

## Australian Equity Research

2 February 2015

## BUY

unchanged

PRICE TARGET A\$1.05↓

from A\$1.25

Price (2-Feb) A\$0.37  
Ticker HGO-ASX

52-Week Range (A\$):	0.35 - 0.75
Avg Daily Vol (M) :	0.1
Shares Out. (M) :	147.7
Market Cap (A\$M):	53.9
Enterprise Value (A\$M):	79.1
Cash (A\$M):	8.80
Long-Term Debt (A\$):	(18.0)
NAV /Shr (AUC):	1.05
Major Shareholders:	Perennial Value Mgt 12.5% Platinum Partners 8.4%

FYE Dec	2014E	2015E	2016E
Cu prod'n (000t)	21	18	19
C1 Cash Cost (US\$/lb)	2.13	1.95	2.09
EBITDA (A\$M)	41.0↓	32.0↓	32.5↓
Previous	41.5	46.7	58.4
P/E (x)	29.3	15.5	15.4



Hillgrove Resources Ltd (HGO:ASX) is an Australian mining company whose primary asset is the 100%-owned Kanmantoo copper mine, located in South Australia

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## Lowering Target Price

## DecQ Report: Things could get tight

## Investment Recommendation

HGO has recorded a solid FY14, with DecQ production allowing HGO to meet FY14 guidance. While we are encouraged by continued improvement in key operating aspects at the project level, we are now concerned about the impact of lower metal prices on HGO's ability to meet its current debt repayment schedule and capex obligations. HGO has commenced discussions with financiers, and we note that any re-financing is relatively modest versus HGO's market cap. We maintain our BUY rating on valuation, but see elevated financial risk until any debt re-structuring is completed.

## Investment Highlights

- HGO reported DecQ production 4.8kt Cu in concentrate, 12% below our forecasts due to lower than modelled grades and recoveries. On the positive side, this was offset during the DecQ by record mill throughput. C1 costs also missed our estimates at US \$1.97/lb due primarily to lower Cu production. The result took FY14 production to 20.7kt, in line with guidance and our estimates.
- Cash was reported at \$9m, below our forecasts due to lower than modelled production/concentrate sales. Debt was reduced to \$18m, while un-audited FY14 EBITDA was in line with CGe at A\$42m. HGO maintains a hedge book covering ~78% of production until MarQ'16 at an average price of A\$3.50/lb (vs spot Cu of A\$3.20/lb).
- 2015 guidance was also provided at 18.5-20.5kt Cu in concentrate (vs CG prior estimates of 19.5kt), as part of an updated Life of Mine Plan (LOMP). The new plan includes the treatment of +2.2 Mt of stockpiled oxide ore (via the addition of a sulphidisation circuit in 1H'15), and an increase in milling and mining rates, with annual production of ~20kt Cu over a +6 year mine life. The cut-back of the "Giant" pit remains central to the new LOMP, with capex guidance (including pre-strip) for FY15 of A\$21-23m above our previously modelled assumptions.
- Against a backdrop of volatile metal prices, we have stress tested our estimated cashflows versus HGO's capital requirements and debt repayment schedule, and conclude that HGO is unlikely to be able to meet its existing obligations under a spot pricing/FX scenario. In our view, HGO will need to refinance its current debt position in order to provide capital flexibility as it funds the cut-back of the Giant pit. We understand that HGO is in discussions with financiers, and as a result, we have revised our financing assumptions to include replacing existing short dated facilities with longer-term debt. We expect HGO to provide details of its debt restructuring efforts in the coming 4-6 weeks.

## Valuation

We have updated our model for the DecQ, including making minor revisions to our LOM production estimates as a result of HGO's updated LOMP, as well as revisions to our FY15 capital expenditure estimates. The net result is a 16% decrease in our target price (derived from a sum of the parts NAV comprising NPV<sub>8%</sub> of operating assets net of corporate and other adjustments) to A\$1.05/share.

## FINANCIAL SUMMARY

### Hillgrove Resources Limited

HGO:ASX

Analyst : Reg Spencer  
Date: 2/02/2015  
Year End: December\*

Rating: **BUY**  
Target Price: **\$1.05**

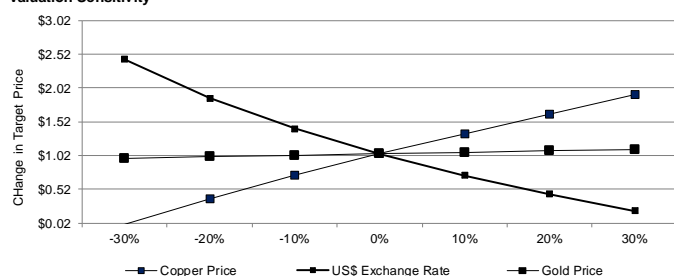
#### Market Information

Share Price	A\$	0.37
Market Capitalisation	A\$m	53.9
12 Month Hi-Lo	A\$	0.752-0.35
Issued Capital	m	148
Options	m	16
Fully Diluted	m	164

Valuation		A\$m	A\$/share
Kanmantoo	NPV @ 8%	190.0	1.29
Exploration		5.0	0.03
Corporate		(24.3)	(0.16)
Copper Forwards NPV		(6.6)	(0.04)
Cash		8.8	0.06
Debt		(18.0)	(0.12)
Total NAV		154.9	1.05
Price/NAV			0.35x
Target Price (rounded)			1.05

Assumptions	2014a*	2014e	2015e	2016e
Gold Price (US\$/oz)	1,300	1,224	1,208	1,220
Copper Price (US\$/lb)	3.19	3.07	2.98	3.06
AUD:USD	0.91	0.85	0.79	0.78

#### Valuation Sensitivity



Production Metrics	2014a*	2014e	2015e	2016e
<b>Kanmantoo</b>				
Cu Prod'n (kt)	17.2	20.7	18.4	18.8
C1 Costs (A\$/lb)	2.62	2.51	2.47	2.68
All in Sust. Costs (A\$/lb)	3.29	3.18	3.04	3.05

Group Reserves & Resources	Mt	Grade Cu	Tonnes Cu
<b>Reserves (100%)</b>			
Kanmantoo	22.10	0.71%	156,730
<b>Resources (100%)</b>			
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

Substantial Shareholders	Shares (m)	%
Perennial Value Mgt	18.46	12.5%
Platinum Partners	12.36	8.4%
Renaissance Smaller Co's	10.90	7.4%

Source: Company reports & Canaccord Genuity estimates  
\* - moved to Dec Yr-end reporting from Jan Year -end as at August'14

#### 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 7 years.

Profit & Loss (A\$m)	2014a*	2014e	2015e	2016e
<b>Revenue</b>	139.2	168.1	150.1	162.4
Operating Costs	107.9	125.6	111.4	122.6
Royalties	1.6	2.1	2.0	2.2
Corporate & O'heads	3.2	3.5	4.9	5.0
Exploration (Expensed)	0.0	0.0	0.4	0.8
<b>EBITDA</b>	<b>39.4</b>	<b>41.0</b>	<b>32.0</b>	<b>32.5</b>
Dep'n	29.2	37.4	25.5	26.4
<b>EBIT</b>	<b>10.3</b>	<b>3.6</b>	<b>6.5</b>	<b>6.0</b>
Net Interest	0.8	-2.3	-0.9	0.2
Tax	0.8	1.1	1.5	2.1
<b>NPAT</b>	<b>-6.4</b>	<b>14.1</b>	<b>3.5</b>	<b>3.5</b>
Abnormals	-7.9	7.1	0.0	0.0
<b>NPAT (reported)</b>	<b>1.6</b>	<b>6.9</b>	<b>3.5</b>	<b>3.5</b>

Cash Flow (A\$m)	2014a*	2014e	2015e	2016e
<b>Cash Flow (A\$m)</b>				
Cash Receipts	121.3	171.6	151.0	161.1
Cash paid to suppliers & employees	-107.5	-113.7	-118.3	-129.8
Tax Paid	0.0	0.0	0.0	-2.1
Net Interest	-2.8	-2.3	-0.9	0.2
Other costs	0.0	5.3	0.0	0.0
<b>Operating Cash Flow</b>	<b>11.0</b>	<b>61.0</b>	<b>31.8</b>	<b>29.4</b>
Exploration and Evaluation	-3.8	-0.7	-0.8	-0.4
Capex	-19.0	-45.4	-20.8	-8.2
Other	0.4	0.0	0.0	0.0
<b>Investing Cash Flow</b>	<b>-22.3</b>	<b>-46.1</b>	<b>-21.6</b>	<b>-8.7</b>
Debt Drawdown (repayment)	-9.8	-22.6	-1.0	-17.0
Share capital	10.8	0.0	0.0	0.0
Dividends	0.0	0.0	0.0	0.0
Financing Expenses	-0.6	0.0	0.0	0.0
<b>Financing Cash Flow</b>	<b>0.4</b>	<b>-22.6</b>	<b>-1.0</b>	<b>-17.0</b>
Opening Cash	27.4	16.5	8.8	18.0
Increase / (Decrease) in cash	-10.9	-7.7	9.2	3.8
FX Impact	0.0	0.0	0.0	0.0
<b>Closing Cash</b>	<b>16.5</b>	<b>8.8</b>	<b>18.0</b>	<b>21.8</b>

Balance Sheet (A\$m)	2014a*	2014e	2015e	2016e
<b>Balance Sheet (A\$m)</b>				
Cash + S/Term Deposits	16.5	8.8	18.0	21.8
Other current assets	35.4	40.4	36.2	39.1
<b>Current Assets</b>	<b>51.9</b>	<b>49.2</b>	<b>54.2</b>	<b>60.9</b>
Property, Plant & Equip.	225.7	233.7	228.9	210.7
Exploration & Develop.	30.5	31.3	32.2	32.6
Other Non-current Assets	14.1	25.3	22.6	9.9
Payables	23.9	21.9	19.6	21.2
Short Term debt	22.8	26.0	17.0	0.0
Long Term Debt	18.0	17.0	0.0	0.0
Other Liabilities	28.9	46.3	69.4	57.6
<b>Net Assets</b>	<b>228.5</b>	<b>228.4</b>	<b>231.8</b>	<b>235.3</b>
Shareholders Funds	206.9	206.9	206.9	206.9
Reserves	-3.3	-10.5	-10.5	-10.5
Retained Earnings	25.0	32.0	35.4	38.9
<b>Total Equity</b>	<b>228.5</b>	<b>228.4</b>	<b>231.8</b>	<b>235.3</b>

Ratios & Multiples	2014a*	2014e	2015e	2016e
<b>Ratios &amp; Multiples</b>				
EBITDA Margin	28%	24%	21%	20%
EV/EBITDA	11.5x	1.5x	1.7x	1.0x
Op. Cashflow/Share	\$0.01	\$0.41	\$0.22	\$0.20
P/CF	39.0x	0.9x	1.7x	1.8x
EPS	\$0.00	\$0.01	\$0.02	\$0.02
EPS Growth	-114%	579%	88%	1%
PER	198.5x	29.3x	15.5x	15.4x
Dividend Per Share	\$0.000	\$0.000	\$0.000	\$0.000
Dividend Yield	0%	0%	0%	0%
ROE	1%	3%	1%	1%
ROIC	5%	2%	4%	4%
Debt/Equity	8%	7%	0%	0%
Net Interest Cover	nm	1.3x	nm	nm
Book Value/share	\$0.19	\$1.55	\$1.57	\$1.59
Price/Book Value	1.9x	0.2x	0.2x	0.2x

## Appendix: Important Disclosures

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Hillgrove Resources Limited - HGO

Our target price is derived from a sum of the parts net asset valuation comprising NPV8% of operating assets net of corporate and other adjustments.

### Risks to achieving Target Price / Valuation:

Hillgrove Resources Limited - HGO

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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#### Global Stock Ratings (as of 02/02/15)

Rating	Coverage Universe		IB Clients
	#	%	%
Buy	595	58.16%	32.61%
Hold	332	32.45%	14.76%
Sell	45	4.40%	2.22%
Speculative Buy	51	4.99%	58.82%
	1023*	100.0%	

\*Total includes stocks that are Under Review

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