Hillgrove Resources Ltd

Construction and commissioning update

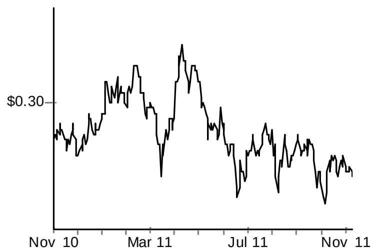
8 November 2011

$0.23

BUY

James Brennan-Chong
03 9640 3893
james.brennan-chong@wilsonhtm.com.au

Price Performance



Security/Capital Details

ASX Code	HGO
Market Cap	$185 M
Issued Shares (dil)	806.0 M
Avg Mth T'over	39.81 M
12 Mth High – Low	$0.36 - $0.21

Key Data/Ratios – FY 2012

EBITDA / Sales	-318.2%
EBIT / Sales	-341.2%
Debt / Equity	15.9%
Interest Cover	-6.3 x
ROE	-1.9%
EPS Growth	73.5%
DCF	$0.50
12 Mth Price Target	$0.58

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

Following commissioning delays at Kanmantoo, we now anticipate first revenue in late December, which is about a one month delay. In addition, an unexpected claim of +$10m from a contractor will result in total capital to completion increasing to $135m. We remain of the view that HGO is fully funded. However, we cannot rule out the requirement for additional capital should further commissioning delays result in a prolonged ramp up period. We retain the BUY rating and we remain drawn to HGO for its production and reserve growth potential. Valuation and target price are reduced 6.4% to $0.49/sh and $0.58/sh respectively.

Key Points

- Construction activities at Kanmantoo are essentially complete with commissioning activities well advanced.
- An unexpected claim from a contractor for +$10m has increased the estimated capital cost to circa $135m. The company is in discussions with the contractor with respect to the claim and we understand that discussions are not adversarial. The timing of the payment is unknown.
- Commissioning activities are 2-4 weeks behind schedule with first ore passing through the mill expected in the next 7-10 days. Mining activities continue at pace, with ~250kt of ore grading between 0.7-0.9% Cu on the ROM pad, this compares to the reserve grade of 0.85% Cu.
- As mining activities continue, the delay to first production will result in working capital costs of ~$2-2.5m per week or approximately $10m per month.
- We have downgraded our production forecast for the January half year 2012. Previously we modelled two months of initial production in the half year, this has now reduced to 1 month, and we forecast modest production of just 1.3kt Cu. We anticipate FY13 (Jan year end) production of 16.1kt Cu before increasing to the nameplate rate of 20ktpa Cu.
- Despite the delay and additional cost capital cost from the unexpected claim, we continue to view HGO as fully funded through the ramp up period, but note an increasing possibility that the company could require additional capital.
- As at 31 July, cash was $55m and we understand that since that time, the remaining $18m of a $30m facility was completely drawn, leaving pro-forma cash of $73m.Remaining capital at 31 July was $26.3m, we add $10m for the unexpected claim, plus $10m additional working capital which would increase the total capital required to ~$46.3m. This would leave pro-forma cash of ~$30m, less corporate costs and less exploration expenses. We estimate a cash balance at 31 January 2012 of $20.4m.
- In the event that commissioning delays continue and prolong the ramp up period HGO has developed and is progressing options to address potential working capital requirements.
- We estimate a Jan 2012 (prior to any modelling changes) gearing ratio of 16% (debt/equity) or 14% (debt/ debt + equity).

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	-13.4	-13.4	-1.7	16.2	-13.9	-5.0	-4.6	0.0	0.0	0
2012e	-3.5	-3.5	-0.4	73.5	-52.3	-0.7	-34.3	0.0	0.0	0
2013e	31.7	31.7	3.9	995.5	5.8	6.4	3.6	0.0	0.0	
2014e	55.4	55.4	6.9	74.4	3.4	11.2	2.1	0.0	0.0	

Revision to valuation and earnings

A$/sh	Valuation	Target
Previous	0.52	0.63
Revised	0.49	0.58
Change	*-5.2%*	*-7.6%*
NPAT – A$m	**FY12**	**FY13**
Previous	-3.33	36.90
Revised	-3.54	31.72
Change	*6.3%*	*-14.0%*

Source: Wilson HTM

Revision to modelling assumptions –Half year figures

	Jan-12	Jul-12	Jan-13	Jan-13
Production (t) Cu	2520	7680	9720	11000
Production (t) Cu	1260	6400	9720	11000
Change	*-50.0%*	*-16.7%*	*0.0%*	*0.0%*
Cash cost US$/lb	-	2.05	1.56	1.29
Cash cost US$/lb	-	2.03	1.60	1.29
Change	-	*2.4%*	*2.7%*	*0.0%*

Source: Wilson HTM

We forecast one month of production in the January half year 2012, previously two months, following the expected delay to first production. We assume that operating profit during the initial ramp up phase in January 2012 is capitalised and do not forecast a cash cost.

50 to 55% of copper production for the first 40 months is hedged at A$3.77/lb, the A$ copper price is currently A$3.45/lb.

Forecast 31 January cash balance

Opening – 31 July 2011	**$55.3**
Balance of debt draw down	$18.0
$30m facility, $12m drawn at 31 July	
Capital expenditure	-$43.7
- $26m capital remaining	
- $10m unexpected claim	
- $10m additional working capital	
net capitalised costs and revenue	
Overheads	-$3.9
Inclusive of net interest	
Exploration	-$5.4
Including both Kanmantoo and Indonesia	
Closing - 31 January 2012	**$20.4**

Source: Wilson HTM

We forecast a January 2012 cash balance of $20.4m. This estimate assumes that the $10m unexpected claim is paid in the half year. We see a possibility that the unexpected claim could be paid in stages or later in 2012 and this would have a positive impact on near term cash flow.

Notwithstanding further delays to commissioning, we see HGO as fully funded. HGO has developed and is progressing options to address potential working capital requirements during the ramp up period

Hillgrove Resources Ltd (HGO : $0.23)

PRODUCTION

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
Copper In Conc - (kt)	0	0	1.3	16.1	22.0
Gold In Conc - (koz)	0	0	0	10	11
Silver In Conc (koz)	0	0	10	198	226
C1 Cash Cost - (US$/lb)	0.00	0.00	-	1.78	1.29

PRICES

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
Gold (US$/oz spot)	994	1250	1617	1900	1783
Silver (US$/oz spot)	15.02	21.65	36.76	41.08	38.75
Copper (US$/lb)	2.46	3.51	4.02	4.10	3.95
AUDUSD (USD)	0.82	0.93	1.02	0.97	0.94

INVESTMENT & VALUATION FUNDAMENTALS

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
EPS Before Abs (c)	-2.0	-1.7	-0.4	3.9	6.9
EPS Growth (%)	N/A	16.2%	73.5%	995.5%	74.4%
PER (x)	**-11.6**	**-13.9**	**-52.3**	**5.8**	**3.4**
CFPS (c)	-1.1	-5.0	-0.7	6.4	11.2
P/CF (x)	**-21.7**	**-4.6**	**-34.3**	**3.6**	**2.1**
EV/EBITDA (x)	-5.9	-3.2	-29.8	2.3	0.6
DPS (c)	0.0	0.0	0.0	0.0	0.0
Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Franking (%)	0%	0%	0%		

DCF VALUATION @

	11.1 %		10 %	
Yr Ending Jan	A$m	A$ps	A$m	A$ps
Kanmantoo - Open Cut	391.0	0.49	408.5	0.51
Corporate Items	-29.9	-0.04	-31.2	-0.04
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	34.4	0.04	36.0	0.04
Hedge Book	-18.4	-0.02	-18.8	-0.02
Net (Debt)/Cash	-9.6	-0.01	-9.6	-0.01
Additional Capital - Dilution	0.8	0.00	0.8	0.00
Total Valuation	398.7	0.49	416.1	0.52

PROFITABILITY RATIOS

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
EBIT / Sales (%)	-710.5%	-670.8%	-341.2%	29.1%	37.0%
ROA (%)	N/A	-19.6%	-3.5%	17.8%	30.5%
ROE (%)	N/A	-7.7%	-1.9%	15.4%	22.2%
ROFE (%)	N/A	-41.2%	-5.3%	24.4%	45.1%

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	0.5	64.1
EBIT	-7.4	-13.9	-2.8	-4.3	15.6
Net Profit	**-2.7**	**-10.7**	**0.5**	**-4.0**	**10.2**
EPS	-0.3	-1.3	0.1	-0.5	1.3

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

BALANCE SHEET ($m)

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
Cash	130.4	118.2	20.4	62.3	139.7
Total Assets	211.1	254.4	283.9	327.6	380.7
Debt	2.5	0.0	30.0	27.5	17.5
Total Liabilities	47.3	68.8	94.7	105.7	103.4
Total Shareholders Equity	163.5	185.3	189.2	221.7	277.1
Total Funds Employed	35.9	67.4	198.9	187.0	155.1

LIQUIDITY & LEVERAGE RATIOS

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
Debt / Equity (%)	1.5%	0.0%	15.9%	12.4%	6.3%
Gearing (%) [1]	1.5%	0.0%	13.7%	11.0%	5.9%
Interest Cover (x)	-0.8	-17.9	2.8	25.1	-54.5
Debt / CashFlow (x)	-0.3	0.0	-5.6	0.5	0.2
(Debt+CNotes)/ CashFlow	-0.1	0.0	-7.4	0.4	0.2

PROFIT & LOSS ($m)

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
Sales Revenue	1.4	3.2	2.1	162.2	208.7
EBITDA	-9.8	-20.9	-6.5	66.8	104.0
Depn and Amortisation	0.4	0.4	0.5	19.6	26.8
EBIT	**-10.2**	**-21.3**	**-7.0**	**47.2**	**77.2**
Net Interest Expense	12.2	1.2	-2.5	1.9	-1.4
Pre-tax Profit	**-22.4**	**-22.5**	**-4.5**	**45.3**	**78.6**
Tax	-6.4	-9.1	-1.0	13.6	23.2
Tax rate (%)	28.5%	40.6%	21.7%	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
Net Profit	**-16.0**	**-13.4**	**-3.5**	**31.7**	**55.4**
Abnormals	71.6	0.0	0.0	0.0	0.0
Reported Net Profit	55.6	-13.4	-3.5	31.7	55.4

CASHFLOW ($m)

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
Operating Cash Flow	-8.5	-40.4	-5.4	51.4	89.9
Capital Expenditure	-7.2	-44.2	-116.6	-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
Investing Cash Flow	154.0	-41.1	-121.9	-7.8	-2.5
Share Issues/(Buybacks)	32.8	83.9	0.0	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
Financing Cash Flow	-22.8	68.7	29.8	-1.7	-10.0
Cash Increase (Decrease)	122.7	-12.8	-97.4	41.9	77.4

EARNINGS SENSITIVITIES - % CHANGE

Yr Ending Jan	2010A	2011A	2012E	2013E	2014E
+/-10% US$ Copper Price	0.0%	0.0%	0.0%	31.4%	24.5%
+/-10% US$ Gold Price	0.0%	0.0%	0.0%	3.7%	2.2%
+/- 1c Movement US$/A$	0.0%	0.0%	0.0%	3.4%	2.6%
+/-10% US$ Silver Price	0.0%	0.0%	0.0%	1.4%	1.6%

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.

Disclaimer

Disclosure of Interest. Hillgrove Resources Ltd

The Directors of Wilson HTM Ltd advise that at the date of this report they and their associates have relevant interests in Hillgrove Resources Ltd. 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 Ltd 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.

In producing research reports, members of Wilson HTM Ltd Research may attend site visits and other meetings hosted by the issuers the subject of its research reports. In some instances the costs of such site visits or meetings may be met in part or in whole by the issuers concerned if Wilson HTM Ltd considers it is appropriate and reasonable in the specific circumstances relating to the site visit or meeting.

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.

BRISBANE
Ph: 07 3212 1333
Fax: 07 3212 1399

SYDNEY
Ph: 02 8247 6600
Fax: 02 8247 6601

MELBOURNE
Ph: 03 9640 3888
Fax: 03 9640 3800

GOLD COAST
Ph: 07 5509 5500
Fax: 07 5509 5599

DALBY
Ph: 07 4660 8000
Fax: 07 4660 4169

HERVEY BAY
Ph: 07 4197 1600
Fax: 07 4197 1699

Our web site: www.wilsonhtm.com.au