

# Hillgrove Resources

## Quarterly Report - Awaiting Kanmantoo Drill Results



Wilson HTM  
INVESTMENT GROUP

1 June 2010

\$0.30

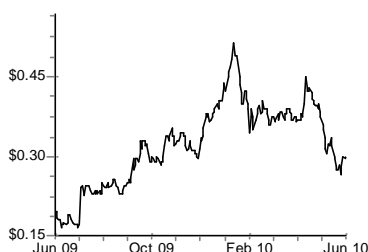
BUY

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### Price Performance



### Security/Capital Details

ASX Code	HGO
Market Cap	\$154 M
Issued Shares (dil)	512.1 M
Avg Mth T'over	37.13 M
12 Mth High – Low	\$0.52 - \$0.17

### Key Data/Ratios – FY 2010

EBITDA / Sales	-684.4%
EBIT / Sales	-710.5%
Debt / Equity	1.5%
Interest Cover	-0.7 x
ROE	-12.9%
EPS Growth	-194.3%
DCF	\$0.40
12 Mth Price Target	\$0.48

### Event

Hillgrove Resources has released quarterly results. We retain our BUY recommendation on HGO. However, we have decreased our valuation slightly following a few amendments to our model to include an increase in capital expenditure and the incorporation of swaptions. Our valuation is now A\$0.40/share (-\$0.03/share) with a price target of A\$0.48/share (-\$0.02/share)

### Key Points

#### Kanmantoo Development

- 60% of the recently purchased Pillara Plant has arrived at Kanmantoo from Northern WA, the remaining components are expected to be on site by July, ready for re-assembly. Civil works have commenced, including haulage roads and initial ground preparations.
- HGO has released details from its copper heap leach operation. The operation is currently not modelled into our valuation as the DFS assumed the wind up of the operation in H2-2010 and our valuation is dated 31 July 2010. In April, the operation produced 72t of contained Cu @ A\$1.33/lb.
- HGO has confirmed that they will process at 2.4mt, above the original plan of 2mtpa. The expansion will incur an additional cost of A\$4m for a secondary crusher.

#### Financing

- We understand HGO to be in the final stages of financing with three banks. Due diligence is still in progress and management have stated that they expect to receive a binding letter of offer before the board meeting to discuss the Final Investment Decision (FID). We see these two events coinciding with the company's AGM in late June.
- HGO purchased A\$8.7m in swaptions (options to take out hedging) and incurred A\$15m of development costs. Cash at 30 April was A\$101m.

#### Exploration

- HGO has completed approximately 5,200m of RC and Diamond Core drilling to test for further mineralisation at Kanmantoo. Drilling tested for pit shell extensions and below pit mineralisation as well as satellite targets. HGO has not released results from the drilling, as the company awaits final assays.

#### Further Upside Potential

- Management are assessing options to expand the heap leach operation to bring forward additional production. In addition, management continues to assess the potential for underground development. We have not modelled either potential expansion. However, they have the potential to increase production materially above our current estimated production rate of ~20kt pa Cu. Our current upside case assumes an additional ~3 years of production at 20kt pa Cu contained copper and values HGO at A\$0.59/share.

We continue to see significant upside potential at Kanmantoo, and the latest release from HGO reaffirms this position.

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 %
2009a	11.3	-4.6	-1.1	-120.8	-12.3	-1.1	-11.5	0.0	0.0	0
2010e	55.6	-16.0	-3.1	-194.3	-9.6	-1.7	-18.1	2.0	7.1	0
2011e	6.0	-1.7	-0.3	89.4	-90.9	-5.5	-5.4	0.0	0.0	0
2012e	12.4	12.4	2.4	833.3	12.4	4.7	6.4	0.0	0.0	0

## Amendments to the model

- Increased Kanmantoo's project CAPEX by A\$4m to A\$102m to include secondary crushing capacity. This has been incorporated as a result of a recommendation by SRK following their technical audit of the higher 2.4mt pa throughput rate.
- Adjusted timing of expenditure to effectively bring forward additional CAPEX for Kanmantoo on the current half year.
- Included copper price hedging and related costs (15kt @ A\$8,500/t). We understand the A\$8.7m expensed incurred for the swaptions to be in full.
- Incorporated recently upgraded gold price forecasts.
- Increased administration overheads to A\$5.8m pa from previous A\$4.8m pa.
- Pushed back production start date for Kanmantoo to half year ending Jan 2012. With a 14 month construction time, it now looks highly unlikely that Kanmantoo will commission in the July 2011 half year.

## NPAT Forecasts – A\$m

Yr end Jan	2011	2012	2013
Previous	-0.2	27.5	25.5
Revised	-1.7	12.4	31.1
% change	-740%	-55%	22%

Source: Wilson HTM

- We have delayed first production to the half year ending Jan 2012. The impact of this reduces our year-end Jan 2012 NPAT forecast from A\$27.5m to A\$12.4m. We have revised down production in the year end Jan 2012 from 14kt to 7kt Cu. In addition, the year end Jan 2013 NPAT figures have been impacted by 1) in the money swaptions and 2) higher gold prices (refer *Precious Metals Weekly* 26/5/10).

## DCF Valuation and Target Price

A\$/share	Valuation	Target
Previous	0.43	0.50
Revised	0.40	0.48
% change	-7%	-4%

Source: Wilson HTM

- The culmination of the changes to our model has reduced our valuation and target price by 7% and 4% respectively.

## DCF Valuation and Target Price Sensitivity

A\$/share	Valuation	Target
Current Price Deck	0.40	0.48
Copper price +15%	0.42	0.49
Copper price -15%	0.39	0.46

Source: Wilson HTM



## 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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