

## Hillgrove Resources Ltd

Path to net cash becomes clearer; upgrade to OW

### ▲ Overweight

Previous: Neutral

HGO.AX, HGO AU

Price: A\$0.08

### ▲ Price Target: A\$0.11

Previous: A\$0.10

We upgrade our HGO recommendation to Overweight and set our 12 month price target to A\$0.11ps. Whilst acknowledging uncertainty around the declining grade profile and the potential for elevated waste stripping over the next 12-18 months, we believe risks surrounding HGO's ability to repay debt have now subsided and, as such, the balance of risks warrants a re-rating over the medium-term. The upcoming site trip to Kanmantoo provides a near-term catalyst that should further reinforce the improvements that have been made from an operational perspective.

- **Risks surrounding debt have subsided.** HGO had ~A\$31m of current debt as at the Jan-14 financials. We estimate ~A\$15m of repayments over each of the next two halves (Project finance facility and the Gold loan; the A\$10m Mezzanine facility is non-current) vs. free cash flow generation of ~A\$13m and ~A\$17m, coupled with an existing cash balance of A\$14m (noting ~\$10m liquidity is required). We estimate HGO will be net cash by early CY15 (guidance is for gross debt to be zero by Jul-15). At least part of the reason for HGO's underperformance (c.-30% since the start of 2013), which was exacerbated by operational issues, has been its balance sheet. As the path to net cash becomes clearer then we believe a re-rating towards NPV is warranted.
- **Quarterly production.** Copper production of 5.6kt was -6% vs. JPMe 5.9kt, driven by lower than expected grade (0.80% vs. 0.85%). Gold production of 1.3koz was slightly stronger vs. JPMe on the back of stronger recoveries, although somewhat offset by grade. C1 costs of US\$2.11/lb were 7% better than we had forecast, despite the lower copper volumes, and reflects continued improvement on the cost front.
- **Upgrade to Overweight.** We upgrade HGO to an Overweight on the basis of a de-risking of the equity towards NPV. Key risks to our recommendation are 1) medium-term grade profile lower than JPMe, 2) weaker cost performance, and 3) higher than expected waste stripping over the next 12-18 months.

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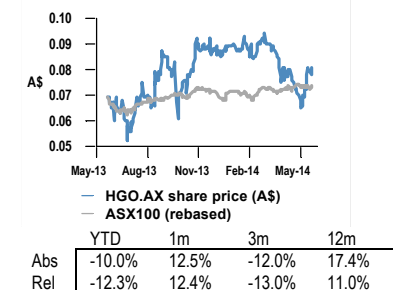
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### Price Performance



### Hillgrove Resources Ltd (Reuters: HGO.AX, Bloomberg: HGO AU)

Year-end Jan (A\$)	FY12A	FY13A	FY14A	FY15E	FY16E
Revenue (A\$ mn)	12	115	139	190	175
EBITDA (A\$ mn)	(2)	19	37	49	29
Net Profit (A\$ mn)	(8)	(11)	1	15	5
EPS (A\$)	(0.01)	(0.01)	0.00	0.01	0.00
P/E (x)	NM	NM	57.5	6.3	19.0
EV/EBITDA (x)	NM	4.8	2.5	1.3	1.4
DPS (A\$)	0.00	0.00	0.00	0.00	0.00
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%
Normalised EPS (A\$)	(0.01)	(0.01)	0.00	0.01	0.00
Normalised EPS Growth	(28.3%)	38.1%	(112.6%)	1295.3%	(66.9%)
Normalised PE	NM	NM	87.6	6.3	19.0

Source: Company data, Bloomberg, J.P. Morgan estimates.

### Company Data

Shares O/S (mn)	1,024
Market Cap (A\$ mn)	82.92
Market Cap (\$ mn)	76.73
Price (A\$)	0.08
Date Of Price	22 May 14
Free Float(%)	-
3M - Avg daily vol (mn)	1.05
3M - Avg daily val (A\$ mn)	0.08
3M - Avg daily val (\$ mn)	0.1
ASX100	4559.10
Exchange Rate	0.93
Price Target End Date	31-Jan-15
Price Target (A\$)	0.11

See page 6 for analyst certification and important disclosures, including non-US analyst disclosures.

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## Upgrade to Overweight

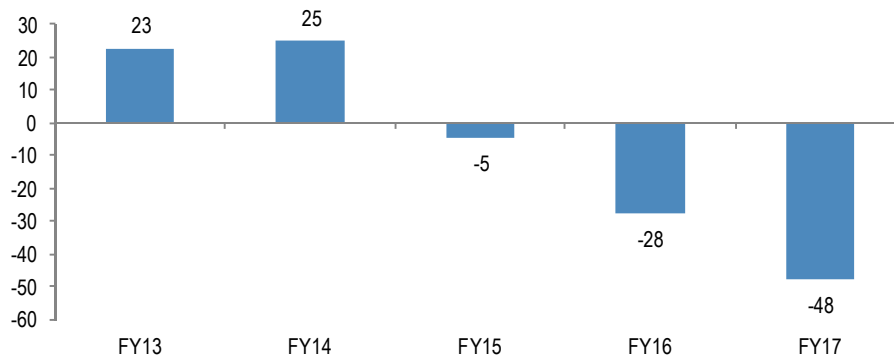
We upgrade HGO to an Overweight based on an expectation of a re-rating towards our DCF-based price target over the medium-term as the path towards net cash becomes clearer.

Furthermore, sequential quarters of solid operating performance at Kanmantoo, reflected in mill throughput / mining rates and mined / milled grades, provides us with comfort that the company will continue to be able to reduce its debt balance.

HGO had ~A\$31m of current debt as at the Jan-14 financials. We estimate ~A\$15m of repayments over each of the next two halves (Project finance facility and the Gold loan; the A\$10m Mezzanine facility is non-current) vs. free cash flow generation of ~A\$13m and ~A\$17m, coupled with an existing cash balance of A\$14m (noting ~\$10m liquidity is required).

HGO guidance is for gross debt to be zero by Jul-15 which is roughly in-line with our forecasts, although we expect the company to be net debt by early 2015. As the path to net cash becomes clearer then we believe a re-rating towards NPV is warranted.

Figure 1: Net debt profile (A\$m)



Source: J.P. Morgan estimates.

We also note that 90% of payable copper production is hedged at ~A\$3.65/lb (spot ~A\$3.40/lb) until mid-year, and thereafter 65% of payable production is hedged at a copper price of A\$3.60/lb until mid-2015. This increases our certainty that HGO can become net cash over the next 12-18 months.

## Changes to forecasts

We have implemented the AprQ production report in to our model, and made minor adjustments to our strip ratio profile (increased in FY16 and FY17) and near-term unit mining rates (reduced). The net impacts on our forecasts are shown in the table below.

Table 1: Changes to HGO forecasts

	NPV A\$ps	Underlying NPAT (A\$m)		
		2015F	2016F	2017F
Previous	0.10	12	4	1
Revised	0.11	15	5	3
Change	0.01	3	1	2
Change	8%	27%	17%	318%

Source: J.P. Morgan estimates.

## Investment Thesis, Valuation and Risks

### Hillgrove Resources Ltd (*Overweight; Price Target: A\$0.11*)

#### Investment Thesis

We have an Overweight recommendation on HGO. The Kanmantoo operating performance has shown consistency and balance sheet risks have subsided which together warrant a re-rating towards NPV.

#### Valuation

Our Jan-15 price target of A\$0.11ps is derived off our Jan-14 NPV of A\$0.11ps, based on our DCF valuation of Kanmantoo using a 12% WACC.

#### Risks to Rating and Price Target

Key downside risks to our Overweight recommendation include: 1) worse-than-expected grade profile at Kanmantoo; 2) weaker cost performance, and 3) higher than expected waste stripping over the next 12-18 months.

## HGO Summary: Jan-yr end (A\$m)

Relative recommendation: **OW**

Profit & Loss (A\$m)					Valuation Summary				
	2014A	2015E	2016E	2017E				A\$m	
Revenue	140	190	175	175	Current Market Capitalisation			92.1	
Operating Expenses	(102)	(141)	(146)	(149)	EV			87.3	
EBITDA	37	49	29	26					
Depreciation & Amortisation	(29)	(25)	(22)	(23)	<b>12 mth price target (January 2015)</b>			<b>0.11</b>	
EBIT	8	24	7	2	Capital growth to price target			35%	
Other	(1)	-	-	-	12 mth forecast DYld			0.0%	
Interest	(5)	(2)	0	1	<b>12 mth forecast total return</b>			<b>34.6%</b>	
PBT	2	22	7	4	WACC			12.0%	
Tax	(1)	(7)	(2)	(1)					
Minorities & other	-	-	-	-	<b>Current DCF (January 2015)</b>			<b>A\$m A\$ps</b>	
NPAT - reported	1	15	5	3	Kanmantoo			140.0 0.12	
Exceptional items	(1)	-	-	-	Investments			0.2 0.00	
NPAT - adjusted	1	15	5	3	Corporate costs			(23.2) (0.02)	
					<b>Sub-total</b>			<b>117.0 0.10</b>	
Shares outstanding (m)	1,176	1,186	1,186	1,186	Net cash/(debt)			4.8 0.00	
Reported EPS (A¢ps)	0.1	1.3	0.4	0.2	Exploration potential			3.0 0.00	
Normalised EPS (A¢ps)	0.1	1.3	0.4	0.2	<b>Total</b>			<b>124.8 0.11</b>	
Normalised EPS growth	n/a	912%	(67%)	(50%)					
DPS (A¢ps)	0.0	0.0	0.0	0.0					
DPS growth	n/a	n/a	n/a	n/a					
DPS / EPS payout	0%	0%	0%	0%					
Cashflow (A\$m)					Key Ratios				
	2014A	2015E	2016E	2017E		2014A	2015E	2016E	2017E
Cashflow from operations	11	41	30	26	PE Ratio	61.3	6.1	18.3	36.9
Capex	(19)	(11)	(7)	(6)	EV / EBITDA	3.1	1.8	2.2	1.7
Free cashflow	(8)	30	23	20	Dividend yield	0%	0%	0%	0%
Investing cashflow	(22)	(11)	(7)	(6)	ROE [Norm NPAT / Equity]	0%	6%	2%	1%
Dividends	-	-	-	-	ROA [EBIT / (assets - cash)]	3%	8%	3%	1%
Financing cashflow	0	(31)	(10)	-	ROIC [EBIT / assets]	3%	8%	2%	1%
Change in cash	(11)	(1)	13	20	EBIT / net interest	1.5	11.6	na	na
					EBITDA / net interest	6.9	23.7	na	na
Balance Sheet (A\$m)					Attributable Production				
	2014A	2015E	2016E	2017E		2014A	2015E	2016E	2017E
Cash and cash equivalents	16	16	29	49	Concentrate (kt)	75.4	96.6	89.8	85.7
Property plant & equipment	226	211	196	179	Copper (kt metal in conc.)	17.2	22.4	20.1	19.2
Total assets	322	301	297	299	Gold (koz)	6.0	7.2	9.5	9.1
Debt	42	11	1	1	Silver (koz metal in conc.)	132.9	133.6	176.7	168.5
Total liabilities	94	58	48	48					
Total equity	229	244	249	251	Cash Costs (C1)				
Net debt / (cash)	25	(5)	(28)	(48)		2014A	2015E	2016E	2017E
					US\$/lb (post credits)	2.49	2.35	2.64	2.76
					A\$/lb (post credits)	2.41	2.08	2.36	2.45
Half Yearly P&L (A\$m)					Price Assumptions				
	1H14A	2H14A	1H15A	2H15A		2014A	2015E	2016E	2017E
Revenue	58.8	80.7	95.6	94.4	A\$/US\$ FX rate	0.88	0.89	0.89	0.85
Operating Expenses	-40.4	-61.6	-69.1	-72.1	Copper (US\$/t)	6,896	6,766	6,857	7,102
EBITDA	18.4	19.1	26.4	22.3	Gold (US\$/oz)	1,260	1,232	1,236	1,261
Depreciation & Amortisation	-12.4	-16.7	-14.6	-10.2	Silver (US\$/oz)	21.04	21.27	20.38	19.28
EBIT	6.0	2.3	11.8	12.1					
Other	3.3	-3.9	0.0	0.0	Sensitivities (+/- 10% move)				
Interest	-3.0	-2.4	-1.3	-0.7		2014A	2015E	2016E	2017E
PBT	6.3	-4.0	10.5	11.3	Copper (US\$/lb)				
Tax	-2.3	1.5	-3.1	-3.4	Gold (US\$/oz)				
Minorities & other	0.0	0.0	0.0	0.0	A\$/US\$ FX rate				
NPAT - reported	4.0	-2.5	7.3	7.9					
Exceptional items	-3.0	2.5	0.0	0.0					
NPAT - adjusted	1.0	0.0	7.3	7.9					
					Segmented revenue (A\$m)				
	2014A	2015E	2016E	2017E		2014A	2015E	2016E	2017E
Copper	126.2	171.7	157.3	157.0	Copper (US\$/lb)				
Gold	9.8	13.8	13.6	13.4	Gold (US\$/oz)				
Silver	3.1	4.4	4.4	4.1	A\$/US\$ FX rate				

Source: J.P.Morgan estimates, Company data, Bloomberg

**JPM Q-Profile**

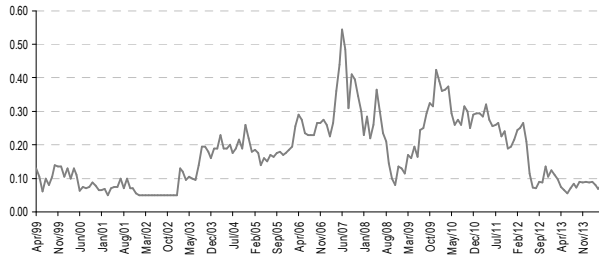
**Hillgrove Resources Limited (AUSTRALIA / Materials)**

As Of: 16-May-2014

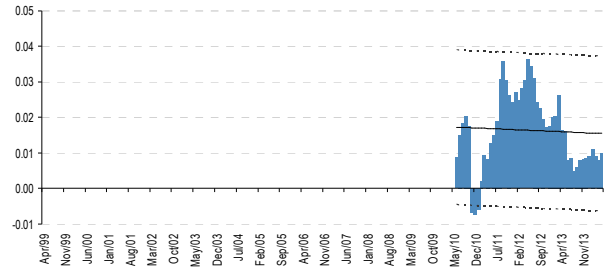
**Global Equity Quantitative Analysis**

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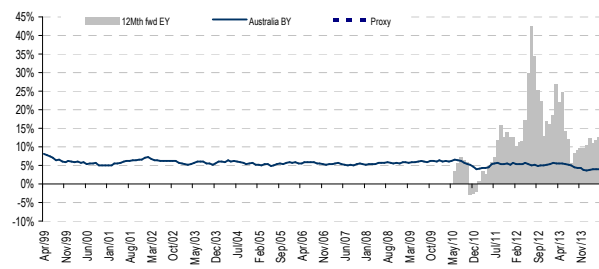
**Local Share Price** Current: **0.08**



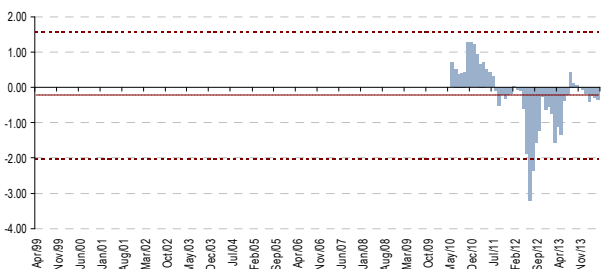
**12 Mth Forward EPS** Current: **0.01**



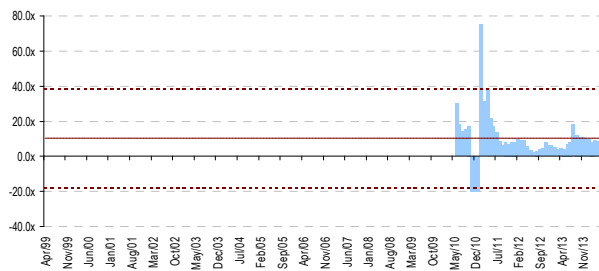
**Earnings Yield (& local bond Yield)** Current: **12%**



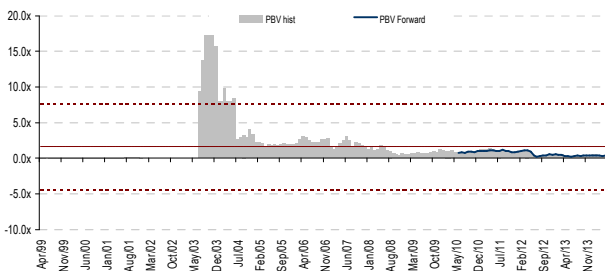
**Implied Value Of Growth\*** Current: **-36.27%**



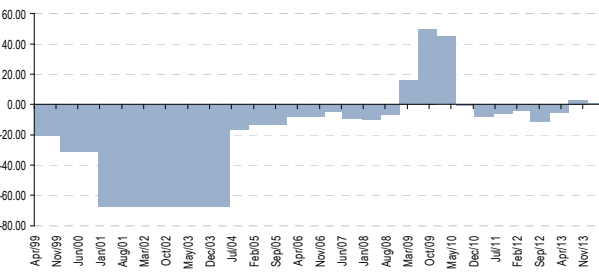
**PE (1Yr Forward)** Current: **8.1x**



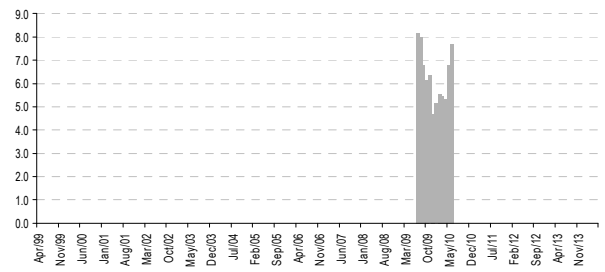
**Price/Book Value** Current: **0.4x**



**ROE (Trailing)** Current: **0.67**



**Dividend Yield (Trailing)** Current: **0.00**



**Summary**

Hillgrove Resources Limited		SEDOL		6426150		As Of:		16-May-14			
AUSTRALIA						Local Price:		0.08			
Materials						EPS:		0.01			
	Latest	Min	Max	Median	Average	2 S.D.+	2 S.D. -	% to Min	% to Max	% to Med	% to Avg
12mth Forward PE	8.10x	-20.00	75.00	8.21	10.17	38.59	-18.26	-347%	826%	1%	25%
P/BV (Trailing)	0.42x	0.00	17.32	0.79	1.64	7.67	-4.38	-100%	4043%	90%	292%
Dividend Yield (Trailing)	0.00	0.00	8.16	0.00	0.42	3.63	-2.79				
ROE (Trailing)	0.67	-67.43	50.00	-10.37	-18.98	43.66	-81.63	-10223%	7406%	-1657%	-2950%
Implied Value of Growth	-36.3%	-3.21	1.28	-0.18	-0.22	1.58	-2.01	-784%	452%	50%	40%

Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, J.P. Morgan Calcs

\* Implied Value Of Growth = (1 - EY/Cost of equity) where cost of equity = Bond Yield + 5.0% (ERP)

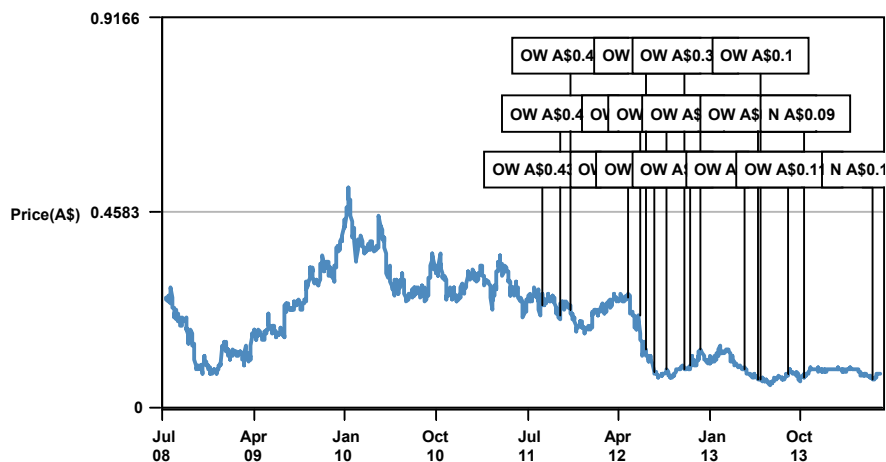
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Hillgrove Resources Ltd (HGO.AX, HGO AU) Price Chart



Date	Rating	Share Price (\$)	Price Target (\$)
12-Aug-11	OW	0.24	0.43
06-Oct-11	OW	0.22	0.42
08-Nov-11	OW	0.23	0.41
27-Apr-12	OW	0.26	0.44
01-Jun-12	OW	0.22	0.41
21-Jun-12	OW	0.14	0.41
16-Jul-12	OW	0.08	0.32
23-Aug-12	OW	0.09	0.32
12-Oct-12	OW	0.09	0.31
02-Nov-12	OW	0.10	0.31
30-Nov-12	OW	0.14	0.28
09-Apr-13	OW	0.09	0.13
24-May-13	OW	0.07	0.13
31-May-13	OW	0.06	0.10
21-Aug-13	OW	0.08	0.11
08-Oct-13	N	0.07	0.09
01-May-14	N	0.07	0.10

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Aug 12, 2011.

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J.P. Morgan ratings or designations: OW = Overweight, N= Neutral, UW = Underweight, NR = Not Rated

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IB clients*	58%	49%	40%
JPMS Equity Research Coverage	45%	48%	7%
IB clients*	78%	67%	60%

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