



1 April 2011

\$0.32

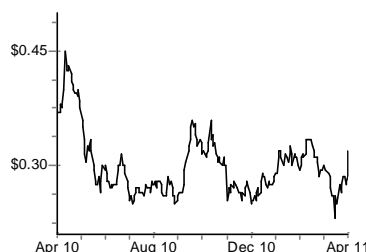
BUY

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Price Performance



Security/Capital Details

ASX Code	HGO
Market Cap	\$265 M
Issued Shares (dil)	827.7 M
Avg Mth T'over	39.81 M
12 Mth High – Low	\$0.45 - \$0.23

Key Data/Ratios – FY 2011

EBITDA / Sales	-842.6%
EBIT / Sales	-855.3%
Debt / Equity	0.0%
Interest Cover	-2.1 x
ROE	-5.7%
EPS Growth	29.5%
DCF	\$0.53
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

While we have for some time viewed Hillgrove Resources as a cheap copper exposure with high upside exploration potential in Indonesia, progress on the Kanmantoo copper mine build is impressive and in our view indicates that the company is in the process of transforming itself into a solid producer, developer and explorer. Kanmantoo remains on time and within budget for first production November 2011. Ongoing exploration drilling at Sumba Island in Indonesia offers the potential for further upside near term with drilling results expected within the next 2-3 weeks. Recommendation: BUY. Target Price: \$0.64/share.

Key Points

- Hillgrove is now transforming itself from a relatively wide exploration, asset acquisition/sale focussed company, to a producer of copper gold concentrate with a copper gold exploration focus in highly prospective parts of Indonesia. The strategy is doing fewer things with excellence.
- We visited the site of the Kanmantoo copper mine in South Australia on Thursday this week, this being our third visit to the site. Kanmantoo is expected to produce first copper in early November 2011. The project is on time and within budget. Total CAPEX is expected to be \$144.2m, inclusive of a \$10m contingency.
- The site is now a hive of activity with typically 250 construction and construction management personnel on site on any one day, including the mining contractor's personnel.
- While we see Hillgrove as significantly undervalued at currently \$0.32/share, both Kanmantoo and particularly the exploration portfolio in Indonesia offer further significant upside.
- The Kanmantoo mine plan is undergoing further optimisation which is expected to improve the project's cashflow profile and NPV by deferring some waste stripping from early to later years and by allowing higher grade ore to be mined in the early years. The plant acquired from the owners of the previous Pillara lead-zinc project offers upside production potential (2.4 to 3.5 Mtpa throughput) for minimal capital cost subject to further resource and reserve delineation.
- The Indonesian exploration portfolio (Sumba Island and Bird's Head projects) is currently providing a free option on high upside exploration potential. Bird's Head in West Papua provides exposure to the potential for porphyry copper-gold discovery, Sumba Island epithermal gold, although the Pelitalira prospect may also prove prospective for copper-gold.
- A new exploration manager has been appointed at Kanmantoo. There is high expectation given the relative paucity of recent exploration beyond the mine area as well as obvious mineralisation in the area surrounding the mine, that further work will add to the resource, and ultimately reserve base. Again at current levels, this potential upside is a free option to investors at the present time.

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	-16.6	-1.0	-31.1	0.0	0.0	0
2011e	-6.4	-11.2	-1.4	29.5	-23.5	-4.2	-7.7	0.0	0.0	0
2012e	-4.2	-4.2	-0.5	63.2	-64.0	-0.5	-68.1	0.0	0.0	0
2013e	66.4	66.4	8.0	1,706.0	4.0	11.2	2.8	0.0	0.0	



Construction Progress

- Project construction is now 35% complete.
- The three main work packages are:
 - Plant construction.
 - Pre-strip waste and ore mining.
 - Tailings dam construction.
- The plant is now visibly under construction with significant above ground steel work in place. The contractor responsible for plant construction is Abesque Engineering with several sub-contractors appointed by Abesque. There is good alignment here, with Abesque having been responsible for the dismantling of the plant in Western Australia, the plant having been the previous Pillara Lead-Zinc plant. Abesque is also responsible for the commissioning of the plant.
- A decision has been taken to acquire a new rather than second hand re-grind mill. The additional cost is approximately \$0.5m. The re-grind mill's purpose is in helping to produce a higher grade concentrate (27-29% Cu vs 24% Cu). This in turn results in savings in terms of concentrate transportation costs.
- Purchase, transport and re-erection of the second-hand plant is expected to cost a total of \$68m. However, the main benefit of acquiring this second hand plant is the ability to scale up production. The plant has two circuits, only one of which will initially be used to treat 2.4Mtpa ore. The second circuit provides the ability to take throughput to 3.5Mtpa for modest capital cost. This second circuit is also being considered for the treatment of oxide/transitional ores.
- The pre-strip operation (Exact Mining Services – mid size mining contractor with experience at Olympic Dam as well as Prominent Hill) is now in full-swing (24hrs/day to advance as far as possible before Winter rain, which could slow the mining rate) with total material movement about 2.0Mt/month. Sulphide ore has been exposed in one area, and some material which was expected to be waste is proving to be oxide/transitional ore. Around 145kt of oxide ore has been mined and stockpiled during waste stripping so far. There is an additional ~2.0Mt of available oxide ore from previous mining in the 1970s. At some point the waste dump from previous mining will be sampled and this could yield additional oxide/transitional ore.
- Due to the mine being in the Murray-Darling catchment area, the tailings dam represents a significant part of the total capital cost of the project. \$17.1m is budgeted for pre-production ore mining, the tailings dam and grade control, with the majority of this being the tailings dam. The tailings dam construction involves multiple barrier layers, including a basal clay layer overlain by multiple HDPE and HDPE mesh layers and finally topped with a specialised geotech liner.

Revised Mine Plan

- As part of gaining access to the \$30m project debt facility, Hillgrove needs to bring its mine plans up to date, based on the latest available information and analysis, and submit this to its banking syndicate. This is a normal part of the banking process. Hillgrove expects to require access to the facility around July 2011. Conditions precedent have already been met for access to the separate bonding facilities provided by the banking syndicate.
- In keeping with this process and the additional quality control drilling data available, Hillgrove has been running a large number of planning scenarios to produce a newly optimised plan. The new plan is expected to be superior to that already submitted to the banking syndicate with in particular an improved cash generation profile. The higher cash generation in the early years will be due both to accessing higher than average grade ore as well as a smoothing of the waste stripping profile to defer some waste until later in the project's life. As a result NPV should increase other things equal.



Safety

- Safety standards imposed at the site appear to be very high.
- No LTIs have been reported to date.
- There is a zero alcohol tolerance limit on entering the site for the construction workforce.

Quality Control

- The sulphide orebody comprises chalcopyrite mineralisation in a series of parallel steeply dipping lenses which pinch and swell along strike and down dip. As a result, grade control needs to be tight.
- Grade control drilling has been undertaken on 5m x 5m or 10m x 10m patterns with sampling every 2m.
- A relatively small 200 tonne excavator able to selectively extract ore of different grades and types as well as waste will be employed. Different grade ores will be stockpiled separately and blended into the crusher.
- While the orebody is not massive, consisting of a series of lenses, investors can take comfort from the fact that the orebody was successfully mined in the 1970s.

Concentrate Off-Take Agreement

- Life of mine off-take agreement with J. P. Morgan Metals & Concentrates LLC.
- The agreement was struck in 2005, and TC/RCs while confidential are said to be consistent with charges prevailing at that time. The TC/RCs are fixed for the first 80kt of copper in concentrate and then revert to market benchmark rates.
- The off-take agreement covers concentrate produced from ore mined within a 5km radius of the mine, together with some mineralisation beyond 5km.

Cash Cost

- The average life-of-mine C1 cash cost is US\$1.61/lb copper in concentrate based on by-product credit values of gold (US\$900/oz) and silver (US\$13/oz).
- At current gold and silver prices the C1 cash cost is lower by approximately US\$0.15/lb or US\$1.46/lb.
- The cash cost profile per the current mine plan (note comments regarding optimisation of the mine plan earlier) is however not flat and begins at a higher level of close to US\$2.00/lb due to the impact of a higher up-front stripping ratio. As noted above, the optimised mine plan will see the up-front waste stripping requirement reduce, and hence the cash cost in the early years should also reduce.

Hillgrove Resources (HGO : \$0.32)

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	2.08	1.68

PRICES

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
Gold (US\$/oz spot)	871	994	1255	1635	1990
Silver (US\$/oz spot)	14.58	15.02	21.51	38.95	49.32
Copper (US\$/lb)	2.99	2.46	3.53	4.75	5.12
AUDUSD (USD)	0.84	0.82	0.93	0.98	0.93

INVESTMENT & VALUATION FUNDAMENTALS

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
EPS Before Abs (c)	-1.1	-1.9	-1.4	-0.5	8.0
EPS Growth (%)	N/A	-82.1%	29.5%	63.2%	1,706.0%
PER (x)	-12.3	-16.6	-23.5	-64.0	4.0
CFPS (c)	-1.1	-1.0	-4.2	-0.5	11.2
P/CF (x)	-11.5	-31.1	-7.7	-68.1	2.8
EV/EBITDA (x)	-15.4	-14.0	-15.2	-47.9	1.5
DPS (c)	2.0	0.0	0.0	0.0	0.0
Yield (%)	15.3%	0.0%	0.0%	0.0%	0.0%
Franking (%)	0%	0%	0%	0%	

DCF VALUATION

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11.1%

10.0%

Yr Ending Jan	A\$m	A\$ps	A\$m	A\$ps
Kanmantoo - Open Cut	328.9	0.40	347.8	0.42
Corporate Items	-20.4	-0.02	-21.1	-0.03
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	39.8	0.05	42.0	0.05
Hedge Book	-26.4	-0.03	-26.9	-0.03
Net (Debt)/Cash	79.8	0.10	79.8	0.10
Additional Capital - Dilution	9.7	0.01	9.8	0.01
Total Valuation	441.9	0.53	461.7	0.56

PROFITABILITY RATIOS

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
EBIT / Sales (%)	-710.5%	-855.3%	-680.4%	44.6%	
ROA (%)	N/A	-9.5%	-9.8%	-2.7%	38.8%
ROE (%)	N/A	-12.9%	-5.7%	-1.8%	24.3%
ROFE (%)	N/A	-13.0%	-13.0%	-2.9%	43.7%

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	0.0	0.0
EBIT	-4.9	-5.3	-7.4	-4.9	-3.0
Net Profit	54.0	1.6	-2.7	-3.7	-1.9
EPS	-1.2	-0.9	-0.3	-1.0	-0.2

BALANCE SHEET (\$m)

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
Cash	7.7	130.4	79.8	59.2	141.9
Total Assets	140.9	211.1	249.8	299.7	384.9
Debt	44.0	2.5	0.0	43.5	41.0
Total Liabilities	56.6	47.3	16.6	60.1	78.9
Total Shareholders Equity	83.7	163.5	232.8	239.2	305.7
Total Funds Employed	120.5	35.9	153.3	223.8	205.1

LIQUIDITY & LEVERAGE RATIOS

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
Debt / Equity (%)	52.6%	1.5%	0.0%	18.2%	13.4%
Gearing (%) ¹	34.3%	1.5%	0.0%	15.4%	11.8%
Interest Cover (x)	-4.7	-0.8	-16.9	4.2	-96.8
Debt / CashFlow (x)	-9.0	-0.3	0.0	-11.1	0.4
(Debt+CNNotes) / CashFlow	-5.4	-0.1	0.0	-11.1	0.4

PROFIT & LOSS (\$m)

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
Sales Revenue	0.0	1.4	1.4	0.8	210.5
EBITDA	-6.7	-9.8	-12.1	-5.2	112.7
Depn and Amortisation	0.2	0.4	0.2	0.3	18.8
EBIT	-6.9	-10.2	-12.3	-5.5	93.9
Net Interest Expense	1.5	12.2	0.7	-1.3	-1.0
Pre-tax Profit	-8.4	-22.4	-13.1	-4.2	94.9
Tax	-3.7	-6.4	-1.8	0.0	28.5
Tax rate (%)	44.5%	28.5%	14.1%	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
Net Profit	-4.6	-16.0	-11.2	-4.2	66.4
Abnormals	15.9	71.6	4.9	0.0	0.0
Reported Net Profit	11.3	55.6	-6.4	-4.2	66.4

CASHFLOW (\$m)

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
Operating Cash Flow	-4.9	-8.5	-34.4	-3.9	93.0
Capital Expenditure	-2.5	-7.2	-80.9	-52.6	-2.4
Expln, Develop, Evaln	-12.6	-4.4	-8.4	-10.6	-5.4
Asset Sales/Acquisitions	-4.5	165.6	8.5	0.0	0.0
Other	1.0	0.0	-0.6	-7.5	0.0
Investing Cash Flow	-18.6	154.0	-81.3	-70.8	-7.9
Share Issues/(Buybacks)	42.6	32.8	75.5	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	-10.1	0.0	0.0
Financing Cash Flow	27.6	-22.8	62.9	54.1	-2.5
Cash Increase (Decrease)	4.1	122.7	-52.8	-20.6	82.7

EARNINGS SENSITIVITIES - % CHANGE

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
+/-10% US\$ Copper Price	0.0%	0.0%	0.0%	0.0%	21.3%
+/-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%	2.3%
+/-10% US\$ Silver Price	0.0%	0.0%	0.0%	0.0%	0.7%

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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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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