

# Stock Focus

## Hillgrove Resources (HGO)



EVANS & PARTNERS

### SITE VISIT TO KANMANTOO PROJECT

#### RECOMMENDATION : POSITIVE

Trading Data	
Last Price	\$0.40
12 month range	\$0.16 - \$0.52
Market cap.	\$192m
Free Float	\$0m (0%)
Avg. daily volume	1.8m
Avg. daily value	\$0.6m
12m return (historical)	154.5%

**We visited the Kanmantoo site on Friday, and came away very positive with the development on schedule, and clear further upside through the potential addition of satellite deposits. The only slight negative was a small increase in operating costs, which we feel is a trend industry wide. With a valuation of \$0.71, or a premium of 78% to the current share price, we feel Hillgrove represents excellent value, and retain our POSITIVE recommendation.**

#### Earnings Forecasts

Yr to	10A	11E	12E	13E
NPAT (\$m)	(1)	26	42	43
EBITDA (\$m)				
EPS (¢)	(0.3)	5.1	8.3	8.6
EPS Gth (%)	N/A	N/A	63.6	3.7
<b>PER (x)</b>	-	<b>7.9</b>	<b>4.8</b>	<b>4.6</b>
Production (kt)	0	8	17	17
Cost (\$/\$ lb)	0	1	2	2
DPS (¢)	0.0	0.0	0.0	0.0
<b>Yield (%)</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
Franking (%)	0%	0%	0%	0%
NetDebt/EBITDA (x)				

**Kanmantoo on track for commissioning first half 2011.** The Pillara plant is currently being dismantled in WA, and is due on site before the end of the month. A lay out area is currently being prepared. All approvals are now in hand, with road work also underway.

**Debt funding expected to be finalised shortly.** Hillgrove are looking at funding approximately \$50m of the \$100m project capex via the debt markets. Whilst, with over \$100m cash on hand, Hillgrove doesn't actually need any debt to fund the project, we see the logic behind the proposed borrowings. Hillgrove are effectively minimising the company's exposure to the project by half. In addition, they should receive highly favourable debt terms given the strength of the balance sheet, so it really does make a lot of sense to secure some low cost funding whilst the balance sheet is in such good order.

**Valuation (DCF - cps)** **0.71**

#### Share Price History



**Copper hedging likely.** With the copper forward curve in positive Contango, Hillgrove are looking to lock in some hedging within the very short term. Proposed hedging will cover no more than 25% of reserves, and should secure a price of close to US\$3.50/lb for any copper hedged. Again we see this as a sound financial decision, with the copper price currently well above our long term forecast of \$US2.50/lb.

**Future expansion at Kanmantoo a possibility.** The Kanmantoo plant can be expanded by 20-30% at very little additional cost, however current mine life does not justify any expansion. Given the short term focus on exploration at Kanmantoo is on satellite deposits for additional mill feed, we feel there is a very real possibility that we will see a further expansion of capacity at Kanmantoo in the short-medium term.

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April 12, 2010  
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## DETAILS

**Dismantling of the Pillara plant is now 50% complete**, with freighting to site expected to commence in around 8 days. Establishment of a set down area for the plant is already underway, as is development of internal roads for the project. Bulk earthworks are set to start shortly, with construction expected to be completed by Dec/Jan, and a rolling 3 months plant commissioning with final completion expected at the end of March 2011. The team who are involved with the plant dismantling, will also be involved with construction, and were also involved with building the nearby Angas silver-lead-zinc mine.

Hillgrove currently has a very **small (but innovative) heap leach operation** at Kanmantoo, which is producing around 18t per week of copper concrete (around 98% copper metal) per month, and generating \$2-\$3m net profit per annum. They are looking at a larger scale version to process the estimated 2mt oxide and transitional material above the existing primary reserves, but this study is in relatively early stage.

**All approvals are now in place**, with the final approval on the tailings dam construction received last week. Whilst the general layout is in place, we see further fine tuning on the grade profile over early years of production following the grade control drilling phase (which is about to commence). Also Hillgrove are looking at two different methods of tailings dam construction (turkeys nest or valley fill), but these decisions are very minor in terms of impact on the project.

**Very conservatively run in every facet of the operation.** Hillgrove is looking a funding half the \$100m capital via project debt, which effectively halves Hillgrove's exposure to the project, and, given the strong balance sheet, we would anticipate extremely favourable terms would be available. In addition, the company is also looking at hedging approximately 25% of reserves given the continued short term strength of the copper price, which again we feel is a very reasonable approach given the moderate cost nature of this operation. Hillgrove is looking at a conservative start up to production at Kanmantoo, based purely on current reserves/resources. However, once in production, we see good potential for a further plant expansion through either a simultaneous underground operation and/or the addition of further feed via satellite deposits (Emily star South currently awaiting assay results, with Wheal fortune also under analysis).

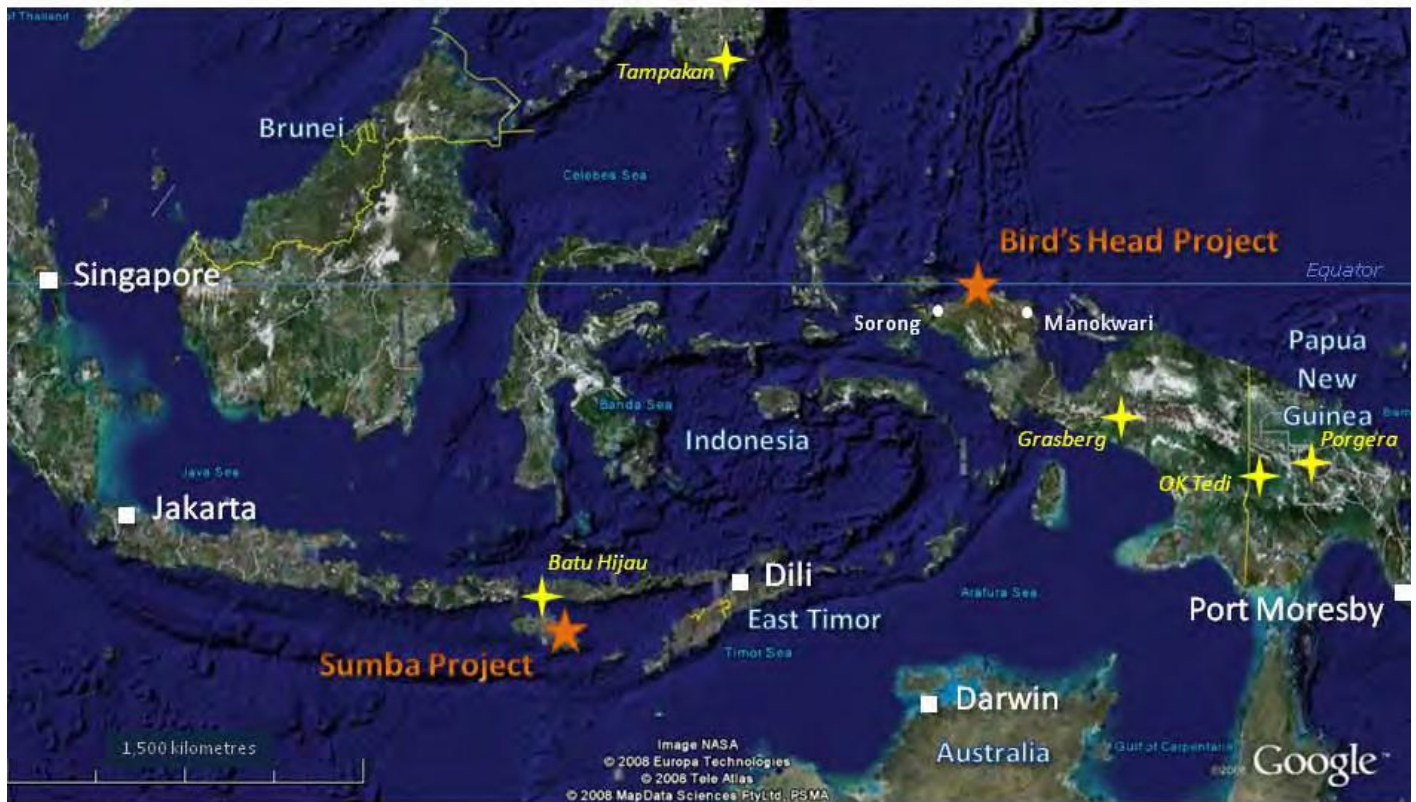
**Costs up** on earlier estimates, but we feel this will be an industry wide trend given the number of new projects currently under construction. We were budgeting on \$1.42/lb, whereas costs are now being quoted in the range of \$1.50-\$1.70/lb. However, this has had a minimal impact on valuation, which has only fallen 4c to \$0.71/share.

**Significant future exploration upside**, given the limited exploration in the region. We have previously stressed that poor economics historically and the fragmented land holding limited earlier work on the project area. Hillgrove are currently reviewing their exploration budget on Kanmantoo, and we would expect a significant program both near mine and regionally over the next 12 months will result.

**Silver-lead-zinc potential as well.** Hillgrove has just received permitting on the historic A' Clair silver-lead-zinc mine, and also hold the Wheal Ellen silver-lead-zinc project, which is close to Terramin's Angas mine. Whilst not an early focus, we see potential to develop quite a significant silver-lead-zinc resource over time in the general region



Drilling at Sumba (West Papua) is expected to commence next week, with a second rig due in the next few months. Drilling at Birds Head will occur later, as more work is required on this deposit, but both present excellent gold targets. Hillgrove is looking at a budget of around \$13m for both these projects.





## FINANCIAL SUMMARY

Hillgrove Resources HGO Recommendation: Positive Share Price \$0.38  
As at: 12/04/10 DCF Valuation \$0.71

Year end	Jan	2010F	2011F	2012F	2013F	2014F
<b>INCOME STATEMENT</b>						
Total Revenue	\$m	94.2	0.7	82.7	171.9	175.1
Operating Costs	\$m	0.0	0.0	-27.2	-77.8	-78.4
Royalty	\$m	0.0	0.0	-4.9	-10.3	-10.4
Exploration W/off	\$m	-1.7	-0.7	-0.7	-0.7	-0.7
<b>Total Op. Costs</b>	<b>\$m</b>	<b>-1.7</b>	<b>-0.7</b>	<b>-32.9</b>	<b>-88.8</b>	<b>-89.6</b>
D&A	\$m	-0.1	0.0	-8.3	-16.6	-16.6
Interest Exp.	\$m	-15.6	-0.2	-0.2	-0.2	-0.2
Corporate	\$m	-3.1	-2.0	-2.0	-2.0	-2.1
Other	\$m	5.8	0.0	0.0	0.0	0.0
<b>Total Costs</b>	<b>\$m</b>	<b>-14.8</b>	<b>-2.9</b>	<b>-43.3</b>	<b>-107.6</b>	<b>-108.3</b>
<b>Pre-Tax Profit</b>	<b>\$m</b>	<b>79.4</b>	<b>-2.2</b>	<b>39.3</b>	<b>64.4</b>	<b>66.8</b>
Tax Provision	\$m	-27.0	0.8	-13.8	-22.5	-23.4
<b>Net Profit</b>	<b>\$m</b>	<b>52.4</b>	<b>-1.4</b>	<b>25.6</b>	<b>41.8</b>	<b>43.4</b>
Minorities	\$m	0.0	0.0	0.0	0.0	0.0
<b>Attrib Net Profit</b>	<b>\$m</b>	<b>52.4</b>	<b>-1.4</b>	<b>25.6</b>	<b>41.8</b>	<b>43.4</b>
Abnormal	\$m	0.0	0.0	0.0	0.0	0.0
<b>Reported profit</b>	<b>\$m</b>	<b>52.4</b>	<b>-1.4</b>	<b>25.6</b>	<b>41.8</b>	<b>43.4</b>

<b>CASH FLOW</b>						
Operating Cashflow	\$m	-31.7	-1.0	49.1	56.4	61.1
-Capex	\$m	-7.5	-66.3	-34.3	-2.2	-2.2
-Exploration	\$m	-3.2	-2.8	-2.8	-2.8	-2.8
<b>Free Cashflow</b>	<b>\$m</b>	<b>-42.4</b>	<b>-70.1</b>	<b>12.0</b>	<b>51.4</b>	<b>56.1</b>
-dividends	\$m	-7.5	0.0	0.0	0.0	0.0
+Equity Raised	\$m	9.0	35.0	0.0	0.0	0.0
+Debt Drawdown	\$m	-47.4	0.0	0.0	0.0	0.0
-Other (incl asset sales)	\$m	163.0	0.0	0.0	0.0	0.0
<b>Net Change in Cash</b>	<b>\$m</b>	<b>74.7</b>	<b>-35.1</b>	<b>12.0</b>	<b>51.4</b>	<b>56.1</b>
Cash at End Period	\$m	82.3	47.3	59.3	110.7	166.9

<b>BALANCE SHEET</b>						
Cash	\$m	82.3	47.3	59.3	110.7	166.9
<b>Total Assets</b>	<b>\$m</b>	<b>145.1</b>	<b>178.4</b>	<b>218.6</b>	<b>257.8</b>	<b>301.6</b>
Total Debt	\$m	2.4	2.4	2.4	2.4	2.4
<b>Total Liabilities</b>	<b>\$m</b>	<b>16.1</b>	<b>16.1</b>	<b>16.1</b>	<b>16.1</b>	<b>16.1</b>
<b>Shareholders Equity</b>	<b>\$m</b>	<b>129.0</b>	<b>162.3</b>	<b>202.5</b>	<b>241.7</b>	<b>285.5</b>

<b>Production</b>		09E	10E	11E	12E	13E
<b>Kanmantoo</b>						
Ore Milled (kt)	(kt)	16	16	18	18	18
Head Grade - Cu(%)	(g/t)	0.0%	0.0%	0.9%	0.9%	0.9%
Recovery - Cu (%)	(%)	0.0%	0.0%	92.0%	92.0%	92.0%
Production - Cu(kt)	(kt)	-	-	8	17	17
<b>Profit and Loss Cash Cost</b>						
Cash Cost	(\$US/t)	-	-	43	39	39
Cash Cost	(\$US/lb)	-	0.00	1.44	1.80	1.80
Total Cost	(\$US/lb)	-	0.00	1.88	2.18	2.18

<b>RESOURCES</b>	T	Zn	Cu	Pb	Au
	(m)	%	%	%	(G/t)
Kanmantoo	32.2	0.0	0.9	-	0.2
<b>Attributable share</b>	<b>32.2</b>	<b>0.0</b>	<b>0.9</b>	<b>0.0</b>	<b>0.2</b>

Year end	Dec	2010F	2011F	2012F	2013F	2014F
<b>VALUATION METRICS</b>						
PER	x	3.0	Na	7.4	4.5	4.3
Dividend Yield	%	5.3	0.0	0.0	0.0	0.0
P/FCF	x	Na	Na	Na	Na	Na
ROA	%	36%	-1%	12%	16%	14%
ROE	%	41%	-1%	13%	17%	15%
Net Debt to Equity	%	0%	0%	0%	0%	0%
Debt to Assets	%	0%	0%	0%	0%	0%

<b>Directors</b>	
Chairman	The Hon. Dean Craig Brown
Managing Director	Mr David Archer
Executive Director	Mr Dale Ferguson
Non Executive Director	Mr John Quirke
Non Executive Director	Mr John Gooding
Non Executive Director	Mr Ronald Belz

<b>Substantial Shareholders</b>	Shares (m)	%
The Royal Bank of Scotland	58.3	11.6%
Copulos Group	40.0	8.0%

<b>Valuation Summary</b>	<b>BASE CASE</b>	
	\$AM	A\$/share
<b>Operations</b>		
Kanmantoo	228	0.45
Exploration	20	0.04
<b>Sub Total</b>	<b>248</b>	<b>0.49</b>
Investments	4	0.01
<b>Financial</b>		
Cash	117	0.23
Total Borrowings	0	0.00
Corporate/Other	-11	-0.02
<b>Total Financial</b>	<b>106</b>	<b>0.21</b>
<b>Total Valuation</b>	<b>358</b>	<b>0.71</b>

<b>Assumptions</b>	09E	10E	11E	12E	13E
Copper (US\$/lb)	2.37	3.58	3.58	3.58	3.45
Average Exchange Rate (US\$/A\$)	0.74	0.89	0.86	0.82	0.78
Gold Price (A\$/oz)	1115	1298	1350	1438	1570
Silver Price (USD\$/oz)	12	18	18	17	13

<b>RESERVES</b>	T	Zn	Cu	Pb	Ag
(Contained Metal)	(m)	%	%	%	(G/t)
<b>Attributable share</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>



## RESEARCH RECOMMENDATION DEFINITIONS

Positive	Stock is expected to outperform the S&P/ASX 200 over the coming 24 months
Neutral	Stock expected to perform in line with the S&P/ASX 200 over the coming 24 months
Negative	Stock is expected to underperform the S&P/ASX 200 over the coming 24 months
Speculative	Stock has limited history from which to derive a fundamental investment view or its prospects are highly dependent on event risk, <i>eg.</i> Successful exploration, scientific breakthrough, high commodity prices, regulatory change, etc.
Suspended	Stock is temporarily suspended due to compliance with applicable regulatory and/or Evans & Partners policies in circumstances where Evans & Partners is acting in an advisory capacity.
Not Rated	Stock is not included in our investment research universe.

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Recommendations are primarily determined with reference to how a stock ranks relative to the S&P/ASX 200 on the following criteria:

Valuation	Rolling 12 month prospective multiples (composite of Price-to-Earnings Ratio, Dividend Yield and EV/EBITDA), or long-term NPV for resource stocks.
Earnings Outlook	Forecast 2 year EPS growth.
Earnings Momentum	Percentage change in the current consensus EPS estimate for the stock (rolling 1 year forward basis) over the consensus EPS estimate for the stock 3 months ago.
Shareholder Returns	Composite of forecast ROE (rolling 1 year forward basis) and the percentage change in ROE over 2 years.
Debt Servicing Capacity	Rolling 12 month EBIT Interest Cover ratio.
Cyclical Risk	Qualitative assessment of the 2 year outlook for a stock/industry's profit cycle.
Industry Quality	Qualitative assessment of an industry's growth/returns potential and company specific management capability.
Financial Transparency	If we don't understand it, we won't recommend it.

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