Financing	-137.2	-90.8	-3.5	33.8	41.8	36.8	22.4	17.4
Funded by Equity	0.0	97.5	10.8	0.0	0.0	0.0	0.0	0.0
Funded by Debt	40.0	0.0	-8.5	-30.7	-11.3	0.0	0.0	0.0
Funded by Cash	97.2	-6.7	1.2	-3.1	-30.4	-36.8	-22.4	-17.4

BALANCE SHEET SUMMARY (\$m)								
Year-end January (AUD)	FY12A	FY13A	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E
Cash	20.7	27.4	26.2	29.3	59.7	96.5	118.8	136.2
Current Receivables	6.4	6.4	2.5	1.6	0.8	0.4	0.2	0.1
Current Inventories	9.3	19.7	35.0	22.5	10.6	5.2	2.7	1.3
Net PPE	229.4	243.5	225.6	206.3	175.0	146.4	126.4	109.4
Investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Intangibles / Capitalised	1.0	0.6	0.4	0.4	0.4	0.4	0.4	0.4
Other	32.9	48.7	51.9	51.9	51.9	51.9	51.9	51.9
Total Assets	299.6	346.3	341.5	312.0	298.4	300.8	300.4	299.4
Current Payables	16.0	41.6	38.9	25.6	12.6	6.4	3.5	1.8
Total Debt	50.3	50.3	42.0	11.3	0.0	0.0	0.0	0.0
Other Liabilities	23.4	23.5	22.0	22.0	22.0	22.0	22.0	22.0
Total Liabilities	89.6	115.4	102.9	58.9	34.6	28.4	25.4	23.8
Minorities / Convertibles	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Shareholder Equity	210.0	231.0	238.6	253.1	263.8	272.4	275.0	275.6
Total Funds Employed	260.3	281.2	280.7	264.4	263.8	272.4	275.0	275.6



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 derisked 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 the 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

Hillgrove Resources Limited (HGO) is an Australian mining company focused on the operation of the Kanmantoo copper mine in South Australia, and exploration of 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 it 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 HGO 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
- Market capitalisation: \$110m (at A\$0.094/sh)
- Cash: \$17m (31-Jul-13)
- Debt: \$48m (31-Jul-13)

KEY ASSETS

Kanmantoo copper mine (South Australia) is an open-cut mine with throughput of 2.8 Mtpa, producing approximately 80,000 tonnes of concentrate and 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 the 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)
- Shanthy Smith (Company Secretary)
- Steven McClare (General Manager, Kanmantoo Copper Mine)

RISK TO VIEW

- Inability to achieve and maintain full production capacity at Kanmantoo

CONTACT DETAILS

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Return Reinvestment Matrix and Risk Measures

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

Recommendation Structure and Other Definitions

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