

Hillgrove Resources Ltd

HGO : ASX

BUY

Target: A\$0.14

Reg Spencer

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COMPANY STATISTICS:

Share Price (A\$)	0.066
12 Mth Hi-Lo (A\$)	0.094-0.052
Market Cap (A\$m)	78
Enterprise Value (A\$m)	103
Issued Shares (m)	1,178
Options (various)	128
Cash (31/1/14)	A\$16m
Debt (31/1/14)	A\$41m
Major Shareholders	
IOOF	10.4%
Renaissance Smaller Co's	8.4%

EARNINGS SUMMARY:

Jan Yr End	2015e	2016e	2017e
Cu Prod'n (t)	22,024	19,490	19,809
C1 Costs (A\$/lb)	2.09	2.17	2.00
AISC (A\$/lb)	2.52	2.40	2.33
Copper (US\$/lb)	3.14	3.23	3.15
EBITDA (A\$m)	59.1	47.8	54.9
EV/EBITDA	1.0x	0.3x	-0.4x
P/CF	1.3x	1.6x	1.5x
NPAT (A\$m)	18.8	17.1	21.2
EPS (A\$)	\$0.02	\$0.01	\$0.02
PER	4.2x	4.6x	3.7x

Source: Canaccord Genuity estimates

SHARE PRICE PERFORMANCE:



Source: Interactive Data Corporation

COMPANY DESCRIPTION:

Hillgrove Resources Ltd (HGO:ASX) is an Australian mining company whose primary asset is the 100%-owned Kanmantoo copper mine, located in South Australia. The mine is capable of producing up to +20,000 tpa copper in concentrate, over a mine life of +8 years

All amounts are in AUD unless otherwise noted.

Metals and Mining – Base Metals & Minerals

**SELL OFF NOT JUSTIFIED;
FAVOURABLE HEDGE & POSITIVE
OUTLOOK REMAIN**

Investment Perspective

We re-iterate our BUY rating on HGO, with the recent ~30% pull back in the share price offering an excellent entry point in our view. We acknowledge the downward movement is against a backdrop of lower copper prices (down 10%), but remind investors of the favourable hedge position, significant operational improvements delivered over the last 9 months, and the positive production outlook. Versus the CGAu copper producer coverage universe, HGO offers among the lowest earnings multiples and P/NAV's, supporting our positive view of the shares.

Investment Highlights

- HGO recently released an investor presentation detailing updated cash and debt estimates post Q1'15 (Jan year-end). The updated net debt figure of \$19m is a 20% QoQ improvement, suggesting that HGO's Q1'15 was again strong. The reported net debt figure was below our quarter-end estimates, but assuming production was in line with forecasts of 5.5kt Cu, this could imply higher than modelled capex and/or timing differences on cash receipts from concentrate sales. HGO's quarter report is due to be released in mid-May '15
- HGO has delivered on substantial operational improvements in the last 9 months, with material gains in all key operating metrics. While lower copper prices will have certainly impacted sentiment, we highlight HGO's favourable hedge position which sees +90% of forecast production over 1H'15 hedged at A\$3.60-3.74/lb vs current spot pricing of A\$3.28. Beyond this, ~65% of forecast production is hedged at +A\$3.60/lb (to Q2'16) providing certainty over cashflows and mitigating a large proportion of commodity price risk.
- HGO have set FY15 guidance of 22.3-24.6kt Cu in concentrate (vs CGAu estimates of 22kt), with the forecast +28% YoY lift in production to drive a significant lift in earnings. We estimate FY15 EBITDA of A\$59m, up ~50% YoY, placing the shares on a FY15e EV/EBITDA of only 1.0x.

We re-iterate our BUY rating; \$0.14 target unchanged

Our target price (NPV_{8%} based Net Asset Valuation) remains unchanged at \$0.14/share.

FINANCIAL SUMMARY

Hillgrove Resources Limited

HGO:ASX

Analyst :

Peg Spencer

Date:

5/05/2014

Year End:

January

Rating:

BUY

Target Price:

\$0.14

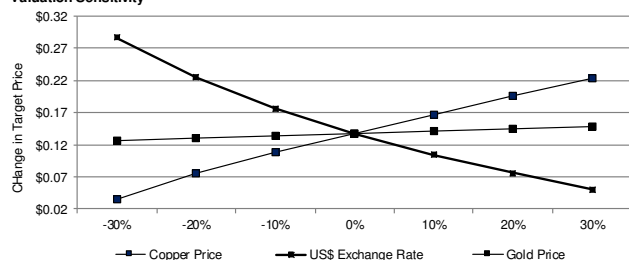
Market Information

Share Price	A\$	0.066
Market Capitalisation	A\$m	77.8
12 Month Hi-Low	A\$	0.094-0.052
Issued Capital	m	1178
Options	m	128
Fully Diluted	m	1306

Valuation		A\$m	A\$/share
Kanmantoo	NPV @ 8%	190.0	0.16
Exploration		10.0	0.01
Corporate		(22.1)	(0.02)
Copper Forwards NPV		7.5	0.01
Cash		16.5	0.01
Debt		(40.8)	(0.03)
Total NAV/Price Target		161.1	0.14
Price/NAV			0.48x

Assumptions	2014a	2015e	2016e	2017e
Gold Price (US\$/oz)	1,300	1,321	1,328	1,366
Copper Price (US\$/lb)	3.19	3.14	3.23	3.15
AUD:USD	0.91	0.93	0.91	0.88

Valuation Sensitivity



Production Metrics	2014a	2015e	2016e	2017e
Kanmantoo				
Cu Prod'n (t)	17,184	22,024	19,490	19,809
C1 Costs (A\$/lb)	2.62	2.09	2.17	2.00
All in Sust. Costs (A\$/lb)	3.29	2.52	2.40	2.33

Group Reserves & Resources

	Mt	Grade Cu	Tonnes Cu
Reserves (100%)			
Kanmantoo	22.10	0.71%	156,730
Resources (100%)			
Kanmantoo	31.29	0.78%	242,529

Directors

Name	Position
Hon. D Brown	Chairman
G Hall	CEO & MD
J Gooding	NED
M Loomes	NED
D Snedden	NED
E Zemancheff	NED

Substantial Shareholders

	Shares (m)	%
IOOF	122.14	10.4%
Renaissance Smaller Co's	98.86	8.4%
Platinum Partners	83.31	7.1%

Company Description

Hillgrove Resources Limited (HGO:ASX) is an Australian mining company whose primary asset is the 100%-owned Kanmantoo Copper mine located in SE South Australia. The mine was commissioned in 2012, and is capable of producing +20,000 tpa of copper in concentrate, over a mine life of +8 years.

Profit & Loss (A\$m)	2014a	2015e	2016e	2017e
Revenue	139.2	184.6	164.4	167.7
Operating Costs	107.9	119.0	109.3	104.5
Royalties	1.6	2.3	2.2	2.2
Corporate & O'heads	3.2	4.9	5.0	5.1
Exploration (Expensed)	0.0	0.0	1.7	4.1
EBITDA	39.4	59.1	47.8	54.9
Dep'n	29.2	32.2	23.4	24.6
EBIT	10.2	26.9	24.4	30.2
Net Interest	0.8	0.7	1.5	3.2
Tax	0.8	8.1	7.3	9.1
NPAT	-6.4	18.8	17.1	21.2
Abnormals	-7.9	0.0	0.0	0.0
NPAT (reported)	1.6	18.8	17.1	21.2

Cash Flow (A\$m)	2014a	2015e	2016e	2017e
Revenue	121.3	186.5	165.7	166.6
Cash Receipts	121.3	186.5	165.7	166.6
Cash paid to suppliers & employee	-107.5	-126.2	-116.4	-111.8
Tax Paid	0.0	0.0	0.0	-7.0
Net Interest	-2.8	-0.8	1.5	3.2
Other costs	0.0	0.0	0.0	0.0
Operating Cash Flow	11.0	59.5	50.8	51.0
Exploration and Evaluation	-3.8	-0.8	-2.9	-2.1
Capex	-19.0	-16.4	-1.7	-5.9
Other	0.4	0.0	0.0	0.0
Investing Cash Flow	-22.3	-17.2	-4.5	-8.0
Debt Drawdown (repayment)	-9.8	-30.5	-10.3	0.0
Share capital	10.8	0.0	0.0	0.0
Dividends	0.0	0.0	0.0	-3.5
Financing Expenses	-0.6	0.0	0.0	0.0
Financing Cash Flow	0.4	-30.5	-10.3	-3.5
Opening Cash	27.4	16.5	28.2	64.1
Increase / (Decrease) in cash	-10.9	11.7	35.9	39.4
FX Impact	0.0	0.0	0.0	0.0
Closing Cash	16.5	28.2	64.1	103.6

Balance Sheet (A\$m)	2014a	2015e	2016e	2017e
Cash + S/Term Deposits	16.5	28.2	64.1	103.6
Other current assets	35.4	44.5	39.8	41.0
Current Assets	51.8	72.7	104.0	144.6
Property, Plant & Equip.	225.7	209.9	188.2	169.5
Exploration & Develop.	30.6	31.4	34.2	36.3
Other Non-current Assets	14.1	27.8	24.9	10.7
Payables	23.9	24.1	21.6	22.2
Short Term debt	30.5	10.3	0.0	0.0
Long Term Debt	10.3	0.0	0.0	0.0
Other Liabilities	28.9	60.0	66.4	59.1
Net Assets	228.5	247.4	263.3	279.7
Shareholders Funds	206.9	206.9	206.9	206.9
Reserves	-3.3	-3.3	-3.3	-3.3
Retained Earnings	25.0	43.8	59.7	76.2
Total Equity	228.5	247.4	263.3	279.7

Ratios & Multiples	2014a	2015e	2016e	2017e
EBITDA Margin	28%	32%	29%	33%
EV/EBITDA	2.6x	1.0x	0.3x	-0.5x
Op. Cashflow/Share	\$0.01	\$0.05	\$0.04	\$0.04
P/CF	7.1x	1.3x	1.5x	1.5x
EPS	\$0.00	\$0.02	\$0.01	\$0.02
EPS Growth	-114%	771%	-9%	24%
PER	36.0x	4.1x	4.6x	3.7x
Dividend Per Share	\$0.00	\$0.00	\$0.00	\$0.00
Dividend Yield	0%	0%	2%	6%
ROE	1%	8%	6%	8%
ROIC	5%	17%	15%	17%
Debt/Equity	5%	0%	0%	0%
Net Interest Cover	nm	nm	nm	nm
Book Value/share	\$0.19	\$0.21	\$0.22	\$0.24
Price/Book Value	0.3x	0.3x	0.3x	0.3x

Source: Company reports & Canaccord Genuity estimates

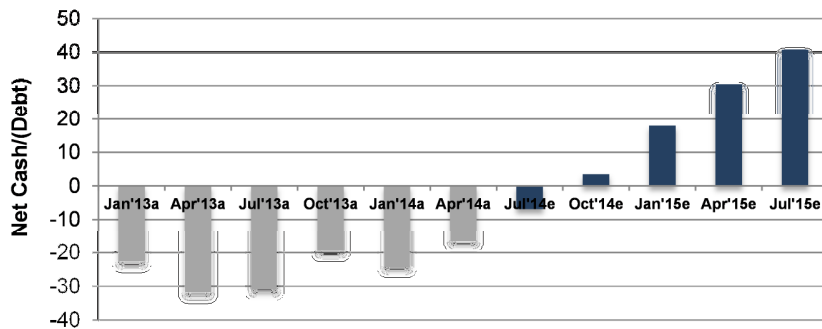
1Q'15 UPDATE – NET DEBT REDUCED 20%

HGO provided a brief glimpse of expected 1Q'15 (January year-end) performance (release expected mid-May '14) when it provided updated cash and debt figures as part of a presentation released to the market.

Cash at May 1 was reported at \$14m, with debt reduced in line with expectations to \$33m. The reported cash balance is below our existing quarter-end estimates, which, assuming our production forecasts (5.5kt Cu and 1.9koz Au) are in line, implies possible increased capex versus our estimates and/or timing differentials on cash receipts from concentrate sales.

The ~20% improvement in net debt suggests that HGO have turned in a solid Q1'15, with the continued improvement in the balance sheet consistent with this year's focus on debt reduction. We currently expect HGO to move into a net cash position in Q3'15 (Figure 1).

Figure 1: Net cash/(debt)

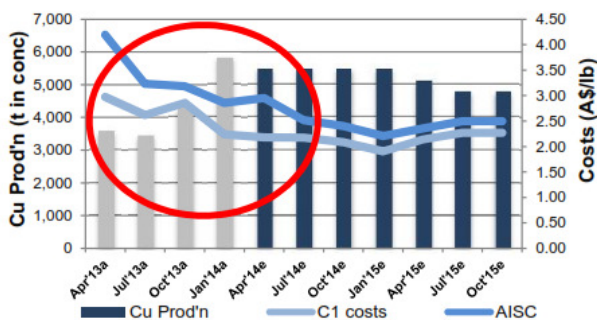


Source: Company reports & Canaccord Genuity estimates

RECENT SELL-OFF UNJUSTIFIED OPERATIONAL TURNAROUND

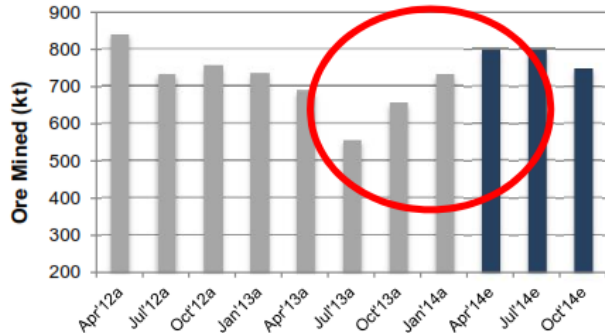
We note the recent ~30% correction in HGO's share price since its 12 month high in late Feb'14. We highlight that HGO have delivered a significant operational turnaround in the last 6-9 months, with no evidence from an operational standpoint to support such a drastic sell off in the shares (Figures 2-6).

Figure 2: Production & cost forecasts



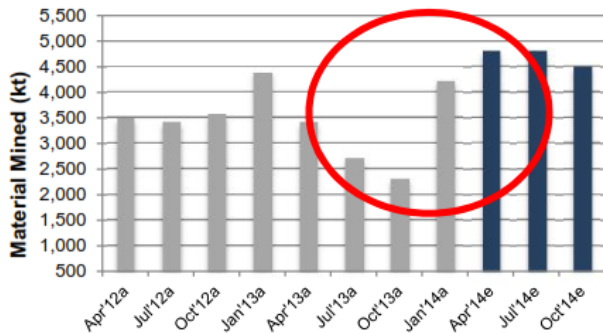
Source: Company reports & Canaccord Genuity estimates

Figure 3: Ore mined



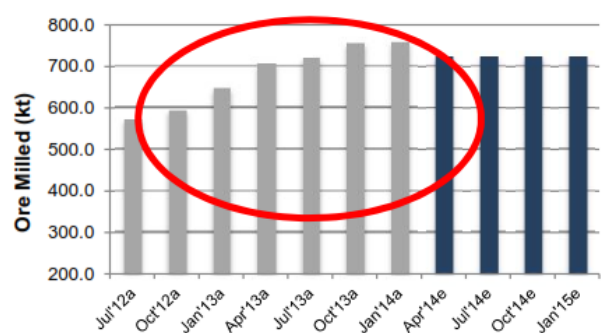
Source: Company reports & Canaccord Genuity estimates

Figure 4: Material mined



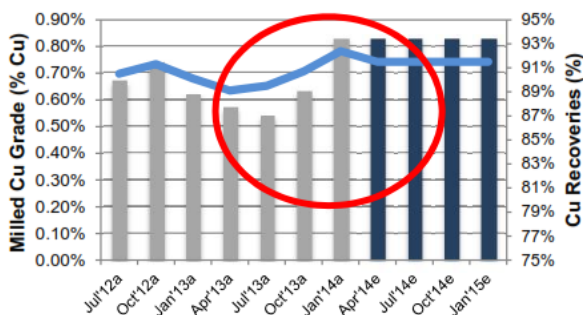
Source: Company reports & Canaccord Genuity estimates

Figure 5: Ore milled



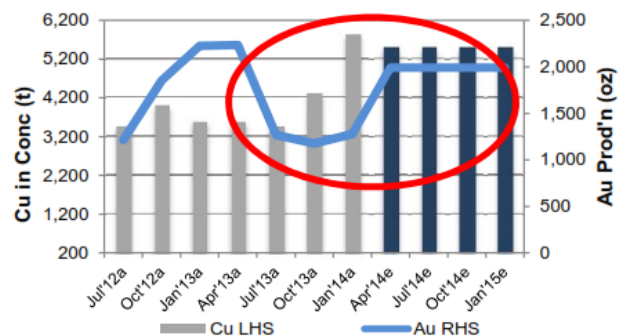
Source: Company reports & Canaccord Genuity estimates

Figure 6: Cu grades & recoveries



Source: Company reports & Canaccord Genuity estimates

Figure 7: Cu & Au in Conc. Production



Source: Company reports & Canaccord Genuity estimates

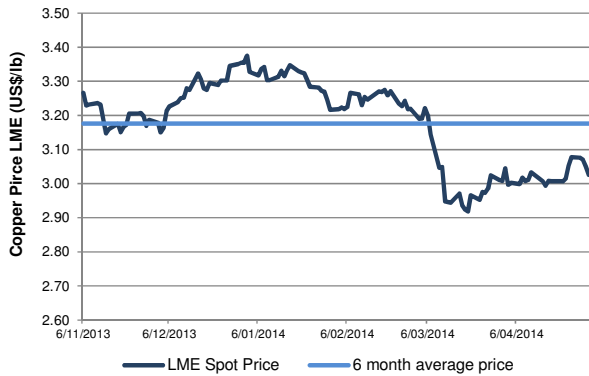
COPPER HEDGE MITIGATES PRICE RISK

We acknowledge that the 10% fall in the copper price since Jan'14 (Figure 8), will have impacted sentiment for copper producers, but we remind investors of HGO's favourable copper hedge position.

As at end FY14, HGO had ~32kt of copper swaps hedged at prices between A\$3.60/lb and A\$3.76/lb. Approximately 85% of forecast production (CGAu estimates) is hedged during 1H'15 at A\$3.64/lb (versus our estimated average AISC for the corresponding period of A\$2.70/lb). Beyond Jul'14, there remains ~23kt hedged until mid'16, representing 65% of our production forecasts at +A\$3.60/lb .

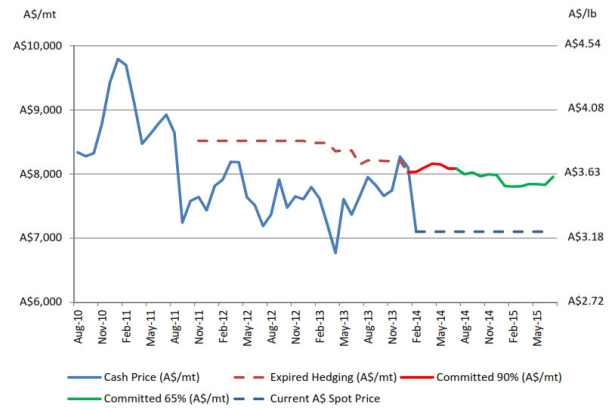
This favourable hedge position (current mark to market estimate of ~A\$25m) provides certainty over cashflows over the coming 24 months, mitigating a significant portion of copper price risk over the corresponding period.

Figure 8: 6 month copper price



Source: IRESS & Canaccord Genuity estimates

Figure 9: HGO Cu hedge position



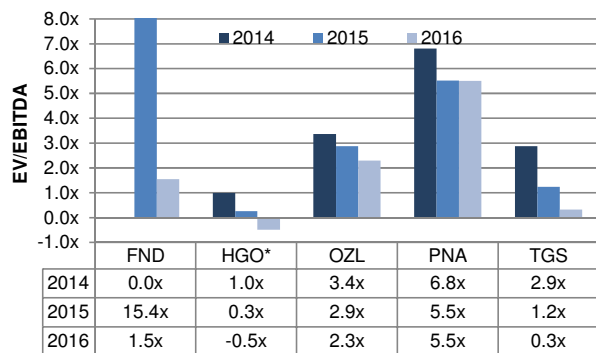
Source: Company reports

EARNING GROWTH POTENTIAL & VALUATION UPSIDE SUPPORTS OUR POSITIVE OUTLOOK

HGO have set FY15 guidance of 22.3-24.6kt Cu in concentrate (vs CGAu estimates of 22kt), with the forecast +28% YoY lift in production to drive a significant lift in earnings. We estimate EBITDA in FY15 of A\$59m (assuming Cu prices of US\$3.14/lb and AUD:USD0.93), up ~50% YoY, placing the shares on a FY15e EV/EBITDA of only 1.0x. Versus the CGAu copper producer universe, HGO continues to rank favourably on this metric.

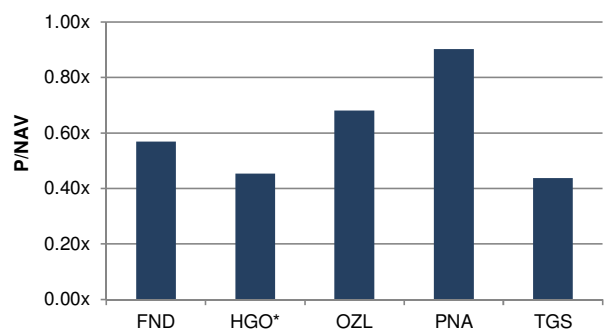
HGO also looks to offer among the greatest upside to target price among our copper sector coverage, with only TGS offering higher valuation upside (Figure 11).

Figure 10: EV/EBITDA - CGAu copper sector coverage



Source: Canaccord Genuity estimates

Figure 11: CGAu copper sector coverage: P/NAV's



Source: Canaccord Genuity estimates

INVESTMENT RISKS

The key investment risks for HGO include:

- Geological & Resource risk – the actual characteristics of a mineral deposit may differ significantly from initial interpretations and expectations. HGO's LOM Plan incorporates Mineral Resources and Exploration Targets whose actual economics are yet to be determined. Grades and tonnages for Exploration Targets are conceptual in nature
 - Operating Risk - As a producer, operating risk is an inherent risk for the company. Halts and or reductions in production due to equipment availability, geotechnical issues, people issues, environmental issues, and weather issues can all reduce and or stop production and therefore revenue and cashflow. Operating risk is a key risk for the company, in particular as HGO is a single asset company.
 - Capital expenditure & operating risk – the risk that capital and or operating costs exceed budget and/or exhaust available funding, reducing the profitability and free cash generation of the project.
 - Commodity price and exchange rate risk: As with all mining and mineral exploration companies, commodity price and exchange rate risk should also be considered.
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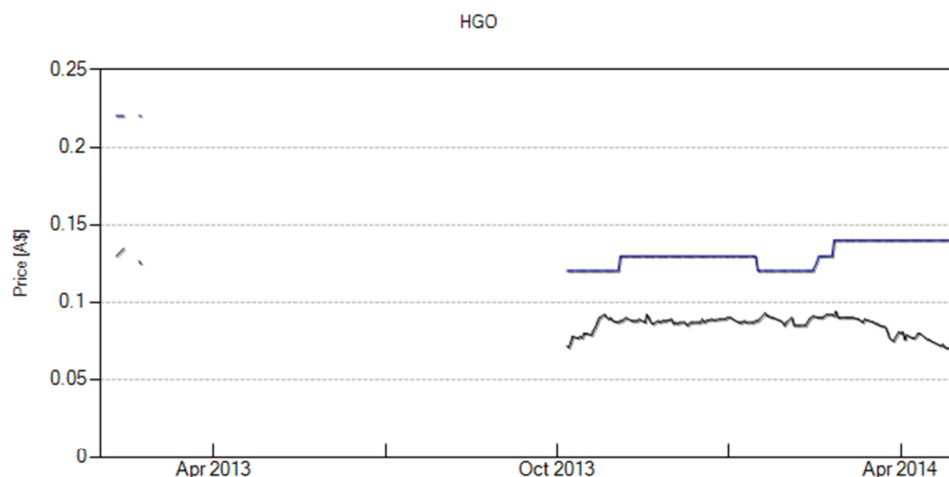
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Site Visit: An analyst has visited the company's material operations in South Australia. No payment was received for related travel costs.
Price Chart:*



Date	Analyst	Rating	Target Price	Date	Analyst	Rating	Target Price
1) 11/09/2012	Bertincourt	Buy	0.21	5) 01/16/2014	Spencer	Buy	0.12
2) 01/23/2013	Smith	Buy	0.22	6) 02/17/2014	Spencer	Buy	0.13
3) 10/08/2013	Spencer	Buy	0.12	7) 02/25/2014	Spencer	Buy	0.14
4) 11/05/2013	Spencer	Buy	0.13	8) 04/10/2014	Smith	Buy	0.14

*Price charts assume event 1 indicates initiation of coverage or the beginning of the measurement period.

**Distribution of Ratings:
Global Stock Ratings
(as of 31 March 2014)**

Rating	Coverage Universe		IB Clients
	#	%	%
Buy	580	58.7%	37.1%
Speculative Buy	43	4.4%	55.8%
Hold	317	32.1%	13.2%
Sell	45	4.6%	4.4%
	988*	100.0%	

*Total includes stocks that are Under Review

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BUY: The stock is expected to generate risk-adjusted returns of over 10% during the next 12 months.

HOLD: The stock is expected to generate risk-adjusted returns of 0-10% during the next 12 months.

SELL: The stock is expected to generate negative risk-adjusted returns during the next 12 months.

NOT RATED: Canaccord Genuity does not provide research coverage of the relevant issuer.

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Hillgrove Resources Ltd	7
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