

Hillgrove Resources (HGO)

First production December 2011

Copper-gold concentrate, SA; Indonesian exploration

Recommendation

BUY

Price

30c

Valuation

41c

ASX / S&P Sector

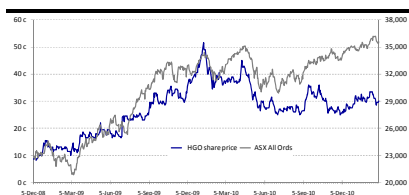
Metals & Mining

- HGO is re-developing the Kanmantoo copper-gold mine in South Australia, which was previously mined 1970 – 1976.
- HGO expects to produce 21kt/yr of copper, at a cash cost of \$1.61/lb, starting December 2011.
- HGO also has highly prospective ELs, near the Kanmantoo mine and in 2 areas of Indonesia.
- Intersuisse's base case valuation of 41c a HGO share gives zero value to HGO's exploration and also assumes copper prices falling back to \$3/lb, and gold back to \$1,000/oz.
- Intersuisse's valuation using spot prices, and the planned increase in throughput to 3.5Mt/yr, is 67c.

Snapshot

Last Price	\$0.300
Market Cap.	\$234 million
Shares on Issue	794m
52 Week High	\$0.515
52 Week Low	\$0.250

Price Chart



HGO is currently re-developing the Kanmantoo copper-gold mine in South Australia, which was mined from 1970 to 1976 by Broken Hill South.

HGO's first date for production was late 2008; some of this delay can be attributed to more conservative financing following the GFC, most of the delay can be attributed to over-optimistic projections. The previous CEO stepped down in June 2010.

After many delays, construction is now taking place.

HGO also has very attractive exploration prospects in Indonesia as well as near the Kanmantoo mine

See www.hillgroveresources.com.au

Analyst: Pieter Bruinstroop :

Investment Highlights

- HGO has secured finance and on-site project construction has started.
- Kanmantoo is expected to produce 21kt, or 46M lb, of copper, a year, at a cash cost of \$1.61/lb, which compares with current copper prices of over \$4.50/lb.
- HGO has valuable exploration prospects in the Kanmantoo exploration lease area and for gold in Sumba Island and copper-gold at Brid's Head, West Papua.
- Assuming successful project delivery and exploitation of existing resources, with current spot prices, Intersuisse's valuation is 90c.

Review

The HGO share price has lagged the copper price and also its progress in development. In Intersuisse's view, this is because the market has become dis-illusioned with has over-promising and under-delivering :

- First mine production will be about 4 years later than originally proposed;
- Development costs are much higher; and
- Much more equity has been required.

In Intersuisse's view, the change in the MD in the middle of 2010 has changed HGO from an entrepreneurial focus to an operations focus, to be able to deliver HGO's potential value

Recommendation

Intersuisse initiates research on HGO with a BUY recommendation.

In our view, the current share price is a significant discount to the value of the Kanmantoo mine re-development. Investors get exploration upside that could have significant potential, for nothing.

Hillgrove Resources Limited (HGO)

HGO is re-developing the Kanmantoo mine in South Australia that was mined by Broken Hill South from 1970 to 1976, producing 4.05Mt of ore at 1.1% copper. The mine was shut when copper was about \$1,500/t (\$5,800/t in 2010 terms) due to falling copper prices and also extended industrial action.

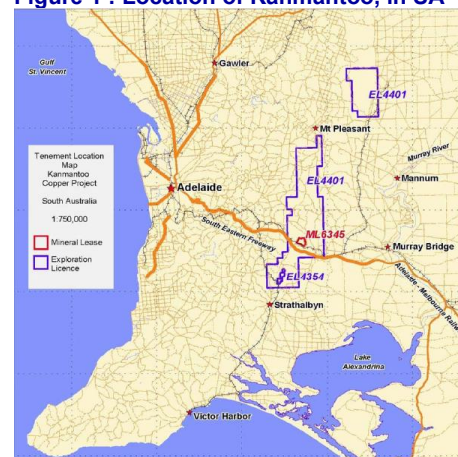
Figure 1 shows that Kanmantoo is in South Australia, 55km from Adelaide, along the south-eastern freeway.

Figure 2 shows that Kanmantoo has Resources of 32.2Mt, grading 0.9% copper, 0.2g/t gold and 3.2g/t silver, of which mineable reserves are 14.8Mt at similar grades.

Figure 3 shows the detail of Intersuisse's valuation of HGO, of 41.2c a HGO share. Note :

- 31.3c of Intersuisse's valuation is in the Reserves shown in Figure 2b
- Intersuisse has given some value to the Resources, as we believe that more than 15Mt will be mined.

Figure 1 : Location of Kanmantoo, in SA



Source : Hillgrove Resources, Presentation

Kanmantoo is 55km from Adelaide by freeway

Kanmantoo has 32.2Mt of resources, at 0.9% copper, 0.2g/t gold and 3.2g/t silver

Figure 2a : Kanmantoo Resources

Resources	Copper	Gold	Silver	
Measured	2.3 Mt	0.9 %	0.2g/t	3.5g/t
Indicated	22.5 Mt	0.9 %	0.2g/t	3.3g/t
Inferred	7.4 Mt	0.9 %	0.2g/t	2.9g/t
Total	32.2 Mt	0.9 %	0.2g/t	3.2g/t

Source : Hillgrove Resources

Figure 2b : Kanmantoo Reserves

Reserves	Copper	Gold	Silver	
Proved	2.3 Mt	0.87 %	0.13g/t	3.2g/t
Probable	12.5 Mt	0.84 %	0.18g/t	3.1g/t
Total	14.8 Mt	0.84 %	0.17g/t	3.1g/t

Source : Hillgrove Resources

Intersuisse's base case valuation of HGO is 41.2c a share

- Intersuisse's valuation :
- is risk weighted
 - gives NO value for exploration; and
 - assumes falling metals prices.

Figure 3 : Detail of Intersuisse's valuation of HGO, of 41.2c a share

discount rate =	12%	31-Jan-11		01-Mar-11	
		100%	Product	per share	
Kanmantoo Reserves	90 %	\$A 162.4m	\$A 146.2m	18.0 c	18.5 c
fanking credits	54 %	\$A 44.7m	\$A 24.1m	3.0 c	3.0 c
Kanmantoo Resources	80 %	\$A 78.1m	\$A 62.5m	7.7 c	7.8 c
fanking credits	48 %	\$A 32.3m	\$A 15.5m	1.9 c	1.9 c
Kanmantoo Extensions	50 %	\$A 0.0m	\$A 0.0m	0.0 c	0.0 c
fanking credits	30 %	\$A 0.0m	\$A 0.0m	0.0 c	0.0 c
Corporate	100 %	(\$A 20.4m)	(\$A 20.4m)	(2.5c)	(2.5c)
Exploration - Sumba	100 %	(\$A 25.7m)	\$A 0.0m	0.0 c	0.0 c
Exploration - Bird's Head	100 %	(\$A 25.7m)	\$A 0.0m	0.0 c	0.0 c
Exploration - other	100 %	(\$A 12.8m)	\$A 0.0m	0.0 c	0.0 c
Hedging	100 %	(\$A 17.5m)	(\$A 17.5m)	(2.2c)	(2.2c)
Cash / debt	100 %	\$A 114.8m	\$A 114.8m	14.1 c	14.0 c
Investments	100 %	\$A 1.7m	\$A 1.7m	0.2 c	0.2 c
Options	100 %	\$A 4.4m	\$A 4.4m	0.5 c	0.5 c
TOTAL		\$A 336.2m	\$A 331.2m	40.8 c	41.2 c
	Shares on issue	793.6m	FPO shares	19.1m	options

Source : Intersuisse estimates

Intersuisse believes that HGO has valuable exploration near mine and also in Indonesia

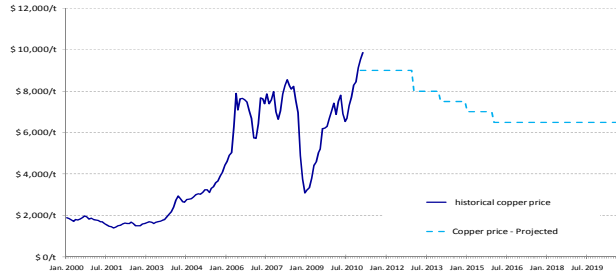
Figure 3 also shows that Intersuisse has given zero value to HGO's exploration. There are 3 focus areas to HGO's exploration :

- Near the Kanmantoo mine, within the exploration leases shown in Figure 1, in which there are many old copper and lead-zinc mines;
- 80% of an EL on Sumba Island, near Batu Hijau on Sumbawa, west of Timor, which has given good gold grades from rock chip sampling, trenching and some shallow drilling; and
- 80% of Bird's Head, an EL on the north coast of West Papua, which contains extensive porphyry style copper-gold and epithermal gold mineralisation and has yielded very good copper-gold grades from trench sampling.

While Intersuisse believes that each of these projects will add value, we do not ascribe any value to them.

The analysis in the main report shows that Kanmantoo is dominantly a copper project. Figure 4 shows the historical copper price and the projected copper prices used by Intersuisse in deriving our base case valuation of 41c. It shows that Intersuisse's valuation is based on copper prices falling to \$3.00/lb, from present levels over \$4.50/lb.

Figure 4 : Historical copper prices and Intersuisse's projections



Source : IRESS, Intersuisse estimates

If current spot prices are assumed, then Intersuisse's valuation increases to 61.5c.

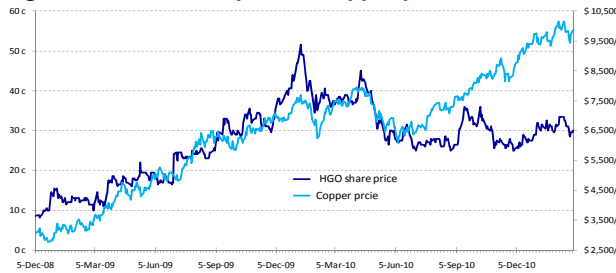
Expanding to 3.5Mt/yr, from 2.7Mt/yr, increase the valuation to 67c.

Removal of the risk discount, due to successful project delivery, further increases this valuation to 90c per HGO share.

Successful project delivery, and expanded production, with base case price projections gives a derived valuation of 62c a HGO share.

Figure 5 shows that the HGO share price moved with the copper price, until about early July, when the copper price moved up but the HGO share price has stayed flat.

Figure 5 : HGO share price v. copper price



Source : IRESS, Intersuisse

In July the original CEO, David Archer, stood down and was replaced by Drew Simonsen, as project development became bogged down, as detailed in Appendix 1, by

- delayed approvals;
- delayed financing, due to the need to do more close spaced drilling; and
- a need for more equity than had been expected

Conclusions

The HGO share price has been left behind by the improving copper price. Intersuisse believes that this has been due to over-promising and under-delivering.

Intersuisse's base case valuation is 41c, which is a significant premium to the current share price of 30c.

There is significant upside potential to Intersuisse's valuation from :

- successful project delivery;
- metals prices remaining stronger than expected; and
- exploration, both near mine and also in Indonesia.

Intersuisse's valuation rises to 62c if current spot prices are assumed to last for the mine life

Expanding to 3.5Mt/yr from 2.7Mt/yr raises the valuation to 67c

Intersuisse's valuation rises further, to 90c, if the risk discount is removed.

Successful project delivery with expanded production, but base case prices, give a valuation of 62c.

HGO's share price has lagged the copper price, in contrast to most of its peers.

In Intersuisse's view, the lagging share price was due to "over-promising and under-delivering"

HGO has secured a new CEO to ensure that its valuable are delivered and generate value for shareholders.

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