



# Hillgrove Resources (HGO)

## Half Year Profit Beats The Street. On Track to Be Debt Free by Year End

### BUY

Risk: HIGH

#### Key Information

Price (\$)	0.60
Target Price (\$)	0.90
Net Present Value (\$)	0.92
Market Cap (\$M)	88.63
GICS Sector	Materials
52 week Hi-Lo (\$)	0.79 - 0.48
Daily Vol (M, mth avg)	3.96
Weight of S&P 200 Index (%)	0.88
Cash (\$M) - 01/07/14	12.15
Debt (\$M) - 01/07/14	26.30
Gearing [ND/(ND+E)] (%)	5.83
Forecast Total Return (%)	50.00

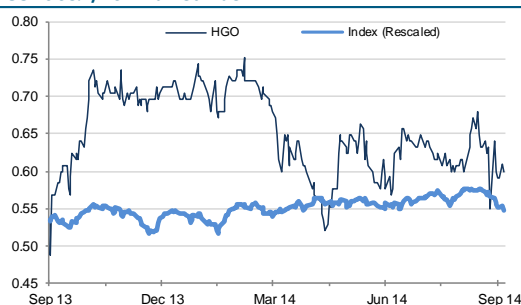
#### Investment Fundamentals

YE 31 Dec	FY12A	FY13A	FY14E	FY15E
Sales (\$M)	109.5	139.2	178.7	166.5
EBITDA (\$M)	3.7	37.3	54.2	28.0
Margin (%)	3.4	26.8	30.4	16.8
NPAT (\$M)	-13.3	1.5	12.6	-3.7
EPS (cps)	-9.0	1.0	8.5	-2.5
EPS Growth (%)	n.a.	n.a.	742.7	n.a.
DPS (cps)	0.0	0.0	0.0	1.4
Franking (%)	0.0	0.0	0.0	100.0

#### Ratio Analysis

YE 31 Dec	FY12A	FY13A	FY14E	FY15E
PE (x)	-6.6	59.2	7.0	-23.7
Yield (%)	0.0	0.0	0.0	2.3

#### HGO vs S&P/ASX Market Index



#### Performance

	1 Mth	3 Mth	12 Mth
Absolute (HGO) (%)	0.0	1.4	11.9
Rel to Market (%)	4.5	2.5	9.3

#### Major Shareholders

	%
Perennial Value	12.5
Platinum Partners	8.4
Renaissance	7.4
Colonial First State	5.5
Freeport Metals & Concentrates	4.7

#### Directors and Management

Hon. Dean Brown	Non-Executive Chairman
Greg Hall	CEO & Managing Director
Douglas Snedden	Non-Executive Director
Edwin Zemancheff	Non-Executive Director
John Gooding	Non-Executive Director
John Quirke	Non-Executive Director
Russell Middleton	CFO
Shanthi Smith	Company Secretary
Steven McClare	General Manager, Kanmantoo

### Event

#### Half Year Result to July 2014.

#### Highlights

- The Result:** HGO delivered a better than expected half year NPAT of \$5.8m (Shaw estimate \$3.1m) mainly due to lower depreciation and tax charges. Revenue of \$92.5m was in-line with Shaw's expectation of \$92.4m and EBITDA of \$27.0m was slightly below Shaw's estimate of \$27.6m. Overall, the company, through very good operational management at the Kanmantoo copper project and tighter cost control at the mine site and head office, is expected to deliver a full year profit (11 months to December 2014) of \$11.9m. Note that the company's year-end will move from a January 12 month reporting period to a December reporting period this year and hence the second half of this year will be a shortened five month period.
- Operations - Mining:** Mining operations continued in the Kavanagh, Nugent and Emily Star open pits. The Kavanagh pit is nearing planned depth, and has been the dominant source of ore supply over the half year. The Nugent pit is expanding and will become the major ore source during the Dec'14 quarter. Following receipt of the new mining lease at the side of the existing lease, a small cutback in Nugent commenced which will widen the pit to its full extent. The Emily Star pit is currently moving from oxide/transitional ore into primary ore. Both Nugent and Emily Star pits are higher grade orebodies and should provide continued excellent results over the coming five month period to December 2014 and into 2015.
- Clearing of Debt:** The improving operating, cost and financial performance allowed further scheduled debt repayments during the half year. Gross debt reduced from \$40.8m as at 31 January 2014 to \$25.4m at 31 July 2014. On our current commodity assumptions, production and cost forecasts, we expected HGO to be Net Debt free by the end of December 2014 with enough accumulated cash to repay \$10m of mezzanine debt which falls due in \$5m lots in April and July 2015.
- Capital Management:** HGO implemented a 1:8 share consolidation which was approved at an Extraordinary General Meeting on 10 September 2014. This resulted in the number of shares on issue being reduced from 1.18bn to ~148m on 17 September 2014. A small shareholder buyback to mop up ~7.5M shares is also likely. Management has signaled its intention to commence dividend payments once the mezzanine debt has been repaid. To this extent, the company has over \$21m in accumulated franking credits on the balance sheet to pay a fully franked dividend once dividend payments commence.

### Recommendation

**Our target price of 90c/share (post 1:8 consolidation) remains. BUY.**



## Financial Summary

## Market Valuation Metrics

<b>Recommendation</b>	<b>BUY</b>
<b>Risk</b>	<b>HIGH</b>
<b>Price (A\$)</b>	<b>0.60</b>
<b>Target Price (A\$)</b>	<b>0.90</b>
<b>Net Present Value (A\$)</b>	<b>0.92</b>
<b>Issued Capital (M)</b>	<b>147.7</b>
<b>Market Cap (\$m)</b>	<b>88.6</b>
<b>Year End</b>	<b>31 Dec</b>

## Investment Statistics

YE 31 Dec	FY12A	FY13A	FY14E	FY15E	FY16E
<b>NPAT (Reported)</b>	(11.8)	1.5	12.6	(3.7)	1.8
<b>NPAT (Adjusted)</b>	(13.3)	1.5	12.6	(3.7)	1.8
<b>EPS (Adj \$)</b>	(0.09)	0.01	0.09	(0.03)	0.01
<b>P/E (x)</b>	n.a.	59.2	7.0	n.a.	49.3
<b>P/NPV (x)</b>	n.a.	11.2	0.6	0.6	0.5
<b>Div (cps)</b>	0.0	0.0	0.0	1.4	2.7
<b>Yield (%)</b>	0.0%	0.0%	0.0%	2.3%	4.5%
<b>Franking (%)</b>	0%	0%	0%	100%	100%
<b>(ND/(ND+E)) (%)</b>	9.4%	9.9%	0.0%	0.0%	0.0%
<b>Net Debt/Equity (%)</b>	10.4%	11.0%	0.0%	0.0%	0.0%
<b>ROE (%)</b>	-6.1%	0.7%	5.2%	-1.6%	0.8%
<b>ROA (%)</b>	-4.0%	0.5%	4.2%	-1.3%	0.6%

## Profit &amp; Loss Statement (A\$m)

YE 31 Dec	FY12A	FY13A	FY14E	FY15E	FY16E
Revenue	109.5	139.2	178.7	166.5	155.3
Revenue growth (%)	na	27.0%	28.4%	(6.8%)	(6.7%)
<b>EBITDA</b>	3.7	37.3	54.2	28.0	32.9
EBITDA margin (%)	3.4%	26.8%	30.4%	16.8%	21.2%
Depreciation & Amortization	(26.5)	(29.2)	(36.6)	(31.7)	(29.5)
<b>EBIT</b>	(23.5)	8.2	16.7	(5.7)	1.4
EBIT margin (%)	(21.5%)	5.9%	9.3%	(3.4%)	0.9%
Net interest	(6.5)	(5.9)	(2.9)	0.4	1.2
Pretax profit	(19.1)	2.2	14.9	(5.3)	2.6
Tax	8.8	(2.1)	(2.3)	1.6	(0.8)
<b>Reported NPAT</b>	<b>(11.8)</b>	<b>1.5</b>	<b>12.6</b>	<b>(3.7)</b>	<b>1.8</b>
Significant items	(1.6)	0.0	0.0	0.0	0.0
<b>Normalised NPAT</b>	<b>(13.3)</b>	<b>1.5</b>	<b>12.6</b>	<b>(3.7)</b>	<b>1.8</b>
NPAT margin (%)	(12.2%)	1.1%	7.1%	(2.2%)	1.2%

## Cashflow Statement (A\$m)

YE 31 Dec	FY12A	FY13A	FY14E	FY15E	FY16E
EBITDA	3.7	37.3	54.2	28.0	32.9
Working Capital Investment (Inc)/Dec	5.7	(21.4)	2.6	14.1	(0.4)
Gross Cash Flow	9.4	15.9	56.9	42.1	32.5
Net interest (paid)/received	(6.5)	(2.8)	(2.9)	0.4	1.2
Tax Paid	0.0	0.0	0.0	0.0	0.0
Other	28.6	0.7	12.7	0.0	0.0
<b>Operating cashflow</b>	<b>31.5</b>	<b>13.8</b>	<b>66.7</b>	<b>42.5</b>	<b>33.7</b>
Investing Activities	(45.7)	(22.2)	(36.6)	(26.6)	(18.3)
<b>Free Cash Flow</b>	<b>(14.2)</b>	<b>(8.5)</b>	<b>30.1</b>	<b>15.9</b>	<b>15.4</b>
Equity raised/options exercised	17.8	10.8	0.0	0.0	0.0
Debt Raised/(paid)	15.0	(10.9)	(29.2)	(11.1)	0.0
Dividends paid	0.0	0.0	0.0	(2.0)	(4.0)
Other	(11.9)	(2.4)	(1.8)	0.0	0.0
<b>Financing cashflow</b>	<b>20.9</b>	<b>(2.5)</b>	<b>(31.0)</b>	<b>(13.1)</b>	<b>(4.0)</b>
<b>Net change in cash</b>	<b>6.7</b>	<b>(11.0)</b>	<b>(0.9)</b>	<b>2.8</b>	<b>11.4</b>

## Balance Sheet (A\$m)

YE 31 Dec	FY12A	FY13A	FY14E	FY15E	FY16E
Cash	27.4	16.5	13.5	16.3	27.6
Property, Plant & Equipment	260.6	256.2	248.3	241.2	228.0
Deferred Tax Asset	12.9	13.8	8.2	9.8	9.1
Other	35.1	35.7	29.6	16.0	15.2
<b>Total assets</b>	<b>336.0</b>	<b>322.2</b>	<b>299.7</b>	<b>283.3</b>	<b>280.0</b>
Debt	50.3	41.7	11.1	0.0	0.0
Other	65.1	52.0	44.0	44.4	43.3
<b>Total liabilities</b>	<b>115.4</b>	<b>93.7</b>	<b>55.1</b>	<b>44.4</b>	<b>43.3</b>
<b>Total shareholders equity</b>	<b>220.6</b>	<b>228.5</b>	<b>244.6</b>	<b>238.9</b>	<b>236.7</b>

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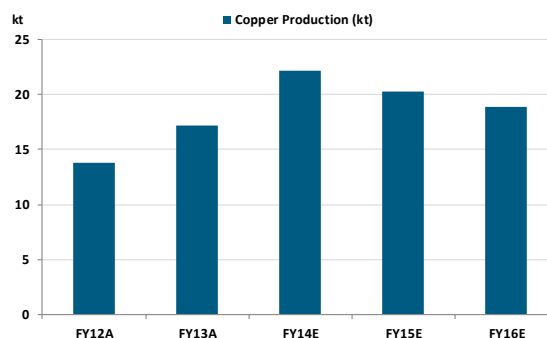
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## Production (kt)

YE 31 Dec	FY12A	FY13A	FY14E	FY15E	FY16E
Kanmantoo	13.7	17.2	22.1	20.3	18.9
Other	0.0	0.0	0.0	0.0	0.0
<b>Total</b>	<b>13.7</b>	<b>17.2</b>	<b>22.1</b>	<b>20.3</b>	<b>18.9</b>



## Cash Costs Summary (US\$/lb)

YE 31 Dec	FY12A	FY13A	FY14E	FY15E	FY16E
C1 Cash Costs	2.19	2.37	2.05	2.35	2.23
<b>Total Costs</b>	<b>3.20</b>	<b>3.15</b>	<b>2.79</b>	<b>3.01</b>	<b>2.89</b>

## Total Resources &amp; Reserves

Resources	Mt	Cu (%)	Au (g/t)	Ag (g/t)	Cu (kt)
Total - In Situ	31.2	0.80	0.15	2.2	256.6
Total - Stockpiles	1.6	0.37	n.a.	n.a.	5.9
<b>Total Kanmantoo</b>	<b>32.8</b>	<b>0.80</b>	<b>0.15</b>	<b>2.2</b>	<b>262.6</b>

Reserves	Mt	Cu (%)	Au (g/t)	Ag (g/t)	Cu (kt)
Total - In Situ	20.7	0.73	0.18	1.9	150.3
Total - Stockpiles	1.4	0.46	na	na	6.4
<b>Total Kanmantoo</b>	<b>22.1</b>	<b>0.71</b>	<b>0.18</b>	<b>1.9</b>	<b>156.9</b>

## Base Case Assumptions\*

YE 31 Dec	FY'13A	FY'14E	FY'15E	FY'16E	FY'17E
Copper Price (US\$/t)	8,068	7,348	6,855	6,814	6,922
A\$:US\$	1.0339	0.9498	0.9125	0.8800	0.8700

\* Bloomberg &amp; Consensus Economics

## Sum of the Parts Valuation

	\$m	/Share
Kanmantoo	159.1	1.08
Hedging	2.7	0.02
Corporate Costs	-16.3	-0.11
Net Debt/Cash	-14.1	-0.10
Other/Exploration	5.0	0.03
<b>Total</b>	<b>136.4</b>	<b>0.92</b>

## Sensitivity Analysis - Changes in Copper Price

Copper Price (US\$/t) & Spot FX - In Perpetuity	DCF	/share
<b>Base Case Assumptions</b>	<b>136</b>	<b>0.92</b>
\$6,500	46	0.31
\$6,750	69	0.47
<b>\$6,774 (Spot)</b>	<b>71</b>	<b>0.48</b>
\$7,000	92	0.62
\$7,500	138	0.93
\$8,000	173	1.17

## Sensitivity Analysis - Changes in Discount Rate

Discount Rate	DCF	/share
7%	155	1.05
8%	149	1.01
9%	142	0.96
<b>10% (Base Case)</b>	<b>136</b>	<b>0.92</b>
11%	131	0.88
12%	125	0.85
13%	120	0.81

## Financial Performance

HGO delivered a better than expected half year NPAT of \$5.8m (Shaw estimate \$3.1m) mainly due to lower depreciation and tax charges. Revenue of \$92.5m was in-line with Shaw's expectation of \$92.4m and EBITDA of \$27.0m was slightly below Shaw's estimate of \$27.6m. Overall, the company, through very good operational management at the Kanmantoo copper project and tighter cost control at the mine site and head office, is expected to deliver a full year profit (11 months to December 2014) of \$11.9m. Note that the company's year-end will move from a January 12 month reporting period to a December reporting period this year and hence the second half of this year will be a shortened five month period.

**Table 1: Year on Year Financial Result Comparison (\$m)**

\$'m	Jul-13	Jul-14	\$'m Change
Revenue from sale of concentrates	58.6	92.5	33.9
Other income	0.2	0.0	-0.2
Cost of production	-29.4	-63.6	-34.2
Changes in inventories of ore and concentrate - Cash	-1.2	5.6	6.8
Materials and services costs	-2.6	-2.6	0.0
Employee expenses	-3.8	-3.0	0.8
Royalties	-0.7	-1.1	-0.4
Corporate and other administration costs	-1.4	-1.5	-0.1
Net foreign exchange gains / (losses)	-1.1	0.7	1.8
<b>EBITDA</b>	<b>18.6</b>	<b>27.0</b>	<b>8.4</b>
Depreciation and amortisation expenses	-12.4	-19.9	-7.5
Gains on derivative financial instruments	3.6	0.4	-3.2
Net financing expenses	-3.0	-1.8	1.2
Other non-cash income/(costs)	-0.5	0.4	0.9
Profit before income tax	6.3	6.1	-0.2
Income tax expense	-2.3	-0.3	2.0
<b>Profit after income tax</b>	<b>4.0</b>	<b>5.8</b>	<b>1.8</b>

Source: Hillgrove Resources & Shaw Stockbroking

### Hedging

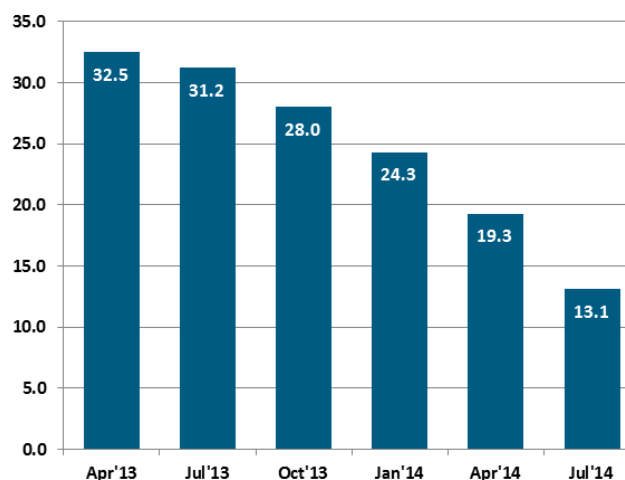
HGO's hedging strategy continued to provide support for Kanmantoo's production revenue and debt repayments. The additional hedging placed in January 2014 of 2,280t provided 90% hedge coverage of payable production for the half year at an average price of A\$8,140/t providing substantial support to allow the total debt reduction of A\$15.6m during the half. Along with this, HGO entered into additional copper hedging contracts in August 2014 to increase the hedge cover to 90% between August and November 2014. This was also done at an opportune time of firmer copper prices to help cover revenue streams required for future debt repayments. These additional hedges were secured at an average price of A\$7,642/t (A\$3.47/lb) for an additional 1,487t, which compares favourably to the current spot price of circa A\$7,500/t. As at the end of July 2014, HGO held 25,000t of copper swaps at an average price of A\$7,800/t with the final expiry in March 2016.

### Balance Sheet

HGO's net debt declined from A\$19.3m (Apr'14) to A\$14.1m as of end of July 2014 (gross debt: A\$26.3m). We forecast HGO to be in a net cash position by the end of calendar 2014 which should enable dividend payments to commence in 2015, with A\$21.3m of franking credits previously accumulated (14.4c/share). Under its newly adopted dividend policy HGO will aim to maintain a minimum dividend payment payout of 40% of net profit, excluding non-recurring items.



Chart 1: HGO Net Debt Profile (A\$m)



Source: Hillgrove Resources & Shaw Stockbroking

### Guidance

Calendar 2014 guidance (adjusted to reflect the change of reporting date, resulting in an eleven month reporting period for the year) was reaffirmed. The revised copper production guidance is proportionally in line with original guidance at 20,500-22,500t of copper in concentrate, although at higher throughput and lower grade. C1 cash cost guidance has reduced from US\$2.10-2.40/lb to US\$2.00-2.20/lb.

Table 2: 2014 Guidance Summary

	Units	HGO Guidance	Shaw Estimates	Upper / Lower end of Guidance
Ore Mined	(kt)	2,850 - 3,000	2,992	Upper
Ore Processed	(kt)	2,900 - 3,000	2,995	Upper
Processed Ore Grade	(% Cu)	0.76 - 0.81%	0.80%	Upper
Copper Recovery	(%)	91.5 - 92.5%	92.0%	Mid
Copper Produced	(t)	20,500 - 22,500	22,117	Upper
Gold Produced	(oz)	6,000 - 7,800	5,804	Below
C1 Cash Cost	US\$/lb	2.00 - 2.20	2.04	Lower

Source: Hillgrove Resources & Shaw Stockbroking

### Shaw Commentary

HGO has over-delivered on production over the last three quarters when new site management and control of site services was taken over. Financially, the company has also delivered with strong cash flow enabling the repayment of debt and placing the company in a healthy financial position to commence payment of dividends post the repayment of \$10m in mezzanine debt by July 2015. **We maintain our BUY recommendation and 90c/share price**

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## Rating Classification

Buy	Expected to outperform the overall market
Hold	Expected to perform in line with the overall market
Sell	Expected to underperform the overall market
Not Rated	Shaw has issued a factual note on the company but does not have a recommendation

## Risk Rating

High	Higher risk than the overall market – investors should be aware this stock may be speculative
Medium	Risk broadly in line with the overall market
Low	Lower risk than the overall market.

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