

Hillgrove Resources

Quarterly Report To 31st Jan 2011 – Drilling Nears



Wilson HTM
INVESTMENT GROUP

28 February 2011

\$0.295

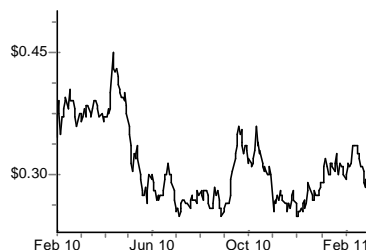
BUY

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Price Performance



Security/Capital Details

ASX Code	HGO
Market Cap	\$228 M
Issued Shares (dil)	827.7 M
Avg Mth T'over	39.81 M
12 Mth High – Low	\$0.45 - \$0.25

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

Hillgrove remains a significantly undervalued copper play, with high upside exploration potential through its exploration programs for copper and gold in Indonesia. We believe that recent share price softness has reflected concerns about the impact of a rising oil price coupled with the company's copper hedge position and the potential for margin squeeze. We note that HGO's Kanmantoo mine will utilise grid power, therefore the main exposure is through the mining operation. We calculate the exposure as very modest at about 1.0c/lb copper for every \$0.10/litre increase in the diesel fuel cost. BUY – target \$0.64/share.

Key Points

- Conditions precedent to access the funded project loan facility of \$30m being worked through – major condition is updated financial model), second condition is need to an Independent Technical Expert that funds available are sufficient to complete the project. Facility required in June 2011.
- Conditions precedent to access the unfunded bonding and guarantee portions of the Project Finance Facility (\$20m) met. Facilities accessed.
- All copper price hedging in place – 40kt over 40 months commencing June 2012 as forwards at an average A\$3.73/lb net. Additional 7kt copper puts in place – 4kt @ A\$3.40/lb deferred premium basis, plus 3kt @ A\$3.40/lb with no deferred premium. Puts are designed to provide revenue protection without delivery obligation during the ramp-up period. Note all hedging is in A\$, debt is in A\$ and intention is to convert US\$ revenue not hedged into A\$ on receipt. There is no gold or silver hedging which reflects absence of historical metallurgical recovery data. However, HGO testwork indicates significant precious metals recovery to concentrate.
- Kanmantoo project build is progressing well – on time and budget, commissioning still scheduled for Nov 2011. Parsons Brinckerhoff, project managers appointed and are on-site managing construction of the project as a risk mitigation measure.
- Strategic review of Kanmantoo exploration program undertaken. Primary objective defined as adding open pit resources. That is, within 150m of surface. Exploration manager for Kanmantoo appointed – Pat Manogue, ex private Canadian company operating in the Solomon Islands.
- Sumba Is exploration Indonesia – extended geological mapping and soil geochemical sampling coverage at Masu. To date, 17 high priority gold targets defined within a 9km long corridor. Aeromagnetic and radiometric survey delayed until late March. At the Pelitalira Prospect central Sumba Is, soil geochemical sampling extended over Pelitalira Hill, as well as more regional reconnaissance of the region. Two distinct gold-in-soil anomalies have been identified over Pelitalira Hill. Scout drilling program is imminent.
- Bird's Head West Papua Indonesia – work concentrated on mapping the extent of porphyry related alteration patterns and copper mineralisation – centre appears to be Green Cliffs, West Delta prospect. Drilling expected to commence at the end of the March quarter hence first assay results should be available in the June quarter. The drilling rig will have the capacity to drill deep holes (to 650m) to test the width and depth of the porphyry systems. Note that permits have yet to be secured for the drilling to proceed. Initial drilling program will be 5,000m.

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	-14.3	-1.0	-26.7	0.0	0.0	0
2011e	-6.4	-11.2	-1.4	29.5	-20.2	-4.2	-6.6	0.0	0.0	0
2012e	-4.2	-4.2	-0.5	63.2	-55.0	-0.5	-58.5	0.0	0.0	0
2013e	66.4	66.4	8.0	1,706.0	3.4	11.2	2.4	0.0	0.0	

Sensitivity To Diesel Fuel Price

- We note recent commentary in the market to the effect that Hillgrove could potentially be subjected to margin squeeze as a result of a rising diesel fuel price coupled with the copper hedge position.
- Hillgrove's hedge position mainly consists of forwards – 40kt copper @ A\$8,230/tonne (A\$3.73/lb). The balance is puts (7kt) but not of concern to the issue of potential margin squeeze.
- Kanmantoo being close to Adelaide and significant infrastructure has access to the National Electricity Grid. While not disclosed, we expect the power cost is around \$0.10/kwhr, significantly less than the cost of generating power from diesel generators which depending on location, would likely be at least twice this cost. As a consequence, the electrical power needs of the site, and the cost of that power will not be exposed directly to a rising diesel fuel price.
- Kanmantoo's will however be exposed to a rising diesel fuel price through the fuel requirements of the mining fleet. However, this should not be overstated.
- We calculate the additional cost of a \$0.10/litre rise in the diesel price expressed on a per pound of payable copper basis (21ktpa) to be approximately 1c/lb. The life of mine C1 cash cost forecast per the Kanmantoo feasibility study is US\$1.61/lb, although at current precious metal prices, the cost will be lower by around \$0.15/lb.

Location Map – Indonesian Exploration Projects



Source: Hillgrove Resources Ltd

Sumba Island Project – Masu Trenching – Significant Results

Project	Prospect	Trench ID	East	North	RL	Length	Intercept	Ag g/t
MASU	Okajara	MATRFT042	204327	8884642	1010	206	5.00 m @ 0.56 g/t Au	1.6
MASU	Okajara	MATRFT048	204194	8884735	978	65	2.00 m @ 0.84 g/t Au	6.1
MASU	Pahandanjal	MATRFT049	204020	8882695	900	68.4	4.00 m @ 1.93 g/t Au	17.35
MASU	Pahandanjal	MATRFT050	204139	8882545	907	60	10.00 m @ 0.91 g/t Au	3.58
MASU	Pahandanjal	MATRFT051	204160	8882400	896	30	5.00 m @ 0.54 g/t Au	0.4
							2.00 m @ 0.58 g/t Au	0.1
MASU	Pahandanjal	MATRFT052	204161	8882461	916	33	6.00 m @ 0.53 g/t Au	2.7
MASU	Pahandanjal	MATRFT054	204216	8882471	884	45	5.00 m @ 1.02 g/t Au	0.3
MASU		MATRFT059	204053	8882025	781	34.3	1.50 m @ 3.15 g/t Au	103
MASU	Pahandanjal	MATRFT101	203588	8881033	640	28	1.00 m @ 2.33 g/t Au	3.7
							1.00 m @ 0.65 g/t Au	2.9
							1.00 m @ 8.78 g/t Au	20.8
MASU	Pahandanjal	MATRFT102	203563	8881085	680	46	5.00 m @ 2.98 g/t Au	8.8
							2.00 m @ 1.04 g/t Au	0.4
MASU	Pahandanjal	MATRFT103				25	3.00 m @ 1.58 g/t Au	8.57
MASU	Pahandanjal	MATRFT104	203638	8881062	680	36	6.00 m @ 1.71 g/t Au	2.2

Source: Hillgrove Resources Ltd

Sumba Island Project – Pelitalira Trenching – Significant Results

Project	Prospect	Trench ID	East	North	RL	Length	Intercept Au g/t	Ag g/t
Tanah Daro	Pelitalira	TDTR01	803384	8933810	562	152	20.00 m @ 1.72 g/t Au	7.25
							5.00 m @ 0.70 g/t Au	1.3
Tanah Daro	Pelitalira	TDTR02	803726	8933800	577	192	4.00 m @ 1.4 g/t Au	<
							12.00 m @ 8.3 g/t Au	193
Tanah Daro	Pelitalira	TDTR04	804003	8938397	506	60	2 m @ 1.9 g/t Au	<
Tanah Daro	Pelitalira	TDTR07	803910	8934344	502	34	2.00 m @ 0.85 g/t Au	6.4
							4.00 m @ 0.65 g/t Au	14.8
							2.00 m @ 0.80 g/t Au	13.4

Source: Hillgrove Resources Ltd

Bird's Head Project – Green Cliffs West Delta Trenching – Significant Copper Intercepts

Prospect	Trench ID	UTM East	UTM North	RL (?)	Total Length	Intersection (x m @ y% Cu)
West Delta	WDT-42	234644	9956986	223	32	32m @ 0.73% Cu including 20m @ 0.95% Cu
West Delta	WDT-43	234652	9956905	295	56	52m @ 0.35% Cu including 12m @ 0.75% Cu
West Delta	WDT-46	234770	9956788	298	10	
West Delta	WDT-47	234502	9956902	290	164	132m @ 0.29% Cu including 18m @ 0.65% Cu
Tawon	WDT-48	234683	9957349	197	112	24m @ 0.36% Cu
West Delta	WDT-49	234515	9956974	229	152	32m @ 0.2% Cu
West Delta	WDT-50	234772	9956798	298	154	
Tawon	WDT-51	234561	9957430	220	132	
Tawon	WDT-52	234945	9957582	216	224	54m @ 0.48% Cu including 22m @ 0.97% Cu
West Delta	WDT-53	234386	9956462	258	111	

Source: Hillgrove Resources Ltd

**Bird's Head Project – Significant Rock Chip Assays – West Delta Prospect**

SampNo	Prospect	Easting	Northing	Cu %	Au g/t	Mo ppm
1483	West Delta	234642	9956985	0.93	0.14	86
1484	West Delta	234640	9956984	1.64	0.26	58
1485	West Delta	234638	9956983	1.08	0.14	13
1486	West Delta	234637	9956982	1.46	0.13	101
1487	West Delta	234635	9956982	1.53	0.3	46
1491	West Delta	234627	9956981	1.18	0.25	12
1497	West Delta	234616	9956979	0.92	0.01	153
1604	West Delta	234669	9956910	1.08	0.07	35
1605	West Delta	234671	9956910	1.49	0.24	377
1606	West Delta	234672	9956910	0.82	0.11	75
1612	West Delta	234682	9956910	0.90	0.06	18
1723	West Delta	234701	9957351	0.79	0.24	93
1742	West Delta	234731	9957353	0.91	0.06	7
1641	West Delta	234527	9956900	1.30	2.88	73
1651	West Delta	234544	9956902	1.34	0.23	99
1657	West Delta	234554	9956902	2.12	0.85	23
1658	West Delta	234556	9956902	0.79	0.38	7
1700	West Delta	234625	9956911	0.68	0.06	6
1801	West Delta	234627	9956911	0.52	0.06	9
1883	West Delta	234614	9956983	0.56	0.01	42

Source: Hillgrove Resources Ltd

Hillgrove Resources (HGO : \$0.295)

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	-14.3	-20.2	-55.0	3.4
CFPS (c)	-1.1	-1.0	-4.2	-0.5	11.2
P/CF (x)	-11.5	-26.7	-6.6	-58.5	2.4
EV/EBITDA (x)	-15.4	-10.2	-12.2	-40.8	1.1
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

@

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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Disclosure of Interest. Hillgrove Resources

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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