

## Hillgrove Resources Ltd

Solid July quarterly production report; de-risking thesis remains on track

HGO reported a solid July quarterly production report. Key highlights: 1) the company remains on track to be net cash by early CY15, 2) operations continue to track along nicely, with quarterly copper production of 5.9kt ahead of our forecast, and 3) no major changes to guidance with the change of reporting to December-year end. Maintain Overweight.

- Solid July quarterly production.** HGO produced 5.9kt Cu-in-concentrate, +2% vs. JPMe, with strong mill throughput (+12% vs. JPMe) offset by lower head grades and recoveries. Milling rates were strong despite planned maintenance and were helped by a draw down of coarse ore stocks. Rain over the quarter restricted access to mining areas within the open pits, which resulted in lower-than-expected head grades delivered to the mill (0.76% vs. JPMe 0.83%); we expect grades to track back towards ~0.80% over the coming quarter. A new screening system was also installed over the quarter which will improve efficiencies in the primary / secondary circuit and concentrate grades are expected to tick up in the coming months from the utilisation of the flotation underflow stream in the re-grind circuit. Quarterly C1 costs of US\$1.94/lb were below JPMe US\$2.06/lb, where lower-than-forecast mining costs were offset by lower by-product credits. Guidance was updated for December-year end (change of reporting), with the company guiding to 20.5-22.5kt for the 11mth to December.
- De-risking of balance sheet continues.** The company finished the quarter with cash of A\$12.1m and gross debt (ex lease liabilities) of A\$25.3m. We forecast ~A\$20m of FCF generation over 2HFY, which will be ample to repay the ~A\$13m in senior debt and ~A\$2.3m of the gold loan; we forecast HGO will be net cash by early 2015. A track record of stable operating metrics gives us further confidence in the de-risking of the balance sheet. Additionally, HGO extended hedging coverage over 90% of production until November at an average price of ~A\$3.47/lb.
- Retain Overweight.** Notwithstanding operational risks around 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 are subsiding and, as such, should help the equity re-rate over the medium-term.

### Overweight

HGO.AX, HGO AU

Price: A\$0.08

Price Target: A\$0.11

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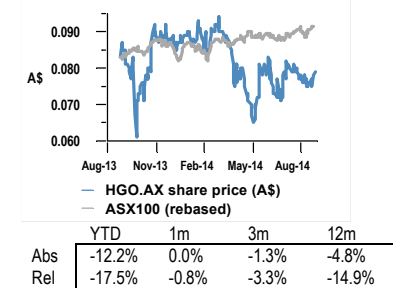
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#### Price Performance



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

Year-end Jan (A\$)	FY12A	FY13A	FY14A	FY15E	FY16E
Revenue (A\$ mn)	12	115	139	187	175
EBITDA (A\$ mn)	(2)	19	37	49	29
Net Profit (A\$ mn)	(8)	(11)	1	11	6
EPS (A\$)	(0.01)	(0.01)	0.00	0.01	0.00
P/E (x)	NM	NM	56.0	8.3	16.8
EV/EBITDA (x)	NM	6.0	3.1	1.8	2.3
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%)	921.4%	(50.2%)
Normalised PE	NM	NM	85.5	8.4	16.8

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

#### Company Data

Shares O/S (mn)	1,182
Market Cap (A\$ mn)	93.35
Market Cap (\$ mn)	86.79
Price (A\$)	0.08
Date Of Price	26 Aug 14
Free Float(%)	-
3M - Avg daily vol (mn)	0.88
3M - Avg daily val (A\$ mn)	0.07
3M - Avg daily val (\$ mn)	0.1
ASX100	4679.40
Exchange Rate	0.93
Price Target End Date	31-Jul-15
Price Target (A\$)	0.11

See page 5 for analyst certification and important disclosures, including non-US analyst disclosures.

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## Changes to forecasts

We have factored in the July quarterly production report, updated our hedge book forecasts and made minor operational changes. The net impact to earnings and valuation is shown in the table below.

Table 1: Changes to HGO forecasts

	NPV A\$ps	Underlying NPAT (A\$m)		
		2015F	2016F	2017F
Previous	0.11	15	4	3
Revised	0.11	11	6	3
Change	0.00	-4	1	0
Change	-4%	-25%	27%	6%

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			A\$m
	2014A	2015E	2016E	2017E				
Revenue	140	187	175	175	Current Market Capitalisation			92.2
Operating Expenses	(102)	(138)	(146)	(149)	EV			76.1
EBITDA	37	49	29	26				
Depreciation & Amortisation	(29)	(31)	(21)	(22)	<b>12 mth price target (July 2015)</b>			<b>0.11</b>
EBIT	8	18	8	3	Capital growth to price target			35%
Other	(1)	-	-	-	12 mth forecast DY'd			0.0%
Interest	(5)	(2)	0	1	<b>12 mth forecast total return</b>			<b>34.6%</b>
PBT	2	16	8	4	WACC			12.0%
Tax	(1)	(5)	(2)	(1)				
Minorities & other	-	-	-	-	<b>Current DCF (July 2015)</b>		<b>A\$m</b>	<b>A\$ps</b>
NPAT - reported	1	11	6	3	Kanmantoo		128.7	0.11
Exceptional items	(1)	-	-	-	Investments		0.2	0.00
NPAT - adjusted	1	11	6	3	Corporate costs		(21.8)	(0.02)
					<b>Sub-total</b>		<b>107.1</b>	<b>0.09</b>
Shares outstanding (m)	1,176	1,186	1,186	1,186	Net cash/(debt)		16.1	0.01
Reported EPS (A\$ps)	0.1	0.9	0.5	0.3	Exploration potential		3.0	0.00
Normalised EPS (A\$ps)	0.1	0.9	0.5	0.3	<b>Total</b>		<b>126.2</b>	<b>0.11</b>
Normalised EPS growth th	n/a	642%	(50%)	(44%)				
DPS (A\$ps)	0.0	0.0	0.0	0.0				
DPS growth th	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	8.3	16.6	29.6
Capex	(19)	(12)	(7)	(6)	EV / EBITDA	3.1	1.8	2.3	1.8
Free cashflow	(8)	29	23	20	Dividend yield	0%	0%	0%	0%
Investing cashflow	(22)	(12)	(7)	(6)	ROE [Norm NPAT / Equity]	0%	5%	2%	1%
Dividends	-	-	-	-	ROA [EBIT / (assets - cash)]	3%	6%	3%	1%
Financing cashflow	0	(31)	(10)	-	ROIC [EBIT / assets]	3%	6%	3%	1%
Change in cash	(11)	(2)	13	20	EBIT / net interest	1.5	8.6	na	na
					EBITDA / net interest	6.9	23.3	na	na
					Net Debt / EBITDA	0.7	na	na	na
					Gearing - net debt / equity	11%	-2%	-11%	-19%
					Gearing - net debt / (net debt + equ)	10%	-2%	-12%	-23%
					EBITDA margin	27%	26%	16%	15%
					Effective tax rate	33%	30%	30%	30%
					CFPS (A\$)	(0.7)	2.4	1.9	1.7
					FCF yield	-9%	31%	25%	22%

Balance Sheet (A\$m)					Attributable Production				
	2014A	2015E	2016E	2017E		2014A	2015E	2016E	2017E
Cash and cash equivalents	16	15	28	48	Concentrate (kt)	75.4	97.5	89.8	85.7
Property plant & equipment	226	207	192	176	Copper (kt metal in conc.)	17.2	22.5	20.1	19.2
Total assets	322	297	293	296	Gold (koz)	6.0	7.1	9.5	9.1
Debt	42	11	1	1	Silver (koz metal in conc.)	132.9	131.5	176.7	168.5
Total liabilities	94	58	48	48					
Total equity	229	240	245	248	<b>Cash Costs (C1)</b>	<b>2014A</b>	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>
Net debt / (cash)	25	(4)	(27)	(47)	US\$/lb (post credits)	2.49	2.30	2.64	2.75
					A\$/lb (post credits)	2.41	2.03	2.36	2.44
					<b>Price Assumptions</b>	<b>2014A</b>	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>
					A\$/US\$ FX rate	0.88	0.89	0.89	0.85
					Copper (US\$/t)	6,896	6,766	6,857	7,102
					Gold (US\$/oz)	1,289	1,240	1,242	1,264
					Silver (US\$/oz)	20.43	20.18	19.51	18.75

Half Yearly P&L (A\$m)				
	1H14A	2H14A	1H15E	2H15E
Revenue	58.8	80.7	92.4	94.4
Operating Expenses	-40.4	-61.6	-65.9	-71.9
EBITDA	18.4	19.1	26.5	22.5
Depreciation & Amortisation	-12.4	-16.7	-21.2	-9.8
EBIT	6.0	2.3	5.3	12.7
Other	3.3	-3.9	0.0	0.0
Interest	-3.0	-2.4	-1.4	-0.7
PBT	6.3	-4.0	4.0	12.0
Tax	-2.3	1.5	-1.2	-3.6
Minorities & other	0.0	0.0	0.0	0.0
NPAT - reported	4.0	-2.5	2.8	8.4
Exceptional items	-3.0	2.5	0.0	0.0
NPAT - adjusted	1.0	0.0	2.8	8.4

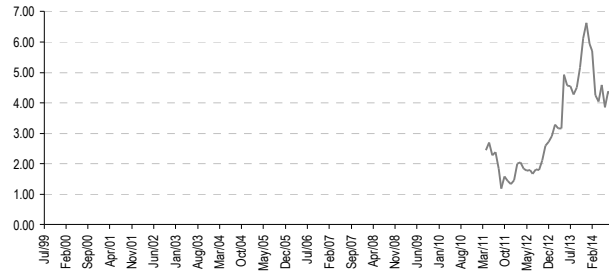
Source: J.P.Morgan estimates, Company data, Bloomberg

**JPM Q-Profile**  
**Hillgrove Resources Limited (AUSTRALIA / Materials)**  
 As Of: 22-Aug-2014

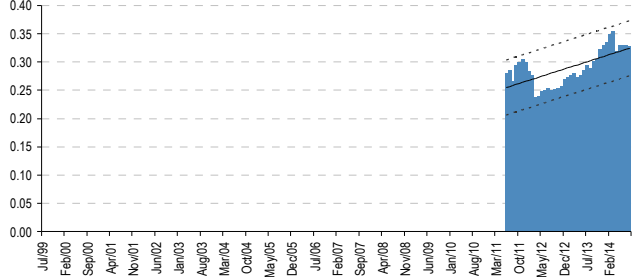
**Global Equity Quantitative Analysis**

Quant\_Strategy@jpmorgan.com

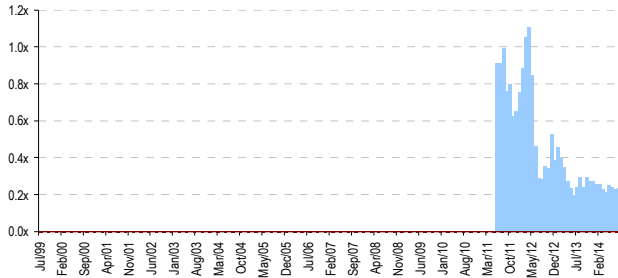
**Local Share Price** **Current: 4.22**



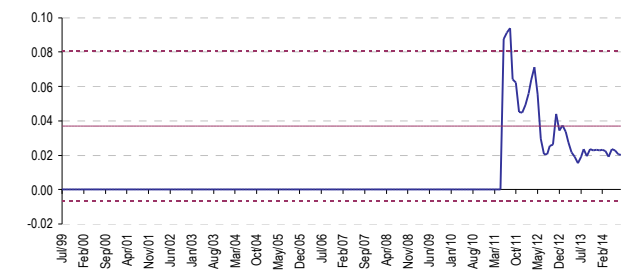
**12 Mth Forward EPS** **Current: 0.33**



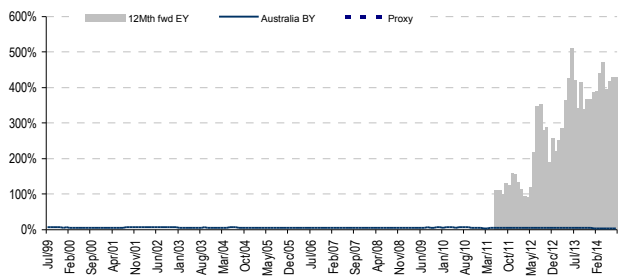
**PE (1Yr Forward)** **Current: 0.2x**



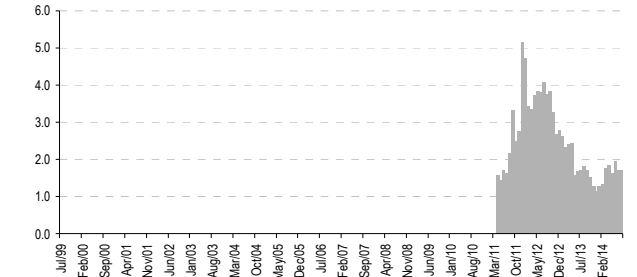
**P/E Relative to S&P/ASX 200 Index** **Current: 0.02**



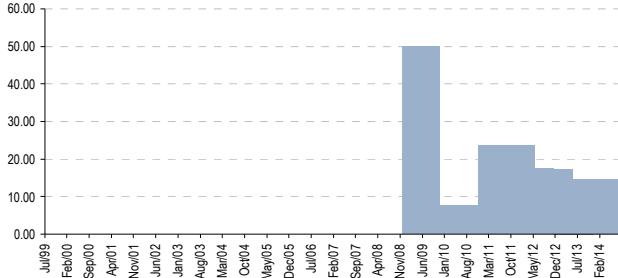
**Earnings Yield (& Local Bond Yield)** **Current: 427%**



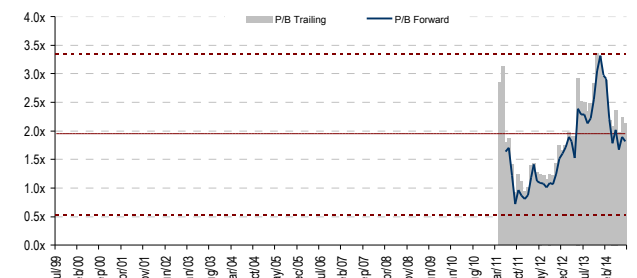
**Dividend Yield (Trailing)** **Current: 1.72**



**ROE (Trailing)** **Current: 14.44**



**Price/Book (Value)** **Current: 2.1x**



**Summary**

<b>Hillgrove Resources Limited</b>		<b>TICKER 1623 HK</b>		<b>As Of: 22-Aug-14</b>							
<b>AUSTRALIA</b>				<b>Local Price: 4.22</b>							
<b>Materials</b>				<b>EPS: 0.33</b>							
	<b>Latest</b>	<b>Min</b>	<b>Max</b>	<b>Median</b>	<b>Average</b>	<b>2 S.D.+</b>	<b>2 S.D. -</b>	<b>% to Min</b>	<b>% to Max</b>	<b>% to Med</b>	<b>% to Avg</b>
12mth Forward PE	0.23x										
P/BV (Trailing)	2.14	0.92	3.36	1.89	1.95	3.35	0.54	-57%	57%	-11%	-9%
Dividend Yield (Trailing)	1.72x	1.16	5.15	2.16	2.47	4.54	0.39	-33%	198%	25%	43%
ROE (Trailing)	14.44	7.60	50.00	17.48	22.40	50.08	-5.29	-47%	246%	21%	55%

Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, JPMorgan Quantitative & Derivative Strategy

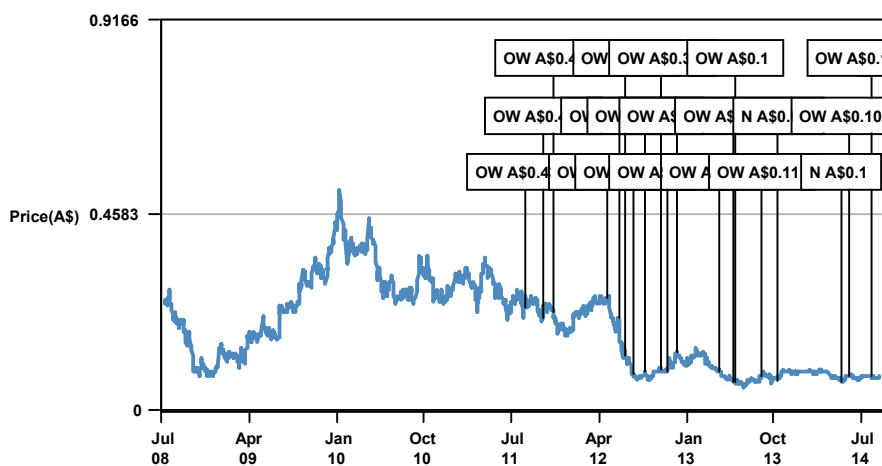
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Hillgrove Resources Ltd (HGO.AX, HGO AU) Price Chart



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

Date	Rating	Share Price (A\$)	Price Target (A\$)
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	0.12	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	0.09	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
22-May-14	OW	0.08	0.10
01-Aug-14	OW	0.08	0.11

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IB clients*	55%	49%	34%
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IB clients*	75%	66%	54%

\*Percentage of investment banking clients in each rating category.

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