

# Hillgrove Resources Ltd

Half year results; set to transition to producer status



Wilson HTM  
INVESTMENT GROUP

12 October 2011

\$0.24

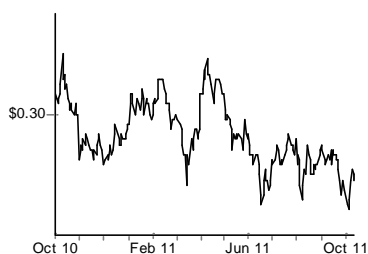
BUY

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## Price Performance



## Security/Capital Details

ASX Code	HGO
Market Cap	\$194 M
Issued Shares (dil)	824.0 M
Avg Mth T'over	39.81 M
12 Mth High – Low	\$0.36 - \$0.21

## Key Data/Ratios – FY 2012

EBITDA / Sales	-239.7%
EBIT / Sales	-268.8%
Debt / Equity	15.3%
Interest Cover	-6.1 x
ROE	-1.8%
EPS Growth	77.3%
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

HGO reported a half year profit of \$0.5m, which included a one-off disposal of its option interest in non-core bauxite tenements in West Kalimantan, Indonesia, which netted a \$4.5m profit. HGO remains a BUY and a top pick in the base metals sector. We are drawn to HGO for its re-rating potential ahead of first copper revenue in November. Moreover, HGO's strategic growth initiatives including expanding the Kanmantoo mine life and production rate to potentially ~30ktpa Cu could elevate HGO's prominence and support further price appreciation. Valuation and target price are \$0.53/sh (-\$0.01) and \$0.64/sh (-\$0.01) respectively.

## Key Points

### Half year results; increasing comfort

- Net profit for the July half year was \$503,000 and compared to a loss of \$2.7m in the July half year 2010. During the half, HGO converted its option interests in bauxite tenements in West Kalimantan into a 39.5% interest in Kalbar Resources. The tenements were later sold and a fully franked dividend totalling \$4.5m was paid to HGO.
- The development and construction of Kanmantoo is on schedule and on budget. The plant is 90% complete with first revenue expected in November. The ramp up to full production of 2.4mtpa (~20ktpa Cu payable) is expected to take 4 to 6 months. This would result in nameplate production achieved in the June quarter, we see this as conservative.
- Total capital spend in the July half year was \$72.9m. Remaining capital to complete construction and development as of 31 July was A\$26.3m. The total construction period cost at completion is ~A\$120-125m, and compares to the estimate of A\$121m at the time of the FID.
- Cash at 31 July was A\$55.3m with \$12m of a \$30m financing facility drawn. HGO plans to draw down the complete \$30m facility by October. HGO remains fully funded to first production without the need to draw completely down on the \$30m facility. The complete draw down, in our opinion, provides additional comfort and flexibility to HGO.
- HGO is hedged for 50-55% of Cu production @ A\$8,320/t for 40 months from July 2012. There is no FX exposure on the hedges.

### Strategic initiatives; growing upside potential at Kanmantoo

- HGO remains a top pick in the base metals sector. The growing upside potential at Kanmantoo, in conjunction with the transition to producer status should, in our opinion, support an upwards re-rating of the share price.
- Near mine drilling around the Kanmantoo pit during the half continues to support the case for inferred material to be converted into either measured or indicated status. Currently, 66.1kt of copper is defined as inferred, the successful conversion of these inferred resources could, in our opinion, add as much as two years to the mine life. Importantly, this does not include potential resource additions from satellite targets, such as the magnetic anomalies to the south of the Emily Star satellite pit, which are currently untested and have the potential to be analogous to Emily Star.
- Sufficient increases to the reserves and resources could support the case for expanding the Kanmantoo plant to 3.5mtpa at an estimated cost of A\$12m, which could potentially lift production to as much as 30ktpa Cu.

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 %
2011a	-14.5	-14.5	-1.8	9.3	-13.4	-5.0	-4.7	0.0	0.0	0
2012e	-3.3	-3.3	-0.4	77.3	-58.8	-0.6	-39.2	0.0	0.0	0
2013e	36.9	36.9	4.5	1,220.0	5.3	7.1	3.3	0.0	0.0	
2014e	58.0	58.0	7.0	57.1	3.3	10.7	2.2	0.0	0.0	

## Equities Research – Hillgrove Resources

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## Kanmantoo Plant



Source: HGO

The Kanmantoo plant is 90% complete with commissioning of the crushing circuit underway and wet plant commissioning expected in October.

HGO is expecting practical completion of the plant to be done by 1 November, first revenue expected later in November. Ramp up to nameplate 2.4mtpa is expected to take 4 to 6 months, implying the achievement of the nameplate rate by the June quarter. We deem this to be conservative and it offers the opportunity for upside to near term production.

## Kanmantoo capital and development costs

	Project Total	FID Capital Costs		Construction Period Costs		
	Total capital costs (AUD M)	Capital costs spent to 31/8/10 (AUD M)	Capital costs for FID (AUD M)	Spend Period to July 2011 (AUD M)	Remaining Budget (AUD M)	Estimated Cost at Completion (AUD M)
Pre-strip	26.7	-	26.7	18.7	6.1	25
Mining, TSF & Grade Control	17.1	0.1	17.0	12.1	2.0	14
Pillara processing plant	67.9	21.3	46.6	49.6	10.2	60
Other infrastructure	9.3	0.4	8.9	8.9	1.5	10
Project Mgt costs/Other	13.2	1.1	12.1	8.3	6.6	15
<b>Contingency</b>	<b>10.0</b>		<b>10.0</b>			
<b>Total</b>	<b>144.2</b>	<b>22.9</b>	<b>121.3</b>	<b>97.6</b>	<b>26.3</b>	<b>124</b>

Source: HGO

Total capital spend in the July half year was \$72.9m. Remaining capital to complete construction and development as of 31 July was A\$26.3m. The total construction period cost at completion is ~A\$120-125m, and compares to the estimate of A\$121m at the time of the FID.

## Kanmantoo Reserves

Category	Tonnes Mt	Cu %	Au g/t	Ag g/t
Proven	2.3	0.87	0.13	3.2
Probable	12.5	0.84	0.18	3.1
<b>Ore reserve</b>	<b>14.8</b>	<b>0.85</b>	<b>0.17</b>	<b>3.1</b>

Source: HGO

The current reserve contains 125.8kt Cu, which supports a six year mine life. We model a ten year mine life, which assumes total mined copper of 228kt. Based on the resource statement below, we assume that the majority of the measured and indicated resources are successfully converted into reserves.

## Kanmantoo Resources

Class	Total (0.25% Cu cut off grade model)						
	Tonnes Kt	Cu %	Au g/t	Ag g/t	Cu Metal Tonnes	Au Ounces	Ag Ounces
Measured	2,290	0.9	0.2	3.5	21,700	12,100	255,300
Indicated	22,525	0.9	0.2	3.3	204,400	139,900	2,381,200
Inferred	7,376	0.9	0.2	2.9	66,100	39,100	677,100
<b>Total</b>	<b>32,192</b>	<b>0.9</b>	<b>0.2</b>	<b>3.2</b>	<b>292,200</b>	<b>191,100</b>	<b>3,313,600</b>

Source: HGO

66.1kt of copper is defined in the inferred category, we see potential for the successful conversion of these inferred resources to add as much as two years to the mine life.

We continue to see growing exploration potential at Kanmantoo. We remain encouraged by magnetics that are suggestive of analogous anomalies to the south of the Emily Star satellite pit. Moreover, HGO has designated four targets adjacent to the current pit shell for follow up testing, which could provide the opportunity for further resource additions.

## Indonesian exploration – Birds Head

HGO continues to wait for the Izin Pinjam Paki permit before commencing drilling at Birds Head. This site remains at a drill ready status, albeit with no drill rig on site. Exploration expenditure during the half year totalled \$1.9m.

## Hillgrove Resources (HGO : \$0.24)

## PRODUCTION

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
Copper In Conc - (kt)	0	0	3	17	22
Gold In Conc - (koz)	0	0	1	11	11
Silver In Conc (koz)	0	0	20	213	226
C1 Cash Cost - (US\$/lb)	0.00	0.00	2.81	1.79	1.29

## PRICES

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
Gold (US\$/oz spot)	994	1250	1617	1900	1700
Silver (US\$/oz spot)	15.02	21.65	36.76	41.08	37.25
Copper (US\$/lb)	2.46	3.51	4.02	4.10	3.85
AUDUSD (USD)	0.82	0.93	1.02	0.97	0.00

## INVESTMENT &amp; VALUATION FUNDAMENTALS

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
EPS Before Abs (c)	-1.9	-1.8	-0.4	4.5	7.0
EPS Growth (%)	N/A	9.3%	77.3%	1,220.0	57.1%
<b>PER (x)</b>	<b>-12.1</b>	<b>-13.4</b>	<b>-58.8</b>	<b>5.3</b>	<b>3.3</b>
CFPS (c)	-1.0	-5.0	-0.6	7.1	10.7
<b>P/CF (x)</b>	<b>-22.8</b>	<b>-4.7</b>	<b>-39.2</b>	<b>3.3</b>	<b>2.2</b>
EV/EBITDA (x)	-6.7	-3.5	-29.2	1.7	0.4
DPS (c)	0.0	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>	<b>0.0%</b>
Franking (%)	0%	0%	0%		

## DCF VALUATION

Yr Ending Jan	@ 11.1%		@ 10%	
	A\$m	A\$ps	A\$m	A\$ps
Kanmantoo - Open Cut	391.6	0.48	409.0	0.50
Corporate Items	-21.4	-0.03	-22.1	-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	39.7	0.05	41.7	0.05
Hedge Book	-18.4	-0.02	-18.8	-0.02
Net (Debt)/Cash	17.3	0.02	17.3	0.02
Additional Capital - Dilution	0.8	0.00	0.8	0.00
Total Valuation	440.0	0.53	458.2	0.56

## PROFITABILITY RATIOS

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
<b>EBIT / Sales (%)</b>	<b>-710.5%</b>	<b>-706.5%</b>	<b>-268.8%</b>	<b>30.4%</b>	<b>38.1%</b>
ROA (%)	N/A	-20.7%	-3.6%	21.7%	33.9%
<b>ROE (%)</b>	<b>N/A</b>	<b>-8.3%</b>	<b>-1.8%</b>	<b>17.1%</b>	<b>22.1%</b>
ROFE (%)	N/A	-43.4%	-5.5%	30.9%	52.5%

## INTERIMS (\$m)

Half Yr	Jul 10	Jan 11	Jul 11	Jan 12	Jul 12
Yr Ending Jan	1H A	2H A	1H A	2H E	1H E
Sales Revenue	1.4	1.7	1.6	0.9	76.9
EBIT	-7.4	-15.1	-2.7	-4.0	19.8
<b>Net Profit</b>	<b>-2.7</b>	<b>-11.8</b>	<b>0.5</b>	<b>-3.8</b>	<b>13.6</b>
EPS	-0.3	-1.4	0.1	-0.5	1.6

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

## BALANCE SHEET (\$m)

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
Cash	130.4	117.1	47.3	96.4	171.9
Total Assets	211.1	253.2	291.0	342.0	395.5
Debt	2.5	0.0	30.0	27.5	17.5
Total Liabilities	47.3	68.8	94.7	108.0	103.4
Total Shareholders Equity	163.5	184.2	196.2	233.9	291.9
Total Funds Employed	35.9	67.4	179.0	165.2	137.7

## LIQUIDITY &amp; LEVERAGE RATIOS

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
Debt / Equity (%)	1.5%	0.0%	15.3%	11.8%	6.0%
Gearing (%) <sup>1</sup>	1.5%	0.0%	13.3%	10.5%	5.7%
Interest Cover (x)	-0.8	-18.9	2.7	93.6	-27.8
Debt / CashFlow (x)	-0.3	0.0	-6.1	0.5	0.2
(Debt+CNotes) / CashFlow	-0.1	0.0	-8.4	0.4	0.2

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

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
Sales Revenue	1.4	3.2	2.5	175.0	208.7
EBITDA	-9.8	-22.0	-6.0	72.7	104.0
Depn and Amortisation	0.4	0.4	0.7	19.4	24.5
<b>EBIT</b>	<b>-10.2</b>	<b>-22.4</b>	<b>-6.8</b>	<b>53.3</b>	<b>79.4</b>
Net Interest Expense	12.2	1.2	-2.5	0.6	-2.9
<b>Pre-tax Profit</b>	<b>-22.4</b>	<b>-23.6</b>	<b>-4.3</b>	<b>52.7</b>	<b>82.3</b>
Tax	-6.4	-9.1	-1.0	15.8	24.3
Tax rate (%)	28.5%	38.7%	22.8%	30.0%	29.5%
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>-16.0</b>	<b>-14.5</b>	<b>-3.3</b>	<b>36.9</b>	<b>58.0</b>
Abnormals	71.6	0.0	0.0	0.0	0.0
Reported Net Profit	55.6	-14.5	-3.3	36.9	58.0

## CASHFLOW (\$m)

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
<b>Operating Cash Flow</b>	<b>-8.5</b>	<b>-41.5</b>	<b>-4.9</b>	<b>58.6</b>	<b>88.0</b>
Capital Expenditure	-7.2	-44.2	-96.4	-2.4	-2.5
Expln, Develop, Evaln	-4.4	-8.4	-5.4	-5.4	0.0
Asset Sales/Acquisitions	165.6	12.0	0.2	0.0	0.0
Other	0.0	-0.6	0.0	0.0	0.0
<b>Investing Cash Flow</b>	<b>154.0</b>	<b>-41.1</b>	<b>-101.6</b>	<b>-7.8</b>	<b>-2.5</b>
Share Issues/(Buybacks)	32.8	83.9	6.2	0.8	0.0
Debt Drawdown (Repay)	-47.3	-2.5	30.0	-2.5	-10.0
Dividends Paid	-8.3	0.0	0.0	0.0	0.0
Other Fin. Flows	0.0	-12.7	-0.2	0.0	0.0
<b>Financing Cash Flow</b>	<b>-22.8</b>	<b>68.7</b>	<b>36.0</b>	<b>-1.7</b>	<b>-10.0</b>
<b>Cash Increase (Decrease)</b>	<b>122.7</b>	<b>-13.9</b>	<b>-70.6</b>	<b>49.1</b>	<b>75.5</b>

## EARNINGS SENSITIVITIES - % CHANGE

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
+/-10% US\$ Copper Price	0.0%	0.0%	0.0%	29.1%	
+/-10% US\$ Gold Price	0.0%	0.0%	0.0%	3.4%	
+/- 1c Movement US\$/A\$	0.0%	0.0%	0.0%	3.2%	
+/-10% US\$ Silver Price	0.0%	0.0%	0.0%	1.3%	



### 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

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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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