

Hillgrove Resources (HGO)

AGM – Kanmantoo risks reducing



Wilson HTM
INVESTMENT GROUP

23 June 2011

\$0.25

BUY

Keith Williams

03 9640 3802

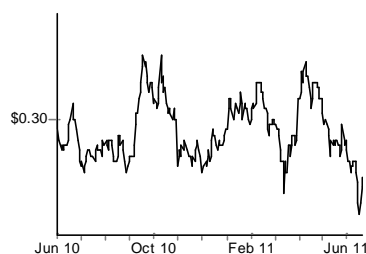
keith.williams@wilsonhtm.com.au

James Brennan-Chong

03 9640 3893

james.brennan-chong@wilsonhtm.com.au

Price Performance



Security/Capital Details

ASX Code	HGO
Market Cap	\$203 M
Issued Shares (dil)	827.9 M
Avg Mth T'over	39.81 M
12 Mth High – Low	\$0.36 - \$0.21

Key Data/Ratios – FY 2011

EBITDA / Sales	-682.7%
EBIT / Sales	-696.2%
Debt / Equity	0.0%
Interest Cover	-3.7 x
ROE	-8.1%
EPS Growth	11.4%
DCF	\$0.52
12 Mth Price Target	\$0.62

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

We view the recent HGO price weakness as unfounded. Despite potentially needing to use part of the \$10m contingency, we see limited risk of a capital cost overrun. The project remains on time and within budget with construction completion expected at the end of September. First production is expected in November with nameplate 21ktpa Cu production rate expected in the first half of CY2012. Kanmantoo near mine exploration drilling has the potential to increase the mine life and potentially support an increased production rate of 3.5mtpa or 30ktpa Cu. BUY rating retained. Valuation and target price are unchanged at \$0.52/sh and \$0.62/sh respectively.

Key Points

Kanmantoo construction completion end of September

- The Kanmantoo Copper mine in South Australia is over 65% complete. The project remains on time and within budget with first copper/gold production expected in November 2011.
- General construction activities are expected to be completed by the end of September, with wet commissioning commencing in early October.
- Management have allowed 6 months for the mill to reach nameplate throughput of 2.4mtpa. We forecast a small amount of copper production in the January 2012 quarter of 2.7kt Cu, before increasing to 20kt Cu in the 2012 calendar year.

\$10m contingency likely to be used, significant cash and debt facilities remain open

- The Kanmantoo capital cost to completion was estimated at A\$121m at the time of the Final Investment Decision (FID) in October 2010, which included A\$10m in contingency. Total capital spent to 31 May 2011 was A\$71.3m (this does not include previous FID expenditure of A\$22.9m). Total remaining cost, inclusive of the \$10m contingency is A\$50m.
- Cash at 31 May was \$71m and HGO is expected to have access to a A\$30m debt facility. In our view, we now see a lower risk that costs will increase beyond the size of the contingency, we remain comfortable that should such a scenario eventuate, that HGO has more than sufficient capital. Our modelling assumes that the full A\$10m contingency is required.
- HGO expects to draw debt in late July.

Mill and reserve expansion potential

- A plant expansion from 2.4mtpa to 3.5mtpa has the potential to lift the production rate from 21kt Cu to 30kt Cu. Capital cost has been estimated at A\$12m. Cost is low as the key capital components were acquired with the Pillara plant. We do not model this scenario, as the expansion is dependent on further reserve additions. We model a throughput rate of 2.7mtpa from FY2014 due to expected achievement of operating efficiencies.
- Near mine exploration drilling has the potential to convert additional resources to reserves, as well as add new resources located outside of existing resource shells. An updated reserve and resource statement is expected in early 2012.

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	-12.7	-1.0	-23.8	0.0	0.0	0
2011e	-14.2	-14.2	-1.7	11.4	-14.3	-5.0	-4.9	0.0	0.0	0
2012e	-3.3	-3.3	-0.4	76.6	-61.3	-0.4	-66.2	0.0	0.0	0
2013e	57.0	57.0	6.9	1,822.5	3.6	10.1	2.4	0.0	0.0	

Kanmantoo capital spend

	A\$m
Initial capital cost at FID – October 2010	121.3
Incurred to 31 May	71.3
Remaining budget inclusive of \$10m contingency	50
Cash at 31 May	71
Cash reserve before corporate and exploration costs	21
Undrawn debt*	30
Remaining available funding	51

* conditional on banking conditions being met
Source: HGO

HGO has flagged that it will likely require the use of part of the A\$10m contingency.

We are aware that the additional costs are generally associated with refurbishment costs, including the refurbishment of pumps for the concentrator. Whilst the cost of refurbishment was more than expected, we do not view this as representative of an adverse cost overrun.

The total capital cost at the time of the FID in October 2010 was A\$121.3m. Notwithstanding pre FID capital expenditure of A\$22.9m, total capital spent to 31 May was A\$71.3m.

Remaining capital, inclusive of A\$10m in contingency, is estimated at \$50m. At 31 May, HGO's cash on hand was A\$71m. Assuming that the entire A\$10m contingency is required, this would leave a cash balance of A\$21m before corporate and exploration costs incurred during the period and also assuming no accrual of costs.

We remain comfortable that the Kanmantoo project will arrive on time and within budget. We see the risks of cost overruns and or delays as materially decreasing as project completion is now 65% complete with all components on site. In addition, construction completion is expected by the end of September.

We find further comfort with HGO's capital position, with the company having access to a A\$30m debt facility with Barclays Bank PLC and Macquarie Bank Limited, subject to final draw down approval. The facility matures 30 September 2015.

HGO expects to draw on the debt facility at the end of July. Access is subject to the banks confirming all Conditions Precedent (CP) have been met, including acceptable project technical review and up to date financial model confirming ability to meet lending requirements.

Mill expansion potential

HGO is targeting nominal throughput from the Pillara Mill of 2.4mtpa. There is scope to increase the mill throughput to 3.5mtpa at a cost of A\$12m. The additional floatation cells required to support the increased throughput were part of the Pillara Mill when it was acquired by HGO.

The expansion to 3.5mtpa has the potential to increase production to 30kt Cu pa.

We do not model this expansion as the existing reserves are not sufficient to support the expansion. At this stage, we model an increase to 2.7mtpa in FY2014 due largely to operational efficiencies



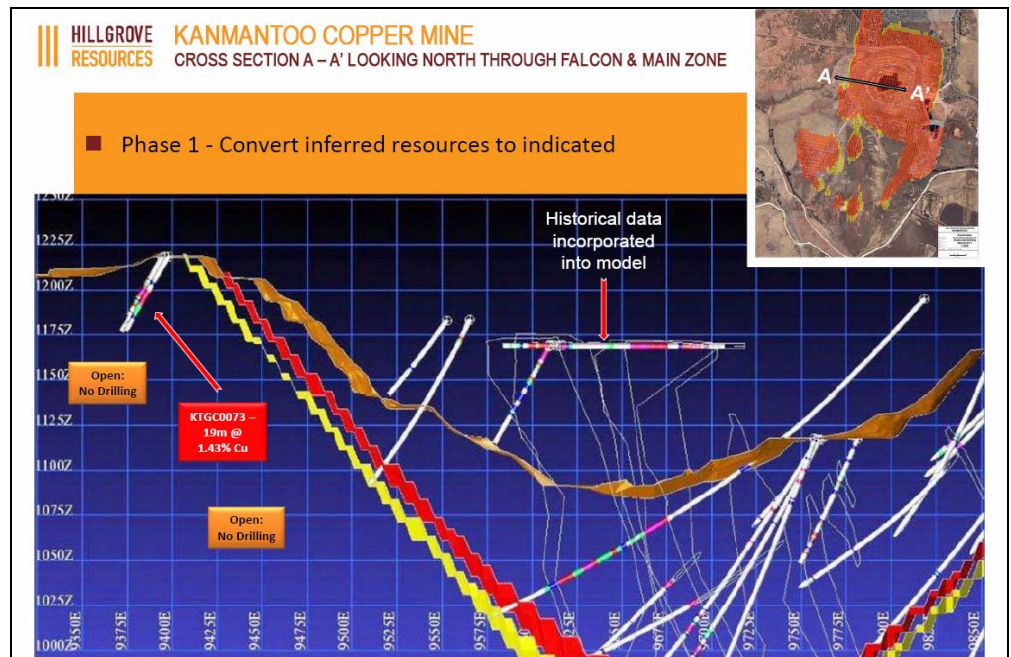
Near mine exploration drilling

The HGO board recently approved a A\$1.5m near mine exploration budget for the 2011 calendar year. Phase 1 of the drilling program for 5,000m of RC drilling involves testing and upgrading the existing inferred resources to indicated status. The inferred resources constitute approximately 23% of the Kanmantoo resource.

The second phase of the program for 2,500m will target additional inferred resources.

An updated reserve and resource statement is expected in early 2012.

Increasing resource potential



Source: HGO

Phase 1 of the drilling program will attempt to expand indicated resources through conversion of inferred resources. Inferred resources lie in between the red and yellow pit shells in the above diagram.

Importantly, we note that beyond these resource shells, there is a significant intersection of 19m @ 1.43% Cu. The intercept could suggest that another parallel mineralised lode is present beyond the existing pit wall.

Indonesia

Following the completion of shallow drilling at Sumba (*April quarter report – Pelitalira down but not out 1/6/11*), aeromagnetic and radiometric surveys have commenced.

At Birds Head, surface mapping continues and ground preparation has commenced with initial drill sites prepared. HGO continues to wait for the Pinjam Paki permit before drilling. Today's AGM presentation indicates HGO believes it is very close to being awarded the permit.



Treatment and refining charges – TC/RC’s

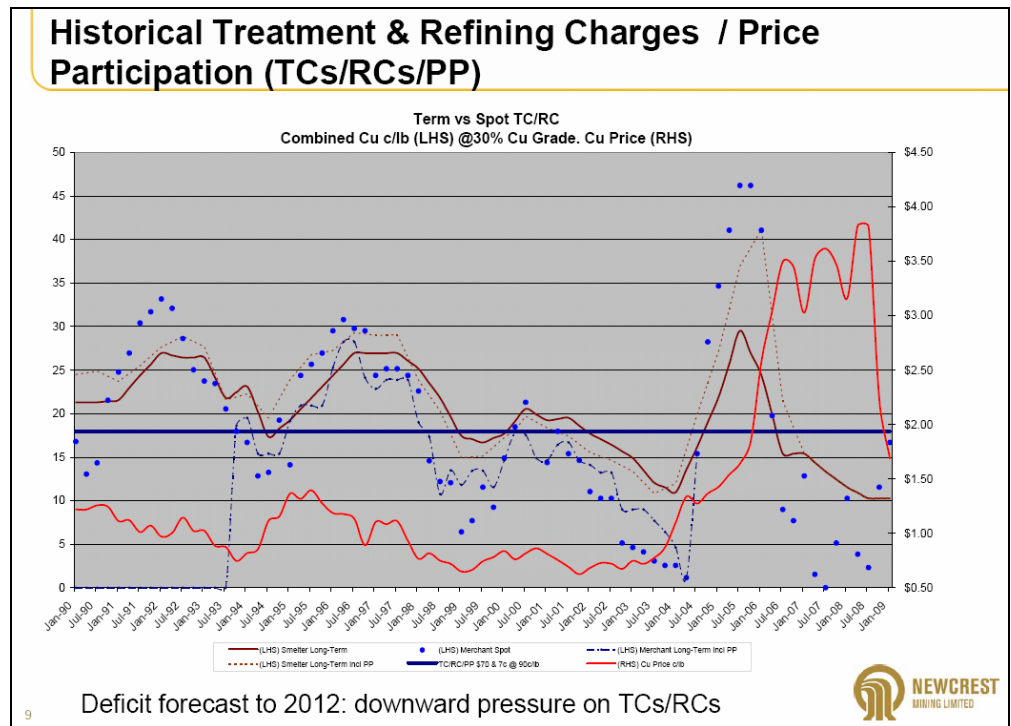
HGO has in place a life of mine off take agreement with J.P Morgan Metals & Concentrates LLC. The terms of the TC/RC’s have been set for the first 80kt of copper concentrate produced. This is approximately the first 4 years of production, after which time the terms revert to market pricing. We understand there is no price participation.

We understand the terms were set in 2005 and would have likely been set against bench mark TC/RC rates at the time.

Based on the chart below, and notwithstanding the significant volatility in the TC/RC’s during 2005, over the course of 2005, the combined TC/RC for a 30% concentrate ranged between approximately US\$0.21-0.29/lb payable copper. This implies a combined TC/RC at the lower end of 80/8, and at the upper end 105/10.5. Changes to the plant flowsheet are expected to increase the grade of the HGO concentrate from an originally projected 24% copper to 28% copper.

Importantly, whatever the actual TC/RC under the off-take agreement, it is factored into the feasibility study life of mine average cash cost of \$1.61/lb. This cash cost is based on conservative by-product credit assumptions of US\$900/oz Au and US\$13/oz Ag. At spot prices, cash costs reduce by around \$0.15/lb.

Historical TC/RC’s



Source: Concentrate Marketing, Greg Robinson. Newcrest Mining.



Kanmantoo reserves

	Tonnes Mt	Cu %	Au g/t	Ag g/t	Cu Kt	Au koz	Ag koz
Proven	2.3	0.87%	0.13	3.2	20	9.6	236.7
Probable	12.5	0.84%	0.18	3.1	105	72.3	1246.0
Total	14.8	0.84%	0.17	3.1	125	82.0	1482.6

Source: HGO

Kanmantoo resources

	Tonnes Mt	Cu %	Au g/t	Ag g/t	Cu Kt	Au koz	Ag koz
Measured	2.3	0.90%	0.20	3.5	22	12.1	255.3
Indicated	22.5	0.90%	0.20	3.3	204	139.9	2381.2
Inferred	7.4	0.90%	0.20	2.9	66	39.1	677.1
Total	32.2	0.90%	0.20	3.2	292	191.0	3313.6

Source: HGO

Hillgrove Resources (HGO : \$0.25)

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	2.25	1.85

PRICES

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
Gold (US\$/oz spot)	871	994	1250	1612	1990
Silver (US\$/oz spot)	14.58	15.02	21.61	39.68	49.32
Copper (US\$/lb)	2.99	2.46	3.52	4.72	5.12
AUDUSD (USD)	0.84	0.82	0.93	1.04	1.02

INVESTMENT & VALUATION FUNDAMENTALS

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
EPS Before Abs (c)	-1.1	-1.9	-1.7	-0.4	6.9
EPS Growth (%)	N/A	-82.1%	11.4%	76.6%	1,822.5%
PER (x)	-12.3	-12.7	-14.3	-61.3	3.6
CFPS (c)	-1.1	-1.0	-5.0	-0.4	10.1
P/CF (x)	-11.5	-23.8	-4.9	-66.2	2.4
EV/EBITDA (x)	-15.4	-7.6	-3.9	-36.2	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 %

Yr Ending Jan	A\$m	A\$ps	A\$m	A\$ps
Kanmantoo - Open Cut	362.2	0.44	379.9	0.46
Corporate Items	-19.4	-0.02	-20.0	-0.02
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	38.7	0.05	40.7	0.05
Hedge Book	-16.0	-0.02	-16.1	-0.02
Net (Debt)/Cash	28.7	0.03	28.7	0.03
Additional Capital - Dilution	5.9	0.01	5.9	0.01
Total Valuation	430.5	0.52	449.5	0.54

PROFITABILITY RATIOS

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
EBIT / Sales (%)	-710.5%	-696.2%	-680.4%	41.4%	
ROA (%)	N/A	-9.5%	-20.4%	-2.9%	32.6%
ROE (%)	N/A	-12.9%	-8.1%	-1.8%	25.8%
ROFE (%)	N/A	-13.0%	-42.8%	-4.5%	48.0%

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	1.7	0.0
EBIT	-4.9	-5.3	-7.4	-14.7	-3.0
Net Profit	54.0	1.6	-2.7	-11.5	-1.1
EPS	-1.2	-0.9	-0.3	-1.4	-0.1

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

BALANCE SHEET (\$m)

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
Cash	7.7	130.4	117.4	58.2	131.5
Total Assets	140.9	211.1	253.6	304.3	380.1
Debt	44.0	2.5	0.0	43.5	41.0
Total Liabilities	56.6	47.3	68.8	112.3	131.1
Total Shareholders Equity	83.7	163.5	184.5	191.8	248.8
Total Funds Employed	120.5	35.9	67.4	177.4	158.6

LIQUIDITY & LEVERAGE RATIOS

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
Debt / Equity (%)	52.6%	1.5%	0.0%	22.7%	16.5%
Gearing (%) ¹	34.3%	1.5%	0.0%	18.5%	14.1%
Interest Cover (x)	-4.7	-0.8	-18.6	2.6	-133.3
Debt / CashFlow (x)	-9.0	-0.3	0.0	-14.1	0.5
(Debt+CNotes)/ CashFlow	-5.4	-0.1	0.0	-14.1	0.4

PROFIT & LOSS (\$m)

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
Sales Revenue	0.0	1.4	3.2	0.8	195.3
EBITDA	-6.7	-9.8	-21.7	-5.2	99.7
Depn and Amortisation	0.2	0.4	0.4	0.3	18.8
EBIT	-6.9	-10.2	-22.1	-5.5	80.9
Net Interest Expense	1.5	12.2	1.2	-2.1	-0.6
Pre-tax Profit	-8.4	-22.4	-23.3	-3.3	81.5
Tax	-3.7	-6.4	-9.1	0.0	24.4
Tax rate (%)	44.5%	28.5%	39.2%	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	-14.2	-3.3	57.0
Abnormals	15.9	71.6	0.0	0.0	0.0
Reported Net Profit	11.3	55.6	-14.2	-3.3	57.0

CASHFLOW (\$m)

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
Operating Cash Flow	-4.9	-8.5	-41.2	-3.1	83.6
Capital Expenditure	-2.5	-7.2	-43.6	-92.1	-2.4
Expln, Develop, Evaln	-12.6	-4.4	-8.4	-10.6	-5.4
Asset Sales/Acquisitions	-4.5	165.6	12.0	0.0	0.0
Other	1.0	0.0	-0.6	-7.5	0.0
Investing Cash Flow	-18.6	154.0	-40.5	-110.2	-7.8
Share Issues/(Buybacks)	42.6	32.8	83.9	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	-12.7	0.0	0.0
Financing Cash Flow	27.6	-22.8	68.7	54.1	-2.5
Cash Increase (Decrease)	4.1	122.7	-13.0	-59.2	73.3

EARNINGS SENSITIVITIES - % CHANGE

Yr Ending Jan	2009A	2010A	2011E	2012E	2013E
+/-10% US\$ Copper Price	0.0%	0.0%	0.0%	0.0%	22.5%
+/-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%	2.2%
+/-10% US\$ Silver Price	0.0%	0.0%	0.0%	0.0%	0.8%



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

Whilst Wilson HTM Ltd believes the information contained in this communication is based on reliable information, no warranty is given as to its accuracy and persons relying on this information do so at their own risk. To the extent permitted by law Wilson HTM Ltd disclaims all liability to any person relying on the information contained in this communication in respect of any loss or damage (including consequential loss or damage) however caused, which may be suffered or arise directly or indirectly in respect of such information. Any projections contained in this communication are estimates only. Such projections are subject to market influences and contingent upon matters outside the control of Wilson HTM Ltd and therefore may not be realised in the future.

The advice contained in this document is general advice. It has been prepared without taking account of any person's objectives, financial situation or needs and because of that, any person should, before acting on the advice, consider the appropriateness of the advice, having regard to the client's objectives, financial situation and needs. Those acting upon such information without first consulting one of Wilson HTM Ltd investment advisors do so entirely at their own risk. This report does not constitute an offer or invitation to purchase any securities and should not be relied upon in connection with any contract or commitment whatsoever. If the advice relates to the acquisition, or possible acquisition, of a particular financial product – the client should obtain a Product Disclosure Statement relating to the product and consider the Statement before making any decision about whether to acquire the product. This communication is not to be disclosed in whole or part or used by any other party without Wilson HTM Ltd's prior written consent.

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.

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