

# Hillgrove Resources

## Exco transaction underscores fundamental HGO value



Wilson HTM  
INVESTMENT GROUP

20 May 2011

\$0.28

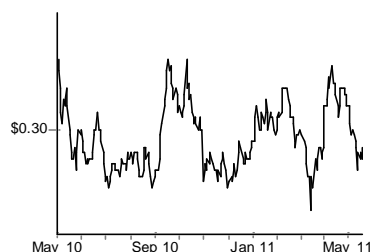
BUY

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### Price Performance



### Security/Capital Details

ASX Code	HGO
Market Cap	\$240 M
Issued Shares (dil)	827.7 M
Avg Mth T'over	39.81 M
12 Mth High – Low	\$0.36 - \$0.23

### Key Data/Ratios – FY 2011

EBITDA / Sales	-682.7%
EBIT / Sales	-696.2%
Debt / Equity	0.0%
Interest Cover	-3.7 x
ROE	-8.1%
EPS Growth	11.4%
DCF	\$0.54
12 Mth Price Target	\$0.64

### Important Disclosure

Wilson HTM Corporate Finance Ltd acted as Joint Lead Manager and Underwriter for the placement announced by Hillgrove Resources Limited in October 2010 and earned fees for acting in this capacity.

### Recommendation

We maintain our BUY recommendation and note that at present, under a clear measure of valuation for Kanmantoo as outlined in this report, Hillgrove still represents excellent value at Friday's close of \$0.28/share. We are materially more bullish on the value of HGO following the recent sale of Exco Resources' Cloncurry Copper Project (CCP) to Xstrata for \$175m. We see similarities between CCP and HGO's Kanmantoo project. Our target price is \$0.64/share with just \$0.02/share assigned to the company's Indonesian exploration portfolio. The value potential of this portfolio has the potential to be materially higher.

### Key Points

- We have examined the recent sale by Exco Resources (ASX:EXS) of its Cloncurry Copper Project (CCP) to Xstrata for \$175m in the context of the value of Hillgrove's Kanmantoo Copper Project.
- The CCP project was undergoing DFS at the time of sale, and hence was at an earlier stage of development relative to Kanmantoo. Notwithstanding this, the two projects are similar in a number of ways such as resource grade, anticipated production levels, and forecast production costs.
- The capital costs for both projects assume contract mining. The CCP project is more capital intensive than Kanmantoo.
- The CCP transaction equates to ~A\$0.15/lb copper in resources. In turn, this values the Kanmantoo copper resource at A\$102m, and other things equal would value HGO at A\$0.32/share based on estimated committed CAPEX to Kanmantoo to valuation date of 31<sup>st</sup> July 2011 of A\$93m.
- In our view, using the CCP transaction as a measure of value for Kanmantoo provides a very clear and robust base case measure of the project's value when the difference in maturity of the two projects is taken into account, as well as other factors such as location, power cost and capital intensity.
- Since reaching a recent peak of \$0.36/share in mid April, Hillgrove's share price has fallen to Friday's close of \$0.28/share. While our DCF modelling suggests the Hillgrove equity is worth \$0.54/share, the CCP transaction more than confirms value at current levels despite the relative maturity and advantages of the Kanmantoo project which point to a higher value being appropriate at this time.
- We once again emphasise that our DCF valuation of \$0.54/share includes just \$0.02/share for the company's Indonesian exploration portfolio. We expect news on recent drilling at Sumba Island as part of the quarterly report, and we understand that a borrow and use permit, or "Pinjam Pakai", for drilling in forestry areas at the Bird's head property is expected to be granted in the near future. Drilling success at Bird's head in particular could prove highly material to the value of Hillgrove.

Year to Jan	NPAT (Rep) \$M	NPAT (PSig) \$M	EPS (PSig) c	EPS Growth %	PER x	CFPS c	P/CF x	DPS c	Div Yld %	Franking %
2010a	55.6	-16.0	-1.9	-82.1	-15.0	-1.0	-28.2	0.0	0.0	0
2011e	-14.2	-14.2	-1.7	11.4	-17.0	-4.9	-5.9	0.0	0.0	0
2012e	-3.3	-3.3	-0.4	76.6	-72.5	-0.4	-78.4	0.0	0.0	0
2013e	65.3	65.3	7.9	2,072.5	3.7	11.1	2.6	0.0	0.0	

### Equities Research – Hillgrove Resources

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## The Exco Transaction

- On 20<sup>th</sup> April, Exco Resources Ltd (ASX:EXS) announced that it had entered into an agreement with Xstrata Copper to sell its Cloncurry Copper Project (CCP) for A\$175m.
- The Cloncurry Copper project bears some similarities to that of Hillgrove's Kanmantoo Copper project in South Australia, namely:
  - Resource grade is similar – CCP: 0.85% Cu, 0.22g/t Au. Kanmantoo: 0.90% Cu, 0.20g/t Au.
  - The projects have similar life-of-mine cash costs – CCP: US\$1.50/lb. Kanmantoo: US\$1.61/lb. However, by-product values are CCP (US\$1,000/oz Au, AUDUSD 0.85), Kanmantoo: (US\$900/oz Au, US\$13/oz Ag).
  - CCP and Kanmantoo projects have comparable stripping ratios of approximately 5:1. The Kanmantoo power cost is expected to be significantly lower than would have applied to a development of the CCP project by EXS, or the cost that Xstrata will incur at Ernest Henry. We expect the former to be around 10-12c/kwhr and the latter around 18c/kwhr.
- The capital cost for the CCP project is higher on a per-tonne of annual capacity basis. Kanmantoo's capital cost based on total CAPEX of A\$144.2m inclusive of a A\$10.0m contingency, and 21ktpa payable copper production is A\$6,867/tonne payable production. This compares with total CAPEX of A\$200m for 25ktpa annual copper in concentrate production, or approximately A\$8,350/tonne annual payable production capacity for CCP.
- The CCP transaction valued a contained tonne of copper equivalent in resources at A\$326/tonne (A\$0.15/lb). The copper equivalent quantity of contained gold in the resource is valued using the following prices: US\$1496/oz gold, US\$4.11/lb copper.

### CCP Copper Resource And Insitu-Value Per Tonne

Resource	Tonnes	Cu (%)	Au (g/t)	Contained Copper	Contained Gold	EV/tonne Copper (A\$/t)	EV/tonne Copper Equiv (A\$/t)
Measured	9,170,000	0.87	0.25	80,000	75,000		
Indicated	28,720,000	0.86	0.22	246,000	199,000		
Inferred	17,870,000	0.82	0.21	146,000	119,000		
<b>Total</b>	<b>55,760,000</b>	<b>0.85</b>	<b>0.22</b>	<b>472,000</b>	<b>394,000</b>	<b>371</b>	<b>326</b>

Note: Cut-off grade is 0.5% except E1 @ 0.3% Cu, Mt Collin 1.25% Cu

Source: Hillgrove Resources, WilsonHTM

### Implied Value Of Kanmantoo Resource

- Based on the current Kanmantoo resource, and using the CCP transaction as a benchmark, the implied value of the Kanmantoo resource is A\$120m.

### Implied Value Of Kanmantoo Resource Using CCP Transaction As Benchmark

Resource	Tonnes	Cu (%)	Au (g/t)	Contained Copper	Contained Gold	Implied Value A\$m
Measured	2,300,000	0.9	0.2	20,700	14,789	
Indicated	22,500,000	0.9	0.2	202,500	144,678	
Inferred	7,400,000	0.9	0.2	66,600	47,583	
<b>Total</b>	<b>32,200,000</b>	<b>0.90</b>	<b>0.20</b>	<b>289,800</b>	<b>207,051</b>	<b>120.1</b>

Note: Cut-off grade is 0.25%

Source: Hillgrove Resources, WilsonHTM

## Implied Value Of Hillgrove Resources

- The following table compares our valuation of HGO using our DCF based valuation of the Kanmantoo asset of \$362m (\$0.44/share), with a valuation in which we substitute the valuation as derived above from the CCP transaction (\$0.13/share), and then allow for capital committed to construction.
- The valuations are dated 31<sup>st</sup> July 2011, being HGO's half year end.
- In the case of the CCP valuation, we estimate \$101m of committed capital at 31<sup>st</sup> July 2011, based on commitments to 31<sup>st</sup> Jan 2011 of \$27.1m and our forecast CAPEX spend of \$65.6m on Kanmantoo in the July half year.

### DCF Based Valuation vs CCP Transaction Derived Valuation

	DCF Valuation		CCP Derived Valuation	
	A\$m	A\$ps	A\$m	A\$ps
Kanmantoo - Open Cut	362.2	0.44	105.6	0.13
Capital Committed - Kanmantoo			93.0	0.11
Corporate Items	-19.4	-0.02	-20.0	-0.02
Interests In Other Entities	3.7	0.00	3.67	0.00
Exploration/Development	19.3	0.02	19.2	0.02
Cash collateralised bond	7.5	0.01	7.5	0.01
Franking Credits	38.7	0.05	40.7	0.05
Hedge Book	-16.0	-0.02	-16.1	-0.02
Net (Debt)/Cash	28.7	0.03	28.7	0.03
Additional Capital - Dilution	5.9	0.01	5.9	0.01
Total Valuation	430.5	0.52	268.1	0.32

Source: WilsonHTM

- While the CCP transaction still indicates that HGO is undervalued, we note that this transaction value should be used carefully in considering the value of Kanmantoo for a number of reasons including those already referred to:
  - Lower capital intensity of Kanmantoo
  - Lower sensitivity to power cost of Kanmantoo vs a stand-alone development of CCP
  - Lower sensitivity to rising labour costs of Kanmantoo, and likely better access to labour given near capital city location
  - Greater uncertainty over capital cost for CCP
  - Previous successful mining history of Kanmantoo
  - Low CAPEX expansion potential of the Kanmantoo processing plant to approximately 3.5Mtpa throughput from initially 2.4Mtpa. This would be equivalent to approximately 30ktpa payable copper and further reduce the capital intensity of the project viz a viz CCP as a stand alone development
  - Earlier production from Kanmantoo (Nov 2011 vs probably earliest 2013/14 for CCP)
  - The CCP transaction was negotiated with Xstrata. While the CCP project has significant additional value to Xstrata due to its ownership of the Ernest Henry processing facility, the balance of negotiating power in our view clearly lay with Xstrata. Xstrata would have seen that EXS's funding of CCP would have been a challenge, with likely significant dilution of existing shareholders to access the necessary capital.

## Hillgrove Resources (HGO : \$0.28)

## PRODUCTION

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
Copper In Conc - (kt)	0	0	0	2	18
Gold In Conc - (koz)	0	0	0	1	8
Silver In Conc (koz)	0	0	0	22	170
C1 Cash Cost - (US\$/lb)	0.00	0.00	0.00	2.25	1.85

## PRICES

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
Gold (US\$/oz spot)	871	994	1250	1612	1990
Silver (US\$/oz spot)	14.58	15.02	21.61	39.68	49.32
Copper (US\$/lb)	2.99	2.46	3.52	4.72	5.12
AUDUSD (USD)	0.84	0.82	0.93	1.04	1.02

## INVESTMENT &amp; VALUATION FUNDAMENTALS

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
EPS Before Abs (c)	-1.1	-1.9	-1.7	-0.4	7.9
EPS Growth (%)	N/A	-82.1%	11.4%	76.6%	2,072.5%
<b>PER (x)</b>	<b>-12.3</b>	<b>-15.0</b>	<b>-17.0</b>	<b>-72.5</b>	<b>3.7</b>
CFPS (c)	-1.1	-1.0	-4.9	-0.4	11.1
<b>P/CF (x)</b>	<b>-11.5</b>	<b>-28.2</b>	<b>-5.9</b>	<b>-78.4</b>	<b>2.6</b>
EV/EBITDA (x)	-15.4	-11.4	-5.6	-43.0	1.3
DPS (c)	2.0	0.0	0.0	0.0	0.0
<b>Yield (%)</b>	<b>15.3%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>
Franking (%)	0%	0%	0%	0%	

## DCF VALUATION

@

11.1 %

10.0%

Yr Ending Jan	A\$m	A\$ps	A\$m	A\$ps
Kanmantoo - Open Cut	362.2	0.44	379.9	0.46
Corporate Items	-19.4	-0.02	-20.0	-0.02
Interests In Other Entities	3.7	0.00	3.67	0.00
Exploration/Development	19.3	0.02	19.2	0.02
Cash collateralised bond	7.5	0.01	7.5	0.01
Franking Credits	38.7	0.05	40.7	0.05
Hedge Book	-16.0	-0.02	-16.1	-0.02
Net (Debt)/Cash	28.7	0.03	28.7	0.03
Additional Capital - Dilution	5.9	0.01	5.9	0.01
Total Valuation	430.5	0.52	449.5	0.54

## PROFITABILITY RATIOS

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
<b>EBIT / Sales (%)</b>	<b>-710.5%</b>	<b>-696.2%</b>	<b>-680.4%</b>	<b>44.3%</b>	
ROA (%)	N/A	-9.5%	-20.4%	-2.9%	37.5%
<b>ROE (%)</b>	<b>N/A</b>	<b>-12.9%</b>	<b>-8.1%</b>	<b>-1.8%</b>	<b>29.0%</b>
ROFE (%)	N/A	-13.0%	-43.0%	-4.5%	55.5%

## INTERIMS (\$m)

Half Yr	Jul 09	Jan 10	Jul 10	Jan 11	Jul 11
Yr Ending Jan	1H A	2H A	1H A	2H E	1H E
Sales Revenue	0.0	1.4	1.4	1.7	0.0
EBIT	-4.9	-5.3	-7.4	-14.7	-3.0
<b>Net Profit</b>	<b>54.0</b>	<b>1.6</b>	<b>-2.7</b>	<b>-11.5</b>	<b>-1.0</b>
EPS	-1.2	-0.9	-0.3	-1.4	-0.1

## BALANCE SHEET (\$m)

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
Cash	7.7	130.4	117.8	60.1	141.7
Total Assets	140.9	211.1	253.6	304.3	388.4
Debt	44.0	2.5	0.0	43.5	41.0
Total Liabilities	56.6	47.3	68.8	112.3	131.1
Total Shareholders Equity	83.7	163.5	184.5	191.8	257.1
Total Funds Employed	120.5	35.9	67.0	175.5	156.7

## LIQUIDITY &amp; LEVERAGE RATIOS

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
Debt / Equity (%)	52.6%	1.5%	0.0%	22.7%	16.0%
Gearing (%) <sup>1</sup>	34.3%	1.5%	0.0%	18.5%	13.7%
Interest Cover (x)	-4.7	-0.8	-18.6	2.6	-101.3
Debt / CashFlow (x)	-9.0	-0.3	0.0	-14.2	0.4
(Debt+CNNotes) / CashFlow	-5.4	-0.1	0.0	-14.2	0.4

## PROFIT &amp; LOSS (\$m)

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
Sales Revenue	0.0	1.4	3.2	0.8	208.3
EBITDA	-6.7	-9.8	-21.7	-5.2	111.2
Depn and Amortisation	0.2	0.4	0.4	0.3	18.8
<b>EBIT</b>	<b>-6.9</b>	<b>-10.2</b>	<b>-22.1</b>	<b>-5.5</b>	<b>92.4</b>
Net Interest Expense	1.5	12.2	1.2	-2.1	-0.9
<b>Pre-tax Profit</b>	<b>-8.4</b>	<b>-22.4</b>	<b>-23.3</b>	<b>-3.3</b>	<b>93.3</b>
Tax	-3.7	-6.4	-9.1	0.0	28.0
Tax rate (%)	44.5%	28.5%	39.2%	0.0%	30.0%
Minorities / pref divs	0.0	0.0	0.0	0.0	0.0
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0
<b>Net Profit</b>	<b>-4.6</b>	<b>-16.0</b>	<b>-14.2</b>	<b>-3.3</b>	<b>65.3</b>
Abnormals	15.9	71.6	0.0	0.0	0.0
Reported Net Profit	11.3	55.6	-14.2	-3.3	65.3

## CASHFLOW (\$m)

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
<b>Operating Cash Flow</b>	<b>-4.9</b>	<b>-8.5</b>	<b>-40.7</b>	<b>-3.1</b>	<b>91.9</b>
Capital Expenditure	-2.5	-7.2	-43.6	-90.7	-2.4
Expln, Develop, Evaln	-12.6	-4.4	-8.4	-10.6	-5.4
Asset Sales/Acquisitions	-4.5	165.6	12.0	0.0	0.0
Other	1.0	0.0	-0.6	-7.5	0.0
<b>Investing Cash Flow</b>	<b>-18.6</b>	<b>154.0</b>	<b>-40.5</b>	<b>-108.8</b>	<b>-7.8</b>
Share Issues/(Buybacks)	42.6	32.8	83.9	10.6	0.0
Debt Drawdown (Repay)	-15.0	-47.3	-2.5	43.5	-2.5
Dividends Paid	0.0	-8.3	0.0	0.0	0.0
Other Fin. Flows	0.0	0.0	-12.7	0.0	0.0
<b>Financing Cash Flow</b>	<b>27.6</b>	<b>-22.8</b>	<b>68.7</b>	<b>54.1</b>	<b>-2.5</b>
<b>Cash Increase (Decrease)</b>	<b>4.1</b>	<b>122.7</b>	<b>-12.5</b>	<b>-57.8</b>	<b>81.6</b>

## EARNINGS SENSITIVITIES - % CHANGE

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
+/-10% US\$ Copper Price	0.0%	0.0%	0.0%	0.0%	22.5%
+/-10% US\$ Gold Price	0.0%	0.0%	0.0%	0.0%	1.5%
+/- 1c Movement US\$/A\$	0.0%	0.0%	0.0%	0.0%	2.2%
+/-10% US\$ Silver Price	0.0%	0.0%	0.0%	0.0%	0.8%

1. Gearing = (Debt + CNotes) / (Debt + CNotes + Equity)



## Recommendation Structure

BUY: Total return +10% or more over a 12 month period

HOLD: Total return expected to be between +10% to -10% over a 12-month period

SELL: Total return expected to be -10% or more over a 12 month period

TOTAL RETURN OR TSR = capital growth in share price + expected dividend yield in that period

## Other definitions

CS Coverage Suspended. Wilson HTM Ltd has suspended coverage of this company.

NR Not Rated. The recommendation has been suspended temporarily. Such suspension is in line with Wilson HTM Investment Group Ltd policies in circumstances where Wilson HTM Corporate Finance Ltd is acting in an advisory capacity in a merger or strategic transaction involving the company and in certain other situations.

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The Directors of Wilson HTM Ltd advise that at the date of this report they and their associates have relevant interests in Hillgrove Resources. They also advise that Wilson HTM Ltd and Wilson HTM Corporate Finance Ltd A.B.N. 65 057 547 323 and their associates have received and may receive commissions or fees from Hillgrove Resources in relation to advice or dealings in securities. Some or all of Wilson HTM Ltd authorised representatives may be remunerated wholly or partly by way of commission.

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## Regulatory Disclosures

Wilson HTM Corporate Finance Ltd acted as Joint Lead Manager and Underwriter for the placement announced by Hillgrove Resources Limited in October 2010 and earned fees for acting in this capacity.

Wilson HTM Investment Group Ltd and its related bodies corporate trades or may trade as principal in the securities that are subject of the research report.

Wilson HTM Corporate Finance Ltd has received compensation for corporate advisory services from this company, its subsidiaries or affiliates during the previous 12 months.

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