HILLGROVE
RESOURCES

**THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION**

**THE MATTERS RAISED IN THIS DOCUMENT WILL AFFECT YOUR SHAREHOLDING IN THE COMPANY. YOU ARE ADVISED TO READ THIS DOCUMENT IN ITS ENTIRETY BEFORE THE GENERAL MEETING REFERRED TO BELOW IS CONVENED.**

**IF YOU ARE IN ANY DOUBT ABOUT THE ACTION YOU SHOULD TAKE, PLEASE CONSULT YOUR STOCKBROKER, SOLICITOR, ACCOUNTANT OR OTHER PROFESSIONAL ADVISER.**

## HILLGROVE RESOURCES LIMITED

ACN 004 297 116

# Notice of Extraordinary General Meeting

## and

# Related Documentation

The Independent Expert, Value Adviser Associates, has concluded that the Share Acquisition described in these meeting materials is:

not fair but reasonable to the non-associated Shareholders and therefore it is in their interest to approve the Share Acquisition.

Each of the Directors who are independent of the proposed Share Acquisition believe that it will be in the best interests of the Company and Shareholders based on the advantages outlined within and recommend shareholders vote IN FAVOUR of the proposed resolution.

**General Meeting to be held at**
**The Pullman Adelaide**
**16 Hindmarsh Square, Adelaide 5000 SA**
**on Friday 8 December 2017 12:00pm (ACDT).**

# NOTICE OF EXTRAORDINARY GENERAL MEETING



## HILLGROVE RESOURCES LIMITED

(ACN 004 297 116)

**Notice is given** that a general meeting of shareholders of Hillgrove Resources Limited (ACN 004 297 116) (**Company**) (ASX: HGO) will be held at The Pullman Adelaide 16 Hindmarsh Square, Adelaide 5000 SA on Friday 8 December 2017 at 12:00pm (ACDT).

Capitalised terms used in this Notice bear the same meaning as in the Glossary or in the summary below.

The Explanatory Statement, the Proxy Form and the accompanying booklet containing the Independent Expert's Report are incorporated in and comprise of this Notice of Meeting.

## 1. BUSINESS OF THE MEETING

### Resolution 1 – APPROVAL OF ACQUISITION OF RELEVANT INTEREST

To consider and, if thought fit, to pass, with or without amendment, the following resolution as an **ordinary resolution**:

***"That for the purposes of item 7 of section 611 of the Corporations Act and for all other purposes, approval is given to the acquisition of a relevant interest in the Company's voting shares, up to a maximum voting power of 31.35% by Ariadne Capital Pty Ltd ACN 125 296 157 and its associates on conversion of all of their Notes into shares on the terms and conditions set out in the Explanatory Statement accompanying this Notice of Meeting"***

### INDEPENDENT EXPERT'S REPORT

Shareholders should carefully consider the report prepared by the Independent Expert in the accompanying booklet for the purposes of the Shareholder approval required under Section 611 Item 7 of the Corporations Act. The Independent Expert's Report comments on the fairness and reasonableness to the non-associated Shareholders in the Company of the Share Acquisition that is the subject of the Resolution.

Further details regarding the Share Acquisition are set out in the accompanying Explanatory Memorandum and Independent Expert's Report which the Directors recommend Shareholders read in full before making any decision in relation to the Resolution.

By order of the Board

**Paul Kiley**
*Company Secretary*

Dated: 6 November 2017

## TABLE OF CONTENTS

# NOTICE OF EXTRAORDINARY GENERAL MEETING

## NOTES

Shareholders in the Company are requested to consider and vote upon the Resolution set out in the Notice.

You can vote by:

- attending and voting at the Meeting; or
- appointing someone as your proxy to attend and vote at the Meeting on your behalf, by completing and returning the Proxy Form to the Company or its share registry in the manner set out on the Proxy Form. The Company or its share registry must receive your duly completed Proxy Form by no later than **12:00pm (ACDT) on Wednesday 6 December 2017**.

## VOTING IN PERSON

To vote in person, please attend the Meeting on the date, time and place set out above.

## VOTING BY PROXY

To vote by proxy, please complete and sign the Proxy Form enclosed with this Document as soon as possible and **either** send, deliver, courier or mail the duly completed Proxy Form:

- online at www.votingonline.com.au/hgogm2017;
- by facsimile to Boardroom Limited on facsimile number +61 (02) 9290 9655;
- deliver to Boardroom Pty Limited at Level 12, 225 George Street, Sydney NSW 2000, Australia; or
- mail to Boardroom Pty Limited at GPO Box 3993, Sydney NSW 2001, Australia;

so that it is received no later than **12:00pm (ACDT) on Wednesday 6 December 2017**.

Details on how to vote by proxy are set out on the back of your Proxy Form.

Please read this Document carefully and in its entirety, determine how you wish to vote in relation to the Resolution and then cast your vote accordingly. If you do not understand any part of this Document, or are in any doubt as to the course of action you should follow, you should contact your financial or other professional adviser immediately.

## DETERMINATION OF MEMBERSHIP AND VOTING ENTITLEMENT FOR THE PURPOSE OF THE MEETING

For the purpose of determining a person's entitlement to vote at the Meeting and in accordance with regulation 7.11.37 of the Corporations Regulations 2001 (Cth), a person will be recognised as a member and the holder of Shares if that person is registered as a holder of Shares at **7:00pm (ACDT)** on **Wednesday 6 December 2017**.

## VOTING EXCLUSION STATEMENT

For the purposes of section 611, Item 7 of the Corporations Act, no votes may be cast in favour of this Resolution by the person proposing to make the Share Acquisition and its associates. Accordingly, the Company will disregard any votes cast on the Resolution by Ariadne Capital Pty Ltd ACN 125 296 157 and any of its associates.

However, this does not prevent the casting of a vote on the Resolution if it is cast by a person as a proxy, for a person who is entitled to vote in accordance with the directions on the proxy form.

## PROXIES

A Shareholder, entitled to attend and vote at this Meeting pursuant to the Constitution, is entitled to appoint no more than two proxies. Where more than one proxy is appointed, each proxy may be appointed to represent a specific proportion of the member's voting rights. A proxy need not be a Shareholder. Any instrument of proxy deposited or received by the Company in which the name of the appointee is not filled in shall be deemed to be given in the favour of the Chair of the Meeting.

The instrument appointing a proxy must be lodged, and any power of attorney or an office copy of a notarially certified copy thereof under which an attorney for a member appoints a proxy, must be lodged by no later than **12:00pm (ACDT)** on **Wednesday 6 December 2017** in accordance with the instructions provided in the Proxy Form.

The instrument appointing a proxy shall be in writing under the hand of the appointor or of his/her attorney or if such appointor is a corporation, under the hand of its attorney or the hand of a person duly authorised by the corporation. The Proxy Form which accompanies this Notice may be used.

## CORPORATE REPRESENTATIVES

A body corporate which is a Shareholder, or which has been appointed as a proxy, may appoint an individual to act as its representative at the meeting. The appointment must comply with the requirements of section 250D of the Corporations Act. The representative should bring to the meeting evidence of his or her appointment, including any authority under which it is signed, unless it has previously been given to the Company.

# EXPLANATORY STATEMENT

## 1. INTRODUCTION

This Explanatory Statement is included in and forms part of the Notice of Meeting. The purpose of this Explanatory Statement is to provide Shareholders with information they require in order to make an informed decision on the Resolution.

If you are in doubt as to how to vote, you should seek advice from your accountant, solicitor, tax advisor or other professional adviser prior to voting. It is important that you read this Explanatory Statement in its entirety for a detailed explanation of the Resolution.

**The Directors who are independent of the Resolution described in these meeting materials unanimously recommend Shareholders vote in favour of the Resolution.**

## 2. BACKGROUND

On 22 November 2016, the Company offered Shareholders the opportunity to participate in a non-renounceable entitlement offer of redeemable, convertible notes (**Notes**). Under the offer, each Note was to be issued at a price of $1.00 per Note, on the basis of 1 Note for every 37.62 Shares held at 28 November 2016 (together with 37.62 attaching Options for every 1 Note subscribed for and issued) to raise approximately $5 million (**Entitlement Offer**).

The Entitlement Offer was fully underwritten by Ariadne Capital Pty Ltd ACN 125 296 157 (**Ariadne Capital**) and together with its associates (**Ariadne**) subscribed in full for their respective entitlements under the Entitlement Offer.

On 11 October 2017, the Board advised that it had issued notice (**Early Redemption Notice**) of its intention to redeem those Notes before the Maturity Date of 20 December 2019 and set 22 December 2017 as the Redemption Date. The early redemption of the Notes would result in a number of benefits including:

- removal of restriction on granting security, on capital raising and the payment of dividends by removing the existing negative covenants; and
- significant cost savings in the order of $1.9 million including the ability to undertake hedging at a significant price differential, elimination of the interest payable on the Notes, a reduction in costs of the Trustee including the Trustee's legal costs, reduction in share registry fees relating to the Notes and reduced administration costs.

Under the terms of the Notes, the Company may redeem all (but not some) of the Notes in whole before their Maturity Date at their Face Value ($1.00) plus an early redemption premium (20% of the Face Value), together with any interest accrued on those Notes to (but excluding) the applicable Redemption Date (**Redemption Offer**).

Alternatively the Notes may be converted, if before Redemption, the Noteholder validly elects to convert the Notes into fully paid ordinary shares in the Company.

Ariadne Capital is the Company's largest shareholder. Ariadne Capital and its associates have indicated that it would like to convert all of its Notes into Shares (equating to an additional 56,906,065 Shares) (Share Acquisition). This would increase its voting power in the Company from the current 21.96% to between 25.97% (if all other Notes are converted) and approximately 31.35% (assuming no other Notes are converted).

Section 606(1) of the Corporations Act prohibits the acquisition by a person of voting shares in a company where, because of the acquisition, that person's (or someone else's) voting power in the company increases:

(a) from 20% or below to more than 20%; or

(b) from a starting point that is above 20% and below 90%

(**Prohibition**).

Item 7 of Section 611 of the Corporations Act provides an exception to the Prohibition, whereby a person may acquire a relevant interest in a company's voting shares with shareholder approval.

On 12 October 2017 the Company received a request from Ariadne Capital to seek shareholder approval for the purposes of the Corporations Act. Pursuant to the Underwriting Agreement, and as outlined in section 2.6 - Control in the Supplementary Prospectus released on 1 December 2016, the Company agreed to call a Shareholders' meeting if requested by Ariadne Capital.

## 3. APPROVAL

The Resolution seeks Shareholder approval for the purposes of Item 7 of Section 611 of the Corporations Act to allow the Company to issue 56,906,065 Shares to Ariadne, following the conversion of Notes. If Shareholders approve the Share Acquisition and Ariadne proceeds to convert all its Notes to Shares, Ariadne's voting power in the Company will increase from 21.96% to between 25.97% and 31.35%, depending upon the number of Notes converted.

As outlined in the table in section 5.3 below, the exact increase in Ariadne's voting power in the Company is dependent on the number of Notes which other Noteholders elect to convert into Shares.

## 4. ITEM 7 OF SECTION 611 APPROVAL

For shareholder approval pursuant to item 7 of section 611 to be effective, Shareholders must be provided with all the information known to the Company, Ariadne or its associates that is material to the decision on how to vote on the resolution, including:

- the identity of the entity proposing to make the acquisition and its associates;
- the maximum extent of the increase in that entity's voting power in the Company that would result from the acquisition;
- the voting power that the entity would have as a result of the acquisition;
- the maximum extent of the increase in voting power of each of that entity's associates that would result from the acquisition; and
- the voting power that each of that entity's associates would have as a result of the acquisition.

ASIC Regulatory Guide 74 specifies information required to be provided to the Shareholders because their approval of the proposed issue of Shares in the Company is sought. Accordingly, this is the basis on which the information in this Explanatory Statement is provided.

## 5. VOTING POWER

For the purposes of item 7, section 611 of the Corporations Act, it is important for Shareholders to note the effect of the proposed Share Acquisition on the voting power of the Company. Under the Corporations Act, voting power is calculated by aggregating the total number of votes attached to all voting shares in the Company that the person or their associates has a relevant interest in and expressing this as a percentage of the total number of votes attached to all the voting shares in the Company.

## 5.1 Current Voting Power by Ariadne Capital and its Associates

Set out below is the current voting power of Ariadne Capital and its associates as at the date of the Notice.

| Holder of relevant interest | Registered holder of securities | Nature of relevant interest | No of ordinary Shares | Current power |
|---|---|---|---|---|
| Portfolio Services Pty Limited | Portfolio Services Pty Limited | Portfolio Services Pty Limited has a relevant interest under section 608(1)(a) of the Act, as the registered holder of the securities. | 61,167,049 | 14.71% |
| Ariadne Holdings Pty Limited | Portfolio Services Pty Limited | Ariadne Holdings Pty Limited has a relevant interest under section 608(3)(b) of the Act, as Portfolio Services Pty Limited is a wholly owned subsidiary and therefore controlled by Ariadne Holdings Ptv Limited. | 61,167,049 | 14.71% |
| Ariadne Australia Limited | Portfolio Services Pty Limited | Ariadne Australia Limited has a relevant interest under section 608(3)(b) of the Act, as Portfolio Services Pty Limited is a wholly owned subsidiary and therefore controlled by Ariadne Australia Limited. | 61,167,049 | 14.71% |
| Bivaru Pty Limited | Portfolio Services Pty Limited | Bivaru Pty Limited has a relevant interest under section 608(3)(a) of the Act, as its voting power in Ariadne Australia Limited is more than 20%.<br>Ariadne Australia Limited has a relevant interest under section 608(3)(b) of the Act, as Portfolio Services Pty Limited is a wholly owned subsidiary and therefore controlled by Ariadne Australia Limited.<br>Portfolio Services Pty Limited has a relevant interest under section 608(1)(a) of the Act, as the registered holder of the securities. | 61,167,049 | 14.71% |
| Ariadne Capital Pty Limited | Ariadne Capital Pty Limited | Ariadne Capital Pty Limited has a relevant interest under section 608(1)(a) of the Act, as the registered holder of the securities. | 30,149,141 | 7.25% |
| Ariadne Australia Limited | Ariadne Capital Pty Limited | Ariadne Australia Limited has a relevant interest under section 608(3)(b) of the Act, as Ariadne Capital Pty Limited is a wholly owned subsidiary and therefore controlled by Ariadne Australia Limited. | 30,149,141 | 7.25% |
| Bivaru Pty Limited | Ariadne Capital Pty Limited | Bivaru Pty Limited has a relevant interest under section 608(3)(a) of the Act, as its voting power in Ariadne Australia Limited is more than 20%.<br>Ariadne Australia Limited has a relevant interest under section 608(3)(b) of the Act, as Ariadne Capital Pty Limited is a wholly owned subsidiary and therefore controlled by Ariadne Australia Limited.<br>Ariadne Capital Pty Limited has a relevant interest under section 608(1)(a) of the Act, as the registered holder of the securities. | 30,149,141 | 7.25% |

## 5.2 Increase of Voting Power on Conversion of Ariadne and its Associates

Set out below is the effect on the voting power should the Share Acquisition proceed and no other Notes are converted into Shares.

| Name of Noteholder | No. of Notes currently held | No. Additional Shares on conversion | Maximum extent of increase | Maximum extent of voting power |
|---|---|---|---|---|
| Portfolio Services Pty Limited[1] | 666,535 | 22,217,832 | 2.93% | 17.64% |
| Ariadne Capital Pty Limited[2] | 1,040,647 | 34,688,233 | 6.46% | 13.71% |
| **Total** | **1,707,182** | **56,906,065** | **9.39%** | **31.35%** |

1 *As per the table in 5.1, Ariadne Holdings Pty Limited, Ariadne Australia Limited and Bivaru Pty Limited have a relevant interest in Portfolio Services Pty Limited.*

2 *As per the table in 5.1, Ariadne Australia Limited and Bivaru Pty Limited have a relevant interest in Ariadne Capital Pty Limited.*

## 5.3 Impact on Voting Power

On completion of the Share Acquisition, assuming that Ariadne converts 100% of its Notes, Ariadne's voting power will change as follows:

| Conversion by Non-associated Noteholders | Increase in Voting Power of Ariadne Capital and its Associates[1] | Total Voting Power of Ariadne Capital and its Associates[1] | Total Voting Power of Non-associated Shareholders |
|---|---|---|---|
| 100% | 4.02% | 25.97% | 74.03% |
| 50% | 6.45% | 28.41% | 71.59% |
| 0% | 9.39% | 31.35% | 68.65% |

1 *As per the table in 5.1, Associates are Bivaru Pty Limited, Ariadne Australia Limited and Portfolio Services Pty Limited.*

The Directors anticipate that most, if not all, Noteholders would elect to convert, having regard to the substantial premium at which the Shares trade on market relative to the conversion price of the Shares under the Note Terms. One may therefore expect, that Ariadne's voting power will only increase to approximately 25.97%.

# 6. INTERESTS OF DIRECTORS IN THE RESOLUTION

Other than Mr Maurice Loomes, none of the Directors have any interest in the proposed Share Acquisition. Mr Maurice Loomes is currently a Non-Executive Director of Ariadne Australia Limited (the parent company of Ariadne Capital) and as such he is not considered independent for the purposes of the Resolution.

# 7. ADVANTAGES

The Directors consider that the following non-exhaustive list of advantages may be relevant to a Shareholder's decision on how to vote on the Resolution:

## (a) Company's cash position

The proposed Share Acquisition will mean that the Company does not need to pay the Early Redemption Amount (i.e. their Face Value ($1.00) plus an early redemption premium (20% of the Face Value) or $1.20 per Note) on the Notes held by Ariadne which would decrease the Company's cash position. Ariadne holds a total of 1,707,182 Convertible Notes. In the event that none of these Notes are converted, the Company's cash position would decrease by $2,048,618.40.

## (b) No material impact

Assuming that all Notes are converted into Shares (as it appears likely having regard to the substantial premium at which the Shares trade on market relative to the redemption price), Ariadne's relevant interest in the Company would increase to 25.97%, as set out in the table at section 5.3 above. This would result in a relatively modest overall increase in Ariadne's shareholding in the Company, considering its current ownership of 21.96%.

In any event, Ariadne could almost replicate this increase within 6 months utilising the "creep" provisions of the Corporations Act (Item 9 of section 611 provides an exception to the Prohibition where a person's voting power in the Company increases by no more than 3% in 6 months).

Ariadne has not sought additional representation on the Company Board as part of the Share Acquisition. Therefore, on one view, Ariadne's "control" over the Company does not significantly change.

### (c) Share price

As outlined in section 9 below, if the Resolution is not approved, Ariadne has indicated that it may sell down part of its existing shareholding in the Company to provide scope to convert its Notes. This will place downward pressure on the Company share price and create uncertainty for other Noteholders when deciding whether to accept the redemption or convert their Notes.

### (d) Investment

Ariadne is making a substantial investment into the Company, by leaving $2,048,618.40 in the Company and has indicated its commitment to the Company's operations and prospects.

This is consistent with its demonstrated prior commitment to the Company by underwriting the issue of Notes and providing short term working capital loans from time to time.

### (e) Takeover offer to represent full value

A party wishing to acquire full ownership of the Company will require Ariadne to agree to the terms and conditions of the offer. Given Ariadne is regarded as a sophisticated and experienced investor this should ensure any offer represents full value for the Company and includes an attractive premium. This offer would be enjoyed by all non- associated Shareholders.

### (f) Future Funding

To the extent Hillgrove's growth pipeline (which includes the underground development, the regional exploration projects and the pumped hydro project) requires external funding, the Board and Management believe Ariadne has the ability to provide capital to assist these projects and it is more likely to do so from a position of being a major shareholder.

### (g) Independent Expert's Report

Value Adviser Associates (**VAA**) has concluded that the Share Acquisition is not fair but reasonable to the non-associated Shareholders and therefore it is in their interest to approve the Share Acquisition.

## 8. DISADVANTAGES

The Directors consider that the following non-exhaustive list of disadvantages may be relevant to a Shareholder's decision on how to vote on the Resolution:

### (a) Dilution of Shareholders' interests

The Share Acquisition may increase the voting power of Ariadne from 21.96% to a maximum of 31.35%, reducing the voting power of non-associated entities in aggregate from 78.04% to 68.65%. Non-associated Shareholders may have their current Shareholdings diluted, meaning that existing Shareholders may receive less distribution of the Company's profits, in the future.

However, having regard to the substantial premium at which the Shares trade on the market relative to the redemption price, it is likely that all Noteholders will elect to convert and Ariadne's voting power will only increase to approximately 25.97%.

### (b) Takeover offer may become more difficult

The increase in Ariadne's voting interest may reduce the likelihood of the Company receiving a takeover offer in the foreseeable future. However, it is noted that Ariadne already holds a substantial interest in the Company which acts as a blocking stake to prevent a shareholder from moving towards 100% ownership through compulsory acquisition.

Nevertheless, it is noted that Ariadne's ability to deliver a significant holding, even if only 25.97%, could encourage a bidder to make a takeover offer which would benefit all Shareholders.

### (c) Special Resolutions

Where a Shareholder's voting interest increases above 25%, the Shareholder may block the passing of a special resolution. However, in any event, Ariadne's current voting power of 21.96% may be sufficient to block a special resolution given that it is unlikely that all Shareholders entitled to vote will attend a meeting or appoint a proxy.

## 9. WHAT WILL HAPPEN IF THE RESOLUTION IS NOT PASSED?

If the Share Acquisition is not approved, Ariadne Capital has indicated in its request for a Shareholder meeting that it may sell down part of its existing shareholding in the Company to provide scope to convert its Notes. This may place downward pressure on the Company share price and create uncertainty for other Noteholders when deciding whether to accept the redemption or convert their Notes.

## 10. DO THE INDEPENDENT DIRECTORS OF THE COMPANY RECOMMEND THE SHARE ACQUISITION?

Yes.

Each of the Directors who are independent of the proposed Share Acquisition believe that it will be in the best interests of the Company and Shareholders based on the advantages outlined above.

## 11. THE FUTURE OF THE COMPANY

Ariadne Capital has informed the Directors that its intentions are as follows:

(a) it has no intention to change the business of the Company;

(b) it has no intention to change the current employment arrangements of the Company;

(c) it has no intention regarding any proposal whereby any property will be transferred between the Company and Ariadne or any person associated with either of them; and

(d) it has no intention to otherwise redeploy the fixed assets of the Company.

## 12. INDEPENDENT EXPERT REPORT

VAA was commissioned by the Directors of the Company to provide an Independent Expert's Report to assess whether the transaction is fair and reasonable to the non-associated Shareholders.

The Independent Expert's Report concludes that the Share Acquisition is not fair but reasonable to the non-associated Shareholders and therefore it is in their interest to approve the Share Acquisition.

Shareholders are urged to carefully read the Independent Expert's Report in relation to the Share Acquisition to understand the scope of the report, the methodology of the assessment and the sources of information and assumptions made.

# GLOSSARY

For the purposes of this document, the following terms have the meanings prescribed below:

**ACDT**

Australian Central Daylight Time

**ASIC**

Australian Securities & Investments Commission.

**ASX**

ASX Limited ACN 008 624 691 or the securities exchange market operated by it, as the context requires.

**Board**

the board of Directors.

**Company**

Hillgrove Resources Limited ACN 004 297 116.

**Constitution**

the constitution of the Company.

**Corporations Act**

Corporations Act 2001 (Commonwealth).

**Director**

a director of the Company.

**Document**

this document entitled "Notice of General Meeting and Related Documentation" including the accompanying booklet containing the Independent Expert's Report.

**Meeting or EGM**

the Extraordinary General Meeting referred to in the Notice.

**Noteholder**

means a holder of the redeemable, convertible notes with a fixed term of three years and a fixed interest rate of 6%, issued by the Company on 20 December 2016.

**Notice or Notice of Meeting**

the Notice of Extraordinary General Meeting, forming part of this Document.

**Proxy Form**

the proxy form attached to this Document.

**Resolution**

a resolution set out in the Notice.

**Share**

a fully paid ordinary share in the Company.

**Share Acquisition**

means the issue of Shares to Ariadne, arising from the conversion of Notes as detailed in this Explanatory Statement.

**Shareholder**

a registered holder of Shares.

**HILLGROVE RESOURCES LIMITED**
ACN 004 297 116

**Adelaide Office**
Ground Floor, 5-7 King William Road,
Unley SA 5061, Australia
P.O. Box 372, Unley SA 5061, Australia
**T:** +61 8 7070 1698
**W:** www.hillgroveresources.com.au

YOUR TRUSTED VALUE ADVISER

## Hillgrove Resources Limited

# Independent Expert's Report in relation to the conversion of notes held by Ariadne to equity

6 November 2017

creating, capturing and communicating value

Value Adviser Associates Pty Ltd  ABN 54 131 852 607

# Contents



ValueAdviserAssociates
creating, capturing and communicating value

6 November 2017

The Independent Directors
Hillgrove Resources Limited
5-7 King William Road
Unley SA 5061

Dear Directors,

**Re: Independent Expert's Report in relation to proposed extraordinary general meeting**

## Proposed Share Acquisition

On 22 November 2016 Hillgrove Resources Limited ["Hillgrove" or "the Company"] issued a Prospectus for a fully underwritten non-renounceable entitlement offer [Entitlement Offer"] to eligible shareholders of 5,000,248 convertible notes ["the Notes"] to be issued at a price of $1.00 per Note, on the basis of one Note for every 37.62 Shares held on the Record Date (together with 37.62 free attaching options ["the Options"] for every one Note subscribed for and issued) to raise approximately $5 million.

According to the Supplementary Prospectus issued on 1 December 2016, it was further stated that before deciding to proceed with the Entitlement Offer, Hillgrove engaged corporate financial advisers to seek alternative debt and equity funding for the Company. Subsequently, the Company did not receive any proposal that it considered equivalent or superior to the Entitlement Offer. On that basis, the Company decided to proceed with the Entitlement Offer, which was fully underwritten by Ariadne Capital Pty Ltd ["Ariadne Capital" or "the Underwriter"]. Ariadne Capital is a subsidiary of an Australian Securities Exchange ["ASX"] listed company, Ariadne Australia Limited ["Ariadne"]. Ariadne owns 21.96% of Hillgrove's ordinary shares as at 3 November 2017, through Ariadne Capital and Portfolio Services Pty Limited. In this report, we have referred to Ariadne, Ariadne Capital and Portfolio Services Pty Limited collectively as "the Ariadne Group". The current capital structure of Hillgrove is shown in the table below:

**TABLE 1 PRE-CONVERSION CAPITAL STRUCTURE**

| Pre-conversion capital structure (dated 31 October 2017) | Hillgrove Resources | Ariadne owned | Ariadne ownership |
|---|---|---|---|
| Total ordinary shares on issue | 415,845,428 | 91,316,190 | **21.96%** |
| Total convertible notes on issue | 4,643,848 | 1,707,182 | **36.76%** |
| Maximum shares available from conversion | 154,794,931 | 56,906,065 | |

Under the Notes' terms, Hillgrove can redeem the Notes before the maturity date of 20 December 2019. The Noteholders can either accept the redemption or elect to convert their Notes at a floating conversion price based on a maximum share price of $0.03 per share.

On 11 October 2017, Hillgrove advised the market of its intention to redeem the convertible notes on 22 December 2017[1].

Two options are available to Noteholders in response to the early redemption notice:

- accept redemption of the Notes at face value of $1.00 plus 20% early redemption premium of the face value totalling $1.20 per Note, together with any interest accrued on those Notes up to (but excluding) the applicable redemption date, or
- elect for conversion of the Notes into ordinary shares at a conversion price of $0.03, or approximately 33.33 shares for each note (based on the 10 October 2017 closing share price of $0.082, each $1.00 convertible note will convert into 33.33 shares with a prima facie value of $2.73).
- On 13 October 2017, Hillgrove announced that it had received a notice from Ariadne Capital requisitioning a shareholders' meeting of Hillgrove to seek approval to convert its Notes into shares.

In addition to the above, shareholders should consider the effect of Ariadne Capital converting its Notes into shares as disclosed in the Prospectus under section 2.6. Following conversion of the Notes, the Ariadne Group's ownership interest in Hillgrove will increase. The impact on control depends upon the extent to which the non-associated shareholders elect to convert their Notes.

The Ariadne Group presently holds more than 20% of the shares on issue in Hillgrove, and therefore its election to convert its holding of Notes into shares (and, as a result, increase its percentage shareholdings in Hillgrove) requires approval by the non-associated shareholders pursuant to Section 611 of the Corporations Act ["Proposed Share Acquisition"].

## Purpose of the Report

The Independent Directors of Hillgrove have appointed Value Adviser Associates Pty Ltd ["VAA"] to prepare this independent expert's report ["IER"] setting out our opinion as to whether the Proposed Share Acquisition is in the best interests of the non-associated shareholders of Hillgrove ["Hillgrove shareholders" or "shareholders"].

The IER will be sent, by the directors of Hillgrove, to shareholders and accompany the Proxy Form and Notice of Meeting.

## Scope

Hillgrove is registered in Australia and, as such, needs to comply with Australian regulatory requirements. This report has therefore been prepared having regard to Australian Securities and Investments Commission ["ASIC"] Regulatory Guide 111 – *Content of Expert Reports* ["RG111"], ASIC Regulatory Guide 112 - *Independence of Experts* ["RG 112'] and ASIC Regulatory Guide 74 – *Acquisitions Approved by Members* ["RG 74"] as well as Clause 8303 of Schedule 8 of the Corporations Regulations.

Clause 8303 of Schedule 8 of the Corporations Regulations (2001) sets out the requirement for an independent expert's report in relation to the Proposed Share Acquisition when a party to that Proposed Share Acquisition has a prescribed shareholding in the company subject to the Proposed Share Acquisition.

[1] http://www.asx.com.au/asxpdf/20171011/pdf/43n49wl6n4y6kt.pdf

The Corporations Regulations require that the directors of Hillgrove provide shareholders with an expert report which assesses whether the proposal is in the best interests of the shareholders.

Regulatory Guide 111 – *Content of Expert Reports* ["RG 111"] sets out the assessment framework (paragraph 111.10 et seq) that requires the expert to separately determine if the offer is fair and, in the event that it is not, whether it is reasonable.

Under RG 111.18 and RG 111.19, an arrangement similar to the Proposed Share Acquisition producing a similar outcome to a takeover is subject to the same "fair and reasonable" considerations as a takeover. Whilst the effect of the Proposed Share Acquisition is not a takeover by Ariadne Capital, if approved it would lead to an enhancement of its influence over Hillgrove, and therefore we followed the guidance in RG 111.18 and 111.19.

Under RG111.11 an offer is 'fair' if the value of the offer price or consideration is equal to or greater than the value of the securities the subject of the offer. This comparison should be made:

a) assuming a knowledgeable and willing, but not anxious, buyer and a knowledgeable and willing, but not anxious, seller acting at arm's length; and

b) assuming 100% ownership of the 'target' and irrespective of whether the consideration is scrip or cash.

Under RG 111.31 when considering whether an offer is fair, "the comparison should be made between the value of the securities being offered (allowing for a minority discount) and the value of the target entity's securities, assuming 100% of the securities are available for sale. This comparison reflects the fact that:

a) the acquirer is obtaining or increasing control of the target; and

b) the security holders in the target will be receiving scrip constituting minority interests in the combined entity.

In other words, if there is a takeover of control, then the value of Hillgrove to shareholders before the Proposed Share Acquisition should be considered assuming 100% control, and the value of the merged entity after the Proposed Share Acquisition should be considered assuming that shareholders hold a minority stake in the merged entity.

Under RG111.12 an offer is 'reasonable' if it is fair. It might also be 'reasonable' if, despite being 'not fair', the expert believes that there are sufficient reasons for security holders to accept the offer in the absence of any higher bid or alternative proposal before the close of the offer.

## Basis of Assessment

In determining whether the Proposed Share Acquisition is in the best interests of Shareholders we have:

- determined whether the value to Hillgrove shareholders is fair. In other words, we have considered whether the value to Hillgrove shareholders post the Proposed Share Acquisition is likely to be equal to or greater than the value to Hillgrove shareholders before the Proposed Share Acquisition;

- considered the position of Hillgrove shareholders should the Proposed Share Acquisition not proceed;
- considered whether there is a better alternative to Hillgrove shareholders than the Proposed Share Acquisition; and
- considered other factors which we consider to be relevant to the Hillgrove shareholders in their assessment of the Proposed Share Acquisition.

To determine the value to Hillgrove shareholders before the Proposed Share Acquisition, we considered both the current share price and the value of Hillgrove's projects. We considered only the value of Kanmantoo mine as cash flows associated with other Hillgrove projects are uncertain and have not been quantified at this time.

To determine the value to Hillgrove shareholders after the Proposed Share Acquisition, a value for the company was determined and the proportion of merged company value held by Hillgrove shareholders was estimated. Both the share price and a valuation of the assets based upon cash flows from the Kanmantoo open pit, surplus cash and working capital were used to estimate fair value of the assets held by Hillgrove. From this, the value of Hillgrove's liabilities were deducted.

This does not mean that no value will emerge from the other projects, merely that the probability of significant value emerging cannot be quantified with sufficient certainty at this time.

The profiles of Hillgrove and of Ariadne which are presented in the body of the report are for background information and the segments of this information that are used in the valuations can be found from the Approach section starting on page 35.

## Summary of Opinion

VAA has assessed that the Proposed Share Acquisition is not fair but reasonable to the non-associated Hillgrove shareholders, and therefore it is in their interest to approve the Proposed Share Acquisition.

Unless otherwise stated, all references to dollar amounts are expressed in Australian dollars.

### Fairness assessment

Hillgrove's main operating asset is the open pit Kanmantoo copper mine located 55km south east of Adelaide, South Australia. The mine commenced production in 2011 with an initial mine life of seven years which has been extended. While the mine is nearing its end of life the cutback is complete and the copper grades mined at Kanmantoo and the associated copper revenue is forecast to increase markedly. A number of initiatives are underway at the mine to access underground resources at the site. Assuming no underground development the mine is expected to reach its end of life in 2020. We have valued the Kanmantoo copper mine on a discounted cash flow basis as set out in Appendix 3.

In addition to the Kanmantoo open pit mine, Hillgrove is exploring the feasibility of a number of projects in its future growth pipeline. These projects include potential underground mining at Kanmantoo, a wholly owned regional exploration project at Kanappa, another wholly owned regional exploration project at Mt Rhine & the pumped hydro concept for Kanmantoo. The economics of the other projects under consideration by Hillgrove management have not been ascertained at this stage.

Our view on these projects is that there should be no value ascribed to these projects until more is known about their feasibility and potential to earn positive returns.

Consequently, no value has been ascribed to the future growth pipeline projects.

Adopting our fair value for the current operating asset (Kanmantoo) and adjusting for other balance sheet assets and liabilities, in our opinion:

- The value on a controlling basis per Hillgrove share prior to the transaction is $0.1554.
- RG 111 requires assessment of value to shareholders on a minority basis after the transaction. The minority value to Hillgrove shareholders (after deducting a 30% minority discount which in our view is reasonable) is $0.1196 as set out below.

Using the six months Volume Weighted Average Price ["VWAP"] to 31 October 2017 to estimate fair market value of a minority holding in Hillgrove:

- The minority value per share before the Proposed Share Acquisition is $0.0809 (rounded). RG 111 requires consideration of Hillgrove on a controlling basis. Adding the 30% control premium takes the value on a controlling basis per share prior to the transaction to $0.1051.

**TABLE 2 VALUATION SUMMARY**

| Pre proposed transaction | Unit | Share price | Sum of the parts |
|---|---|---|---|
| | | 30% control premium | Controlling basis |
| Hillgrove shareholder value (controlling basis) | $'000 | 43,724 | 88,699 |
| Value per Hillgrove share (controlling basis) | $ | 0.1051 | 0.1554 |
| **Post proposed transaction** | | **Share price** | **Sum of the parts** |
| | | No control premium | 30% minority discount |
| Expected conversion | shares '000 | 154,795 | n/a |
| Conversion price | $ | 0.0300 | n/a |
| Conversion value | $'000 | 4,644 | n/a |
| Hillgrove shareholder value post proposed transaction (minority basis) | $'000 | 38,278 | 68,230 |
| Value per Hillgrove share post proposed transaction (minority basis) | $ | 0.0671 | 0.1196 |

The value to Hillgrove non-associated shareholders determined using our asset value (sum of parts) approach is higher than the value to shareholders using a share price approach. Our primary approach is the asset value approach, therefore the expected value to Hillgrove shareholders before the transaction is $88.699 million or $0.1554 per Hillgrove share, and after the minority discount it is $68.23 million or $0.1196 per Hillgrove share. We note that the VWAP should already reflect the probability of conversion.

We assess the value to Hillgrove non-associated shareholders after the Proposed Share Acquisition to be less than the value to non-associated shareholders before the Proposed Share Acquisition on a per share basis.

We therefore conclude that the Proposed Share Transaction is not fair to the non-associated shareholders.

The following table reveals the impact of dilution on the non-associated shareholders in the event of 0%, 50% and 100% conversion of the Notes by the non-associated shareholders and 100% conversion of the Notes by the Ariadne Group.

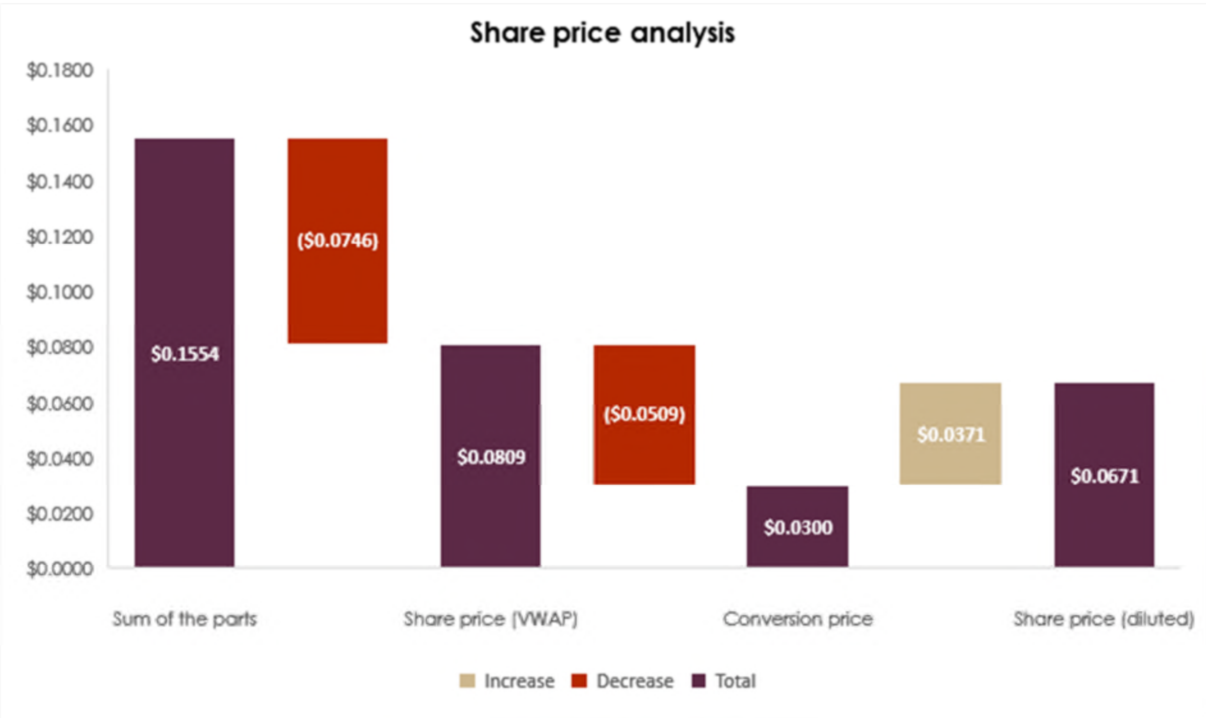
**TABLE 3 POSSIBLE CONVERION OUTCOMES**

| Possible conversion outcomes (dated 31 October 2017) | Hillgrove Resources | Ariadne owned | Ariadne ownership |
|---|---|---|---|
| 100% of notes converted by Ariadne | 56,906,065 | 56,906,065 | |
| 0% of notes converted by other holders | - | - | |
| **Total ordinary shares on issue** | **472,751,493** | **148,222,255** | **31.35%** |
| 100% of notes converted by Ariadne | 56,906,065 | 56,906,065 | |
| 50% of notes converted by other holders | 48,944,434 | - | |
| **Total ordinary shares on issue** | **521,695,927** | **148,222,255** | **28.41%** |
| 100% of notes converted by Ariadne | 56,906,065 | 56,906,065 | |
| 100% of notes converted by other holders | 97,888,866 | - | |
| **Total ordinary shares on issue** | **570,640,359** | **148,222,255** | **25.97%** |

*Source: Hillgrove management*

FIGURE 1 highlights the impact of 100% conversion of the Notes by the Ariadne Group and non-associated shareholders on the market capitalisation and share price as at 3 November 2017.

**FIGURE 1 HILLGROVE PRE AND POST TRANSACTION SHARE PRICE ANALYSIS**



## Reasonableness assessment

RG111 requires that the 'reasonableness' of the Proposed Share Acquisition be separately considered from 'fairness'.

VAA has examined the matters considered by the Hillgrove board in proposing the Early Redemption of the Notes and we set out below our consideration of a range of non-value related issues which in our view provide net benefits to the non-associated shareholders if the Proposed Share Acquisition is approved.

Based on these net benefits, we conclude that the Proposed Share Acquisition is reasonable to the non-associated shareholders:

1. The early redemption notice issued by Hillgrove provides benefits to the company via a significant reduction on hedging and administration costs related to the Notes, as well as reducing constraints imposed on the company whilst the notes are on issue including restrictions on borrowing, pledging assets, raising equity capital and committing to future projects;

2. The conversion by Aridane Capital retains for Hillgrove the cash investment made by Ariadne Capital in acquiring the Notes and therefore reduces the cash funding need to redeem the Notes. Hillgrove does not have cash reserves sufficient to meet a full redemption in any case, and its funding alternatives are limited. Under the covenants of the Notes, Hillgrove is unable to raise any fresh debt and equity (without noteholder approval) until the Notes are redeemed.

3. The conversion by the Ariadne Group strengthens Hillgrove's shareholders' equity and improves its prospects for further capital raisings;

4. Whilst the conversion would lift the Ariadne Group's shareholding from 21.96% to between 25.97% and 31.35% (depending on the extent to which non-associated shareholders elect to convert), the conversion rights were conferred via non-renounceable rights offer on commercial terms that were available to all shareholders and considered appropriate at the time (22 November 2016);

5. On our valuation assessment, conversion is the more likely economic outcome. In any event, The Ariadne Group could almost replicate the shareholding increase, and achieve the same control outcome, within 6 to 18 months utilising the "creep" provisions of the Corporations Act (Item 9 of section 611 provides an exception to the Prohibition where a person's voting power in the Company increases by no more than 3% in 6 months);

6. On our valuation assessment, the rational decision for Noteholders is to convert and therefore Ariadne Capital's increase in percentage holding is likely to be at the lower end of the range and therefore have a limited change in its control and influence. Ariadne already has a blocking stake for a takeover and that does not change, Whilst it technically goes over the threshold to block a special resolution, that relies on the premise that all shareholders vote on resolutions, which is rarely the case;

7. The conversion terms did not impose a conversion control premium on the Noteholders and we do not observe one in the conversion price. However, as noted, the terms were available to all shareholders and in any case, the change in control benefits to Ariadne may be marginal, if non-associated shareholders also elect to convert. On our valuation assessment, conversion is the more likely economic outcome;

8. Ariadne Capital is not seeking a Board position and therefore not looking to exert any fresh influence. In addition, it provides Hillgrove with a strategic shareholder with a strong balance sheet to support future initiatives;

9. If non-associated shareholders reject the Proposed Share Acquisition, it is possible that Ariadne may decide to sell down its interest putting downward pressure on the Hillgrove share price. In addition, funding would be required to meet the Early Redemption obligations;

10. We do not consider that there is a better alternative available to Hillgrove. Other alternatives require the raising of capital to meet the redemption; and,

11. The conversion by Ariadne Capital enhances Hillgrove's capacity to continue to operate as a going concern.

As reported in Hillgrove's FY16 annual report, the Company incurred a net loss of $109.1 million for the year ending 31 December 2016 with Hillgrove's current liabilities exceeding its current assets by $34.4 million[2]. Both the annual report and the independent auditors report (prepared by Deloitte) highlight the uncertainty surrounding Hillgrove's capacity to continue as a going concern if it cannot maintain the continuing support of its creditors.

In addition to reducing the financing and administrative costs directly associated with the Notes, Hillgrove management have identified additional, non-quantifiable benefits of early redemption which may include but are not limited to the renegotiation of more favourable terms with existing creditors as well as the ability to raise debt funding to increase existing mine efficiencies and accelerate growth options.

There is currently no other offer that would provide superior value to Hillgrove shareholders.

## Conclusion

In our opinion, the Proposed Share Acquisition is not fair but reasonable to non-associated shareholders and it would be in the interests of non-associated shareholders to vote in favour of the resolution.

## Other Matters

This report constitutes general financial product advice only and has been prepared without taking into consideration the individual circumstances of the shareholders of Hillgrove. The decision to accept or reject the Proposed Share Acquisition is a matter for individual shareholders. Shareholders of Hillgrove should consider the advice in the context of their own circumstances and preferences. Shareholders of Hillgrove who are in doubt as to the action they should take in relation to the Proposed Share Acquisition should consult their own professional adviser.

Hillgrove has indemnified VAA and its employee's officers and agents against any claim, liability, loss of expense, cost or damage, including legal costs on a solicitor or client basis arising out of reliance on any information or documentation provided by Hillgrove, which is false and misleading or omits any material particulars or arising from a failure to supply relevant documentation or information.

VAA has prepared a Financial Services Guide in accordance with the Corporations Act, 2001. This is included in Appendix 1 to this report.

---

[2] Hillgrove FY16 Annual Report

Our opinion is made as at the date of this report and reflects circumstances and conditions as at that date. Such conditions can change significantly over relatively short periods of time. We have not updated our report for events or circumstances arising after the date of this report.

The above must be read in conjunction with the remainder of this report including its appendices.

Yours faithfully

Michael Churchill
CEO

## Glossary

| | |
|---|---|
| Ag | Silver |
| ASX | Australian Securities Exchange |
| ATO | Australian Tax Office |
| Au | Gold |
| AUD | Australian dollar |
| Cu | Copper |
| DCF | Discounted Cash Flow |
| EL | Exploration licence |
| g/t | Grams per tonne |
| GFC | Global financial crisis |
| Hillgrove | Hillgrove Resources Limited |
| Indicated | An 'Indicated Mineral Resource' is that part of a Mineral Resource for which quantity, grade (or quality), densities, shape and physical characteristics are estimated with sufficient confidence to allow the application of Modifying Factors in sufficient detail to support mine planning and evaluation of the economic viability of the deposit. Geological evidence is derived from adequately detailed and reliable exploration, sampling and testing gathered through appropriate techniques from locations such as outcrops, trenches, pits, workings and drill holes, and is sufficient to assume geological and grade (or quality) continuity between points of observation where data and samples are gathered. An Indicated Mineral Resource has a lower level of confidence than that applying to a Measured Mineral Resource and may only be converted to a Probable Ore Reserve. |
| Inferred | An 'Inferred Mineral Resource' is that part of a Mineral Resource for which quantity and grade (or quality) are estimated on the basis of limited geological evidence and sampling. Geological evidence is sufficient to imply but not verify geological and grade (or quality) continuity. It is based on exploration, sampling and testing information gathered through appropriate techniques from locations such as outcrops, trenches, pits, workings and drill holes. An Inferred Mineral Resource has a lower level of confidence than that applying to an Indicated Mineral Resource and must not be converted to an Ore Reserve. It is reasonably expected that the majority of Inferred Mineral Resources could be upgraded to Indicated Mineral Resources with continued exploration. |
| IVS | International Valuation Standards |
| IVSC | International Valuation Standards Council |
| JORC Resource | A 'Mineral Resource' is a concentration or occurrence of solid material of economic interest in or on the Earth's crust in such form, grade (or quality), and quantity that there are reasonable |

| | |
|---|---|
| | prospects for eventual economic extraction. The location, quantity, grade (or quality), continuity and other geological characteristics of a Mineral Resource are known, estimated or interpreted from specific geological evidence and knowledge, including sampling. Mineral Resources are sub-divided, in order of increasing geological confidence, into Inferred, Indicated and Measured. |
| JORC Reserve | An 'Ore Reserve' is the economically mineable part of a Measured and/or Indicated Mineral Resource. It includes diluting materials and allowances for losses, which may occur when the material is mined or extracted and is defined by studies at Pre-Feasibility or Feasibility level as appropriate that include application of Modifying Factors. Such studies demonstrate that, at the time of reporting, extraction could reasonably be justified. |
| LME | London metals exchange |
| Measured | A 'Measured Mineral Resource' is that part of a Mineral Resource for which quantity, grade (or quality), densities, shape, and physical characteristics are estimated with confidence sufficient to allow the application of Modifying Factors to support detailed mine planning and final evaluation of the economic viability of the deposit. Geological evidence is derived from detailed and reliable exploration, sampling and testing gathered through appropriate techniques from locations such as outcrops, trenches, pits, workings and drill holes, and is sufficient to confirm geological and grade (or quality) continuity between points of observation where data and samples are gathered. A Measured Mineral Resource has a higher level of confidence than that applying to either an Indicated Mineral Resource or an Inferred Mineral Resource. It may be converted to a Proved Ore Reserve or under certain circumstances to a Probable Ore Reserve. |
| Minority interest | A significant but non-controlling ownership of less than 50% of a company's voting shares by either an investor or another company |
| ML | Mining lease |
| Mt | Million tonnes |
| Non-associated shareholders | A shareholder of Hillgrove who is not associated with Ariadne Capital. |
| PFS | Pre-Feasibility Study |
| RG 111 | Regulatory Guide 111 – Content of Expert Reports |
| RG 112 | Regulatory Guide 112 - Independence of Experts |
| Small-cap | Small market capitalisation |
| USD | United States dollar |
| VAA | Value Adviser Associates |
| VALMIN Code | The Code for the Technical Assessment and Valuation of Mineral and Petroleum Assets and Securities for Independent Expert Reports |
| VWAP | Volume-weighted average price |

| | |
|---|---|
| VAA | Value Adviser Associates |
| VALMIN Code | The Code for the Technical Assessment and Valuation of Mineral and Petroleum Assets and Securities for Independent Expert Reports |
| VWAP | Volume-weighted average price |

## Outline of the Proposed Share Acquisition

On 22 November 2016 the Company issued the Prospectus for a fully underwritten non-renounceable entitlement offer ["Entitlement Offer"] to eligible shareholders of 5,000,248 convertible notes ["Notes"] to be issued at a price of $1.00 per Note, on the basis of every 37.62 Shares held on the Record Date (together with 37.62 free attaching options ["the Options"] for every one Note subscribed for and issued) to raise approximately $5 million.

According to the Supplementary Prospectus issued on 1 December 2016, it was further stated that before deciding to proceed with the Entitlement Offer, Hillgrove engaged corporate financial advisers to seek debt and equity funding for the Company. Subsequently, the Company did not receive any proposal that was considered equivalent or superior to the Entitlement Offer. On that basis, the Company decided to proceed with the Entitlement Offer, which was fully underwritten by Ariadne Capital.

Under the Notes Terms Hillgrove can redeem the Notes before the maturity date of 20 December 2019. Noteholders can elect to convert their Notes at a floating conversion price based on a maximum share price of $0.03 per share.

On 11 October 2017, Hillgrove advised the market of its intention to redeem the convertible notes on 22 December 2017[3].

Two options are available to noteholders in response to the early redemption notice:

- redemption of the Notes at face value of $1.00 plus 20% early redemption premium of the face value totalling $1.20 per Note, together with any interest accrued on those Notes up to (but excluding) the applicable redemption date, or
- conversion of the Notes into ordinary shares at a conversion price of $0.03, or approximately 33.33 shares for each note (based on the 10 October 2017 closing share price of $0.082, each convertible note will convert into 33.33 shares with a prima facie value of $2.73).

In addition to the above, shareholders should consider the effect of the Underwriter converting its notes into shares as disclosed in the Prospectus under section 2.6. Following conversion of the Notes, the Ariadne Group's interest in Hillgrove could increase, meaning it could increase its control of Hillgrove without paying a takeover premium. The exact effect on control depends upon the extent to which the non-associated shareholders participate in the Proposed Share Acquisition.

### Key considerations of the Proposed Share Acquisition

As set out in the Supplementary Prospectus under section 5, section 606 of the Act prohibits the acquisition of a relevant interest in voting shares if, because of that transaction, a shareholder's voting power in the company:

- Increases from under 20% to over 20%; or
- Increases from a starting point that is above 20% and below 90%.

[3] http://www.asx.com.au/asxpdf/20171011/pdf/43n49wl6n4y6kt.pdf

Ariadne Australia Limited (the parent company of the Underwriter) will breach the prohibition rule under s. 611 item 7 of the Act if it elects to convert 100% of its remaining Notes. However, there are a number of exceptions to the prohibition in s. 606 including acquisitions approved by shareholders (s. 611 Item 7) and acquisitions resulting from an issue under a disclosure document if the issue is to a shareholder as underwriter and the disclosure document disclosed the effect that the acquisition would have on the shareholder's voting power in the company (s. 611 item 13).

Following Hillgrove's notice to redeem the Notes, the Underwriter has sought, via a notice announced on 13 October 2017[4], that Hillgrove convene an Extraordinary General Meeting ["EGM"] to seek approval from the non-associated shareholders to exercise its right to convert its Notes into ordinary shares and thereby increase its percentage interest in Hillgrove ordinary shares from 22% to between 26.0% and 31.4% (subject to the extent to which non-associated shareholders exercise their rights to convert).

The Underwriter's parent company, Ariadne, currently has a relevant interest of 22.0% in Hillgrove. This is the maximum it was permitted to hold under the Act on exercise of the Options that expired on 22 September 2017. Prior to that, the Ariadne Group reached 19.0% ownership and utilised the creep provisions to exercise the Options (i.e. acquisitions of up to 3% every 6 months from a starting point above 19%). The remaining options held by Ariadne were sold prior to their expiry.

To allow non-associated shareholders to properly consider how to vote during the EGM, the Board has commissioned VAA's opinion on whether the conversion of Ariadne Capital's notes is fair and reasonable to non-associated shareholders.

Given the material value uplift available from note conversion, it is considered likely that all notes will be converted to shares and no cash outflow will be required to redeem the notes.

A summary of possible outcomes following conversion of the Notes is set out in TABLE 4 below.

---

[4] http://www.asx.com.au/asxpdf/20171013/pdf/43n6j61cbny7yt.pdf

#### TABLE 4 POSSIBLE OUTCOMES OF NOTE CONVERSION BY ARIADNE

| Pre-conversion capital structure (dated 31 October 2017) | Hillgrove Resources | Ariadne owned | Ariadne ownership |
|---|---|---|---|
| Total ordinary shares on issue | 415,845,428 | 91,316,190 | **21.96%** |
| Total convertible notes on issue | 4,643,848 | 1,707,182 | **36.76%** |
| Maximum shares available from conversion | 154,794,931 | 56,906,065 | **0.00%** |
| **Possible conversion outcomes** | | | |
| 100% of notes converted by Ariadne | 56,906,065 | 56,906,065 | 0.00% |
| 0% of notes converted by other holders | - | - | 0.00% |
| **Total ordinary shares on issue** | **472,751,493** | **148,222,255** | **31.35%** |
| 100% of notes converted by Ariadne | 56,906,065 | 56,906,065 | 0.00% |
| 50% of notes converted by other holders | 48,944,433 | - | 0.00% |
| **Total ordinary shares on issue** | **521,695,926** | **148,222,255** | **28.41%** |
| 100% of notes converted by Ariadne | 56,906,065 | 56,906,065 | 0.00% |
| 100% of notes converted by other holders | 97,888,866 | - | 0.00% |
| **Total ordinary shares on issue** | **570,640,359** | **148,222,255** | **25.97%** |

## Scope of the Report

This report has been prepared having regard to Australian Securities and Investments Commission ["ASIC"] Regulatory Guide 111 – *Content of Expert Reports* ["RG 111"] and ASIC Regulatory Guide 112 - *Independence of Experts* ["RG 112'] as well as Clause 8303 of Schedule 8 of the Corporations Regulations.

Clause 8303 of Schedule 8 of the Corporations Regulations (2001) sets out the requirement for an independent expert's report in relation to the Proposed Share Acquisition when a party to that arrangement has a prescribed shareholding in the company subject to the Proposed Share Acquisition.

The Corporations Regulations require that the directors of Hillgrove provide shareholders with an expert report which assesses whether the proposal is, in all respects, in the best interests of the shareholders.

RG 111 sets out the assessment framework that requires the expert to separately determine if the offer is fair and, in the event that it is not, whether it is reasonable.

Under RG 111.18 and RG 111.19 an arrangement similar to the Proposed Share Acquisition producing a similar outcome to a takeover is subject to the same "fair and reasonable" considerations as a takeover.

Under RG 111.11 an offer is 'fair' if the value of the offer price or consideration is equal to or greater than the value of the securities the subject of the offer. This comparison should be made:

a) assuming a knowledgeable and willing, but not anxious, buyer and a knowledgeable and willing, but not anxious, seller acting at arm's length; and,

b) assuming 100% ownership of the 'target' and irrespective of whether the consideration is scrip or cash.

Under RG 111.31 when considering whether an offer is fair, "the comparison should be made between the value of the securities being offered (allowing for a minority discount) and the value of the target entity's securities, assuming 100% of the securities are available for sale. This comparison reflects the fact that:

a) the acquirer is obtaining or increasing control of the target; and,

b) the security holders in the target will be receiving scrip constituting minority interests in the combined entity.

In other words, if there is a takeover of control then the value of Hillgrove to shareholders before the Proposed Share Acquisition should be considered assuming 100% control, and the value of the merged entity after the Proposed Share Acquisition should be considered assuming that shareholders hold a minority stake in the merged entity. This is required, notwithstanding that current ordinary shareholders of Hillgrove actually own minority stakes in Hillgrove.

Under RG 111.12 an offer is 'reasonable' if it is fair. It might also be 'reasonable' if, despite being 'not fair', the expert believes that there are sufficient reasons for security holders to accept the offer in the absence of any higher bid before the close of the offer.

## Basis of Assessment

In determining whether the Proposed Share Acquisition is in the best interests of Shareholders, we have:

- determined whether the value to Hillgrove shareholders is fair. In other words, we have considered whether the value to Hillgrove shareholders post the Proposed Share Acquisition is likely to be equal to or greater than the value of Hillgrove shareholders before the Proposed Share Acquisition;
- considered the position of Hillgrove shareholders should the Proposed Share Acquisition not proceed;
- considered whether there is a better alternative to Hillgrove shareholders than the Proposed Share Acquisition; and,
- considered other factors which we consider to be relevant to the Hillgrove shareholders in their assessment of the Proposed Share Acquisition.

## Shareholder's Decision

This report constitutes general financial product advice only and has been prepared without taking into consideration the individual circumstances of Shareholders. The decision to approve the Proposed Share Acquisition is a matter for individual shareholders.

Shareholders should consider the advice in the context of their own circumstances, preferences and risk profiles. Shareholders should also have regard to the Explanatory Notes in relation to the Proposed Share Acquisition.

Shareholders who are in doubt as to the action they should take in relation to the Proposed Share Acquisition should consult their own professional adviser.

## Limitations and Reliance on Information

Our opinion is based on the economic, market and other conditions prevailing at the date of this report. Such conditions can change significantly over relatively short periods of time.

Our report is also based upon financial and other information provided by or on behalf of Hillgrove. We have considered and relied upon this information and believe that the information provided is reliable, complete and not misleading and we have no reason to believe that material facts have been withheld. The information provided was evaluated through analysis, enquiry and review for the purpose of forming an opinion as to whether the Proposed Share Acquisition is in the best interests of the Hillgrove shareholders. However, in assignments such as this, time is limited and we do not warrant that our enquiries have identified or verified all of the matters which an audit, extensive examination or "due diligence" investigation might disclose. None of these additional tasks have been undertaken.

An important part of the information base used in forming an opinion of the kind expressed in this report is the opinions and judgement of management of the relevant companies. This type of information has also been evaluated through analysis, enquiry and review to the extent practical. However, it must be recognised that such information is not always capable of external verification or validation.

All dollar amounts are shown in Australian dollars ["AUD"] unless otherwise stated.

## Profile of Hillgrove Resources Limited

### History and Overview

Hillgrove Resources Limited ["Hillgrove" or "the Company"] is an Australian mining company with a mix of producing and growth projects. It is listed on the ASX.

The Company's principal activity is operation of the Kanmantoo Copper Mine and associated regional exploration targets, located less than 55km from Adelaide in South Australia.

Hillgrove has approximately 245 site-based employees and contractors at Kanmantoo and at head office.

The Company's goal is to become a mid-tier copper and gold resource group. Business growth is expected to be driven by underground extensions of the Kanmantoo Copper Mine operation, its wholly owned Kanappa and Mt Rhine exploration projects and a potential pumped hydro project.

### Kanmantoo Copper Mine

The Kanmantoo Copper Mine is located less than 55 kilometres from Adelaide in South Australia.

Following construction of the plant in late 2011, capital enhancements and continuous improvements have increased plant throughput capacity from a nominal 2.4Mtpa to between 3.0Mtpa and 3.5Mtpa capable of producing up to 100,000 dry metric tonnes of copper concentrate per annum, containing approximately 20,000 tonnes of copper and associated gold and silver per annum over the current life of mine. The Kanmantoo Mine is expected to stay operational for the next three years.

Key characteristics of the project are summarised in TABLE 5 below.

**TABLE 5 KANMANTOO COPPER MINE OVERVIEW**

| Characteristic | Description |
|---|---|
| Mine location | 55 km southeast of Adelaide, South Australia |
| Mining leases | ML6345 and ML6436 |
| Mining area size | 437.1 hectares |
| Mining method | Open pit |
| Commodity mined | Copper, gold and silver (base metals) |
| Remaining mine life | 3 years (up to June 2020) |

*Source: Hillgrove Resources Limited - 2016 annual reports; Program for Environment Protection and Rehabilitation (ML6345 and ML6436)*

Hillgrove's most recent Mineral Resource Estimate is presented in TABLE 6.

**TABLE 6 GLOBAL MINERAL RESOURCE ESTIMATE AT 30 SEPTEMBER 2016**

| JORC 2012 Classification | Tonnage (million tonnes) | Cu (%) | Au (g/t) | Ag (g/t) | Cu Metal (kt) |
|---|---|---|---|---|---|
| Measured | 10.3 | 0.6 | 0.1 | 1.2 | 66 |
| Indicated | 10.8 | 0.6 | 0.1 | 1.4 | 70 |
| Inferred | 13.4 | 0.6 | 0.1 | 1.0 | 75 |
| **Total** | **34.5** | **0.6** | **0.1** | **1.2** | **211** |

*Source: Hillgrove Resources Limited - half year report ended 30 June 2017*

## Major customers

The Kanmantoo Copper Mine has an off take agreement for the life of the mine with Freepoint Metals & Concentrates LLC (formerly known as JP Morgan Metals & Concentrates LLC) for 100% of the copper concentrate produced.

## Financial Information

The historical financial information indicates that Hillgrove has been primarily funded by equity injections since listing on the ASX in 2004. Its major asset is the Kanmantoo copper mine.

For the first half of the 2017 financial year, Hillgrove's two biggest cash expenses are operating costs which include exploration and employee costs. Hillgrove has also incurred non-cash expenses of $5.7 million during the first half of FY17 relating to fair value movements of the Notes.

Profitability of the Kanmantoo mine has been constrained by a fall in the copper commodity price and lower copper grades as the cutback was mined (see for further detail Industry Analysis) which has resulted in operating losses of $(12.7) million and ($20.5) million in FY15 and FY16 respectively. With the cutback now complete the copper grades mined at Kanmantoo, and the associated revenue, are forecast to increase markedly.

### Historical Financial Performance

The table below summarises Hillgrove's audited financial performance for FY15 and FY16 and reviewed financial performance for the six month period to 30 June 2017.

## TABLE 7 CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

| Financial year ending (AUD) | FY15 31-Dec-15 $'000 Audited | FY16 31-Dec-16 $'000 Audited | 1HY17 30-Jun-17 $'000 Reviewed |
|---|---|---|---|
| Revenue | 139,501 | 113,127 | 62,050 |
| Cost of goods sold | (152,202) | (133,665) | (57,231) |
| **Gross profit** | **(12,701)** | **(20,538)** | **4,819** |
| Expenses | (8,813) | (3,949) | (4,966) |
| Other income | 160 | 565 | 99 |
| Impairment charges | (112,915) | (67,117) | - |
| Fair value movement in convertible notes | - | - | (5,683) |
| Interest and finance charges | (3,856) | (4,209) | (2,193) |
| **Profit / (Loss) before income tax** | **(138,125)** | **(95,248)** | **(7,924)** |
| Income tax (expense) / benefit | 7,999 | (13,886) | (1,630) |
| **Profit / (Loss) for the year** | **(130,126)** | **(109,134)** | **(9,554)** |
| Other comprehensive income for the period (net of income tax) | 13,815 | (7,385) | (3,802) |
| **Total comprehensive income for the period** | **(116,311)** | **(116,519)** | **(13,356)** |

The following key points should be noted in respect of the financial performance set out below:

- Revenues have declined by 18.9% from $139.5 million to 113.1 million in FY15 from FY16 respectively as a result of a decline in the copper commodity price and lower copper grades as the cutback was mined. With the cutback now complete the copper grades mined at Kanmantoo, and the associated revenue, are forecast to increase markedly.
- In response to declining revenues, the Company initiated a number of cost reduction and cost deferral initiatives which reduced the cost of goods sold by 14.2% from $152.2 million to 133.6 million in FY16 from FY15 respectively.
- The results for the first half of FY17 show a recovery in gross profit for Hillgrove which has been aided by a recovering commodity price and containment of the cost of goods sold. *"the Australian dollar copper price has significantly improved in the past year, by more than thirty percent" Hillgrove Resources, results for the half year ended 30 June 2017"*.
- Hillgrove incurred non-cash impairment charges of $112.9 million and $67.1 million in FY15 and FY16 respectively, relating to the write down of PP&E at the Kanmantoo mine.
- Hillgrove has reported non-cash expenses of $5.6 million in the first half of FY17 relating to movements in the fair value of the convertible note facility.

## Financial Position

The table below summarises Hillgrove's audited statement of financial position for FY15 and FY16 and reviewed financial performance for the six month period to 30 June 2017.

## TABLE 8 HILLGROVE – AUDITED STATEMENT OF FINANCIAL POSITION

| Financial year<br>as at<br>(AUD) | FY15<br>31-Dec-15<br>$'000<br>Audited | FY16<br>31-Dec-16<br>$'000<br>Audited | 1HY17<br>30-Jun-17<br>$'000<br>Reviewed |
|---|---|---|---|
| Cash and cash equivalents | 6,100 | 1,942 | 377 |
| Trade and other receivables | 3,434 | 3,994 | 4,332 |
| Other financial assets | - | 324 | - |
| Inventories | 6,904 | 4,991 | 6,351 |
| Derivative financial instruments | 10,212 | - | - |
| **Current assets** | **26,650** | **11,251** | **11,060** |
| Property, plant and equipment | 145,632 | 67,105 | 70,312 |
| Exploration and evaluation expenditure | 792 | 802 | 883 |
| Deferred tax assets | 15,577 | 4,856 | 4,856 |
| Derivative financial instruments | 9,382 | - | - |
| **Non-current assets** | **171,383** | **72,763** | **76,051** |
| **Total assets** | **198,033** | **84,014** | **87,111** |
| Trade and other payables | 34,247 | 36,425 | 43,434 |
| Provisions | 2,504 | 3,027 | 3,446 |
| Borrowings | 3,826 | 3,158 | 6,542 |
| Employee benefits payable | 2,360 | 2,768 | 3,855 |
| Deferred income | - | 229 | 277 |
| **Current liabilities** | **42,937** | **45,607** | **57,554** |
| Provisions | 6,660 | 8,574 | 8,981 |
| Borrowings | 15,116 | 10,193 | 12,990 |
| Employee benefits payable | 126 | 927 | 947 |
| Deferred income | - | 468 | 326 |
| **Non-current liabilities** | **21,902** | **20,162** | **23,244** |
| **Total liabilities** | **64,839** | **65,769** | **80,798** |
| **Net assets** | **133,194** | **18,245** | **6,313** |
| Contributed equity | 216,272 | 217,538 | 218,814 |
| Reserves | 16,122 | 10,280 | 6,625 |
| Retained earnings | (99,200) | (209,572) | (219,126) |
| **Total equity** | **133,194** | **18,245** | **6,313** |

The following key points should be noted in respect of the financial position of Hillgrove set out below:

- Non-current assets decreased by $78.5 million from FY15 to FY16 as a result of impairment charges against plant, property and equipment relating to mine investments in FY15.
- Non-current borrowings in FY16 include the $5 million convertible note issue.

## Cash flows

The table below summarises Hillgrove's audited statement of cash flows for FY15 and FY16 and reviewed financial performance for the six month period to 30 June 2017.

**TABLE 9 HILLGROVE – AUDITED STATEMENT OF CASH FLOWS**

| Financial year ending (AUD) | FY15 31-Dec-15 $'000 Audited | FY16 31-Dec-16 $'000 Audited | 1HY17 30-Jun-17 $'000 Reviewed |
|---|---|---|---|
| Cash receipts in the course of operations | 119,379 | 97,302 | 48,573 |
| Cash payments in the course of operations | (106,720) | (76,270) | (45,055) |
| **Net cash generated by operating activities** | **12,659** | **21,032** | **3,518** |
| | | | |
| Payments for exploration and evaluation expe | (1,042) | (383) | (179) |
| Payments for property, plant and equipment | (21,589) | (28,319) | (4,856) |
| Proceeds on sale of available for sale financial | 235 | - | - |
| Proceeds on disposal of plant and equipment | 454 | 611 | - |
| **Net cash from / (used in) investing activities** | **(21,942)** | **(28,091)** | **(5,035)** |
| | | | |
| Proceeds from early termination of derivatives | - | 14,434 | - |
| Proceeds from issue of shares | 10,078 | - | - |
| Proceeds from borrowings | 18,051 | 8,930 | 300 |
| Proceeds from options exercised | - | - | 414 |
| Transaction costs for issue of shares | (830) | - | - |
| Transaction costs of borrowings | (896) | (526) | (214) |
| Repayment of borrowings | (18,000) | (18,354) | (300) |
| Interest received from investments | 144 | 80 | - |
| Interest paid on borrowings | (2,018) | (1,663) | (248) |
| **Net cash from / (used in) financing activities** | **6,529** | **2,901** | **(48)** |
| | | | |
| Cash and cash equivalents at beginning of financial year (or half year where applicable) | 8,854 | 6,100 | 1,942 |
| Net increase / (decrease) in cash held | (2,754) | (4,158) | (1,565) |
| **Cash and cash equivalents at end of financial year (or half year)** | **6,100** | **1,942** | **377** |

## Capital Structure

The total number of ordinary shares on issue as at the date of the Prospectus issued on 22 November 2016, was 188,109,342. TABLE 10 shows a summary of the capital structure at the Prospectus date.

## TABLE 10 HILLGROVE – SUMMARY OF CAPITAL STRUCTURE

| Hillgrove Resources Limited | Shares | Performance rights | Notes | Options |
|---|---|---|---|---|
| Exisiting securities as at the date of prospectus | 188,109,342 | 9,410,500 | - | - |
| New securities issued under entitlement offer | - | - | 5,000,248 | 188,109,342 |
| Shares on conversion of notes | 166,674,933 | - | - | - |
| Shares on exercise of options | 188,109,342 | - | - | - |
| **Total securities on issue following completion of the entitlement offer, conversion of the notes and exercise of the options** | **542,893,617** | **9,410,500** | **5,000,248** | **188,109,342** |

### Options

On 22 November 2016 the Company issued the Prospectus for a fully underwritten non-renounceable entitlement offer ["Entitlement Offer"] to eligible shareholders of 5,000,248 the Notes to be issued at a price of $1.00 per Note, on the basis of every 37.62 Shares held on the Record Date (together with 37.62 free attaching options ["the Options"] for every one Note subscribed for and issued) to raise approximately $5 million.

> *"Exercise of Options - As at 30 June 2017, 13.8m of the Company's 188.1m listed options (exercisable at $0.03) had been exercised. The options had an expiry date of 22 September 2017, and prior to that date, 174.0m of the remaining options were exercised raising $5.2m. Cash on hand at 30 September 2017 was $3.9m, with the remainder of the option proceeds being used for working capital purposes."*[5]

As at 30 September 2017 there were Nil Options in issue as these were either exercised or expired by their expiry date i.e. 22 September 2017.

### Major Shareholders

As at 3 November 2017, the Ariadne Group held 91,316,190 shares, or circa 22% of total Hillgrove shares and was the largest shareholder of Hillgrove. The Ariadne Group owns approximately 14.7% of its shares through Portfolio Services Pty Limited.

The top 20 shareholders held 61.73% of the total shares as at 31 October 2017.

[5] Hillgrove Resources Quarterly Report Period ending 30 September 2017

### TABLE 11 HILLGROVE TOP 20 SHAREHOLDERS

| Top 20 Holdings as at 31-10-2017 | | |
|---|---|---|
| **Name** | **No of shares** | **%age** |
| J P MORGAN NOMINEES AUSTRALIA LIMITED | 34,193,554 | 8.235% |
| ARIADNE CAPITAL PTY LTD | 30,149,141 | 7.261% |
| BNP PARIBAS NOMS PTY LTD <DRP> | 23,766,506 | 5.723% |
| BELL POTTER NOMINEES LTD <BB NOMINEES A/C> | 23,071,761 | 5.556% |
| PORTFOLIO SERVICES PTY LTD | 22,374,730 | 5.388% |
| MR RAYMOND EDWARD MUNRO & MRS SUSAN ROBERTA MUNRO <MUNRO FAMILY SUPER FUND A/C> | 18,000,000 | 4.335% |
| PORTFOLIO SERVICES PTY LTD | 12,202,761 | 2.939% |
| PORTFOLIO SERVICES PTY LTD | 11,343,555 | 2.732% |
| WEYITIN TRADING PTY LTD <WEYITIN SUPER FUND A/C> | 10,127,346 | 2.439% |
| MR ANTONY GORDON BREUER <ANTJO FAMILY A/C> | 10,005,559 | 2.410% |
| EMECO PTY LTD | 9,405,467 | 2.265% |
| PORTFOLIO SERVICES PTY LTD | 8,828,971 | 2.126% |
| COSELL PTY LIMITED | 8,100,672 | 1.951% |
| MR MALCOLM NEIL NICHOLS & MR ANDREW WILLIAM CONSTANTINE <CORVUS INVESTMENT A/C> | 6,719,616 | 1.618% |
| HELEN MA PTY LTD <STEVEMA SUPER FUND A/C> | 6,097,122 | 1.468% |
| HSBC CUSTODY NOMINEES (AUSTRALIA) LIMITED | 4,925,582 | 1.186% |
| W DONNELLY SERVICES PTY LTD <THE DONNELLY SUPER FUND A/C> | 4,904,034 | 1.181% |
| ROSSDALE SUPERANNUATION PTY LTD <ROSSDALE SUPER FUND A/C> | 4,514,400 | 1.087% |
| SIGHET PTY LIMITED <THE SIGHET SUPER FUND A/C> | 3,815,775 | 0.919% |
| MR LACHLAN WALLACE | 3,785,864 | 0.912% |
| **Total Securities of Top 20 Holdings** | **256,332,416** | **61.730%** |
| **Total of Securities** | **415,245,429** | |

*Source: Hillgrove management*

As at the date of this report, Hillgrove directors are as listed below (including the shares and performance rights owned):

### TABLE 12 HILLGROVE – DIRECTORS INTERESTS

| Name | Position | Shares | Notes | Performance rights |
|---|---|---|---|---|
| Mr John Gooding | Chairman | 61,111 | 1,000 | Nil |
| Mr Steven McClare | Chief Executive Office & Managing Director | 5,046,373 | 55,000 | 2,800,000 |
| Mr Philip Baker | Non-Executive Director | 400,960 | 8,000 | Nil |
| Mr Maurice Loomes | Non-Executive Director | 10,127,346 | Nil | Nil |
| Mr Antony Breuer | Non-Executive Director | 14,942,334 | 156,734 | Nil |

*Source: Hillgrove management*

Mr John Gooding accepted the role of Chairman on 31 May 2017 succeeding the Hon. Dean Brown.

Mr Antony Breuer joined the Board on 1 June 2017 as a non-executive director, replacing the Hon. Dean Brown who retired on 31 May 2017.

## Dividends

For financial year ending 31 January 2010, Hillgrove declared two separate cash dividends of $0.01 per ordinary share, fully franked based on tax paid at 30%. The amount of each of the dividends was $4.14m paid on 6 October 2009 and $4.14m paid on 30 November 2009, totalling $8.28m.

## Share Price Performance

FIGURE 2 below sets out Hillgrove's share price history on the ASX for six months ending on 31 October 2017. We make the following observations in relation to Hillgrove's share price over that period:

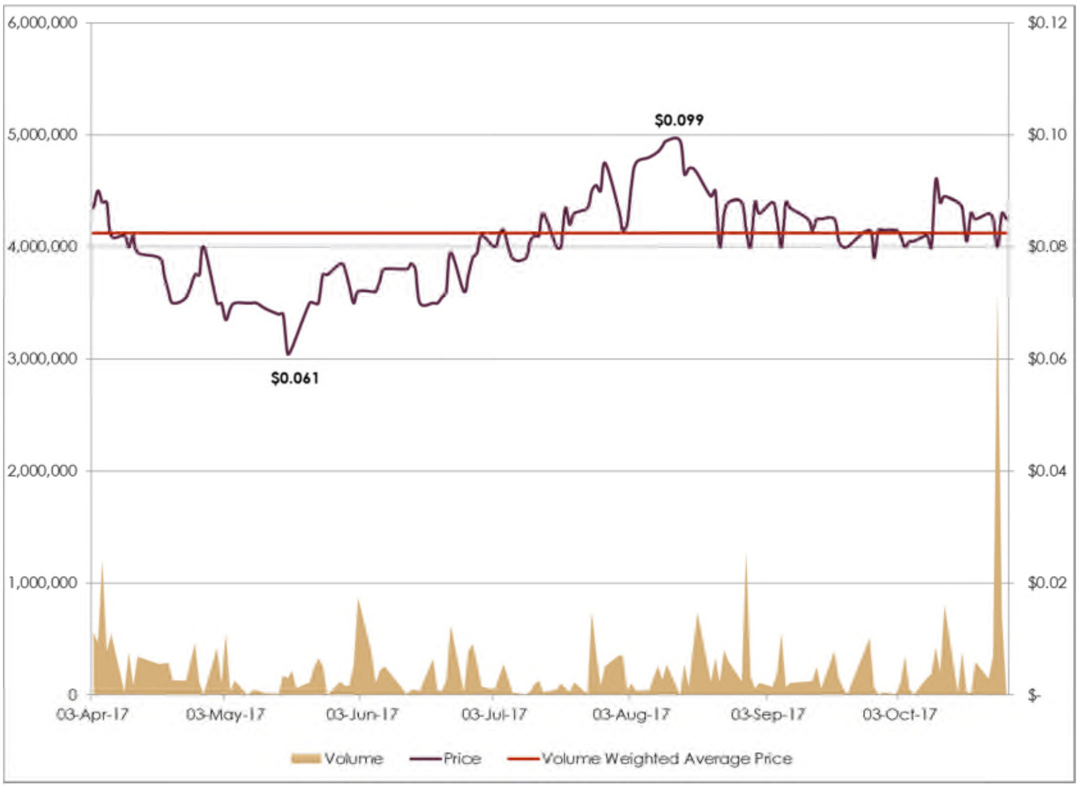
- the last price on 31 October 2017 was $0.084;
- the minimum price occurred on 17 May 2017 and was $0.061;
- the maximum price occurred on 11 August 2017 and was $0.099; and,
- the volume weighted average price for the last 6 months ending on 31 October 2017 was $0.082 (marked by the red line).

### TABLE 13 HILLGROVE – HISTORICAL SHAREPRICE AND TRADING VOLUME

| HGO volume analysis | | Price | | Volume | | | |
|---|---|---|---|---|---|---|---|
| | Period start date | Average price | VWAP | Total volume | % of free float | Average volume | % of free float |
| **Total HGO shares outstanding** | | | | **415,245,428** | | | |
| 1 week to 31-Oct | 25-Oct-17 | 0.08380 | 0.08444 | 4,704,298 | 1.13% | 940,860 | 0.23% |
| 1 month to 31-Oct | 02-Oct-17 | 0.08432 | 0.08431 | 8,227,055 | 1.98% | 373,957 | 0.09% |
| 6 months to 31-Oct | 02-May-17 | 0.08117 | 0.08088 | 27,029,778 | 6.51% | 219,754 | 0.05% |
| 12 months to 31-Oct | 01-Nov-16 | 0.07355 | 0.07341 | 77,819,957 | 18.74% | 321,570 | 0.08% |

*Source: Bloomberg*

### FIGURE 2 HILLGROVE – HISTORICAL SHARE PRICE AND VOLUME




*Source: Bloomberg*

The obligations upon the company to ensure the market remains fully informed have, to the best of our knowledge, been complied with.

# Profile of Ariadne Australia Limited

## Overview

Ariadne Australia Limited ["Ariadne"] is an investment company listed on the ASX under ticker ASX:ARA, with operations in Australia and New Zealand.

### Financial Information

The follow section summarises Ariadne's financial information for FY15 to FY17.

### Historical Financial Performance

The table below summarises Ariadne's audited financial performance for FY15 to FY17.

**TABLE 14 ARIADNE – CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME**

| Financial year ending (AUD) | FY15 30-Jun-15 $'000 Audited | FY16 30-Jun-16 $'000 Audited | FY17 30-Jun-17 $'000 Audited |
|---|---|---|---|
| Rental and letting income | 11,674 | 12,027 | 11,566 |
| Sale of goods and others | 1,196 | 6,632 | 11,310 |
| Share of joint ventures' and associates' profits | 2,185 | 4,114 | 2,751 |
| **Total revenue** | **15,055** | **22,773** | **25,627** |
| | | | |
| Rental and letting expenses | (11,089) | (10,935) | (10,503) |
| Cost of goods sold | (364) | (3,287) | - |
| Other expenses | (5,874) | (3,826) | (4,512) |
| Depreciation and amortisation | (308) | (40) | (163) |
| Finance costs | (305) | (210) | (286) |
| **Profit / (Loss) before income tax** | **(2,885)** | **4,475** | **10,163** |
| Income tax benefit / (expense) | 404 | (623) | 2,066 |
| **Profit / (Loss) for the year** | **(2,481)** | **3,852** | **12,229** |
| Other income | 2,643 | (992) | 12,330 |
| Profit from discontinued operations | - | 8,705 | 68,322 |
| **Total comprehensive income for the period** | **162** | **11,565** | **92,881** |

The following key points should be noted with respect to the historical financial performance of Ariadne:

- The company has historically generated its revenues primarily from the rental and letting income. The rental and letting income has been stable from FY15 to FY17.
- The company revalued its trading and strategic portfolios which resulted in the company recording a significant unrealised gain in FY17 on the portfolio.
- The EBITDA margins increased significantly from a negative 15% to 41% from FY15 to FY17 respectively.
- The company has also reported the results of discontinued operations from its continuing operations. The discontinued operations refer to sale of 50% interest in Secure Parking.

### Financial Position

The table below summarises Ariadne's audited financial position for FY15 to FY17.

### TABLE 15 ARIADNE – AUDITED STATEMENT OF FINANCIAL POSITION

| Financial year<br>as at<br>(AUD) | FY15<br>30-Jun-15<br>$'000<br>Audited | FY16<br>30-Jun-16<br>$'000<br>Audited | FY17<br>30-Jun-17<br>$'000<br>Audited |
|---|---|---|---|
| Cash and cash equivalents | 12,513 | 15,393 | 49,346 |
| Trade and other receivables | 1,455 | 845 | 843 |
| Inventories | 3,059 | - | - |
| Other current assets | 2,419 | 2,010 | 7,334 |
| **Current assets** | **19,446** | **18,248** | **57,523** |
| | | | |
| Receivables | 12,205 | 13,699 | 13,416 |
| Other financial assets | 29,090 | 30,258 | 86,333 |
| Investments in joint ventures and associates | 22,938 | 28,781 | 28,327 |
| Property, plant and equipment | 185 | 38 | 1,056 |
| Deferred tax assets | 6,305 | 6,305 | 3,000 |
| **Non-current assets** | **70,723** | **79,081** | **132,132** |
| | | | |
| **Total assets** | **90,169** | **97,329** | **189,655** |
| | | | |
| Trade and other payables | 607 | 272 | 1,473 |
| Interest-bearing loans and borrowings | 2,343 | 3,160 | 6,643 |
| Provisions | 218 | 289 | 331 |
| **Current liabilities** | **3,168** | **3,721** | **8,447** |
| | | | |
| Interest-bearing loans and borrowings | 1,527 | 834 | 1,095 |
| Provisions | 203 | 253 | 145 |
| **Non-current liabilities** | **1,730** | **1,087** | **1,240** |
| | | | |
| **Total liabilities** | **4,898** | **4,808** | **9,687** |
| | | | |
| **Net assets** | **85,271** | **92,521** | **179,968** |
| | | | |
| Issued capital | 382,614 | 381,631 | 381,697 |
| Reserves | 32,178 | 35,325 | 161,656 |
| Retained earnings | (335,096) | (330,314) | (369,129) |
| **Equity attributable to members of Ariadne** | **79,696** | **86,642** | **174,224** |
| Non-controlling interests | 5,575 | 5,879 | 5,744 |
| **Total equity** | **85,271** | **92,521** | **179,968** |

VAA observed the following key points from the historical Financial Position of Ariadne:

- Current assets of the company increased from $19.4 million in FY15 to $57.5 million in FY17.
- The cash and cash equivalents are reported in the amount of $49.3 million as at 30 June 2017 as a result of disposal of 50% interest in Secure Parking.
- Non-current assets increased materially from $79.0 million in FY16 to $132.1 million in FY17. This significant change is attributable to the revaluation of the trading and strategic portfolios.

## Cash flows

The table below summarises Ariadne's audited financial statement of cash flows for FY15 to FY17.

### TABLE 16 ARIADNE – AUDITED STATEMENT OF CASH FLOWS

| Financial year ending (AUD) | FY15 30-Jun-15 $'000 Audited | FY16 30-Jun-16 $'000 Audited | FY17 30-Jun-17 $'000 Audited |
|---|---|---|---|
| Cash flows from operating activities | 265 | 10,765 | 9,522 |
| Cash flows from investment activities | (1,797) | (3,500) | 26,152 |
| Cash flows from financing activities | (2,257) | (4,385) | (1,721) |
| **Net increase (decrease) in cash and cash equiva** | **(3,789)** | **2,880** | **33,953** |
| Cash and cash equivalents at beginning of period | 16,302 | 12,513 | 15,393 |
| **Cash and cash equivalents at end of financial year (or half year)** | **12,513** | **15,393** | **49,346** |

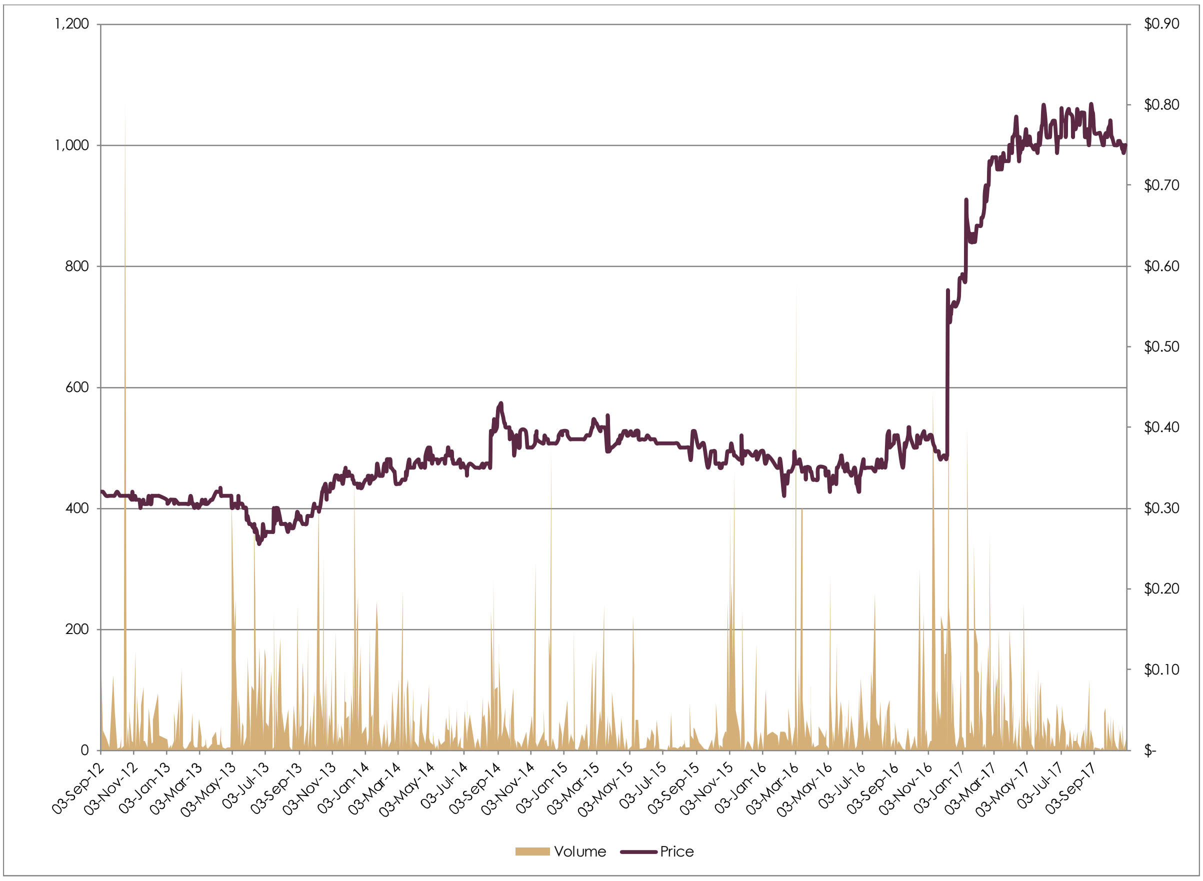
The following key points are observed from the review of the cash flows of Ariadne:

- Whilst the company has significant improved its operating cash flows generation from FY15 to FY17, the operating cash flows remained low in FY17 compared to FY16 in relations to the total revenue in the respective years.
- The company disposed its 50% interest in Secure Parking which resulted in the company generating significant positive cash flows from investing activities.

## Share Price Performance

The following figure sets out Ariadne share price and trading volume history on the ASX over the last five years from 1 September 2012 to 31 October 2017.

## TABLE 17 ARIADNE – HISTORICAL SHARE PRICE AND VOLUME




*Source: Bloomberg*

# Industry Analysis

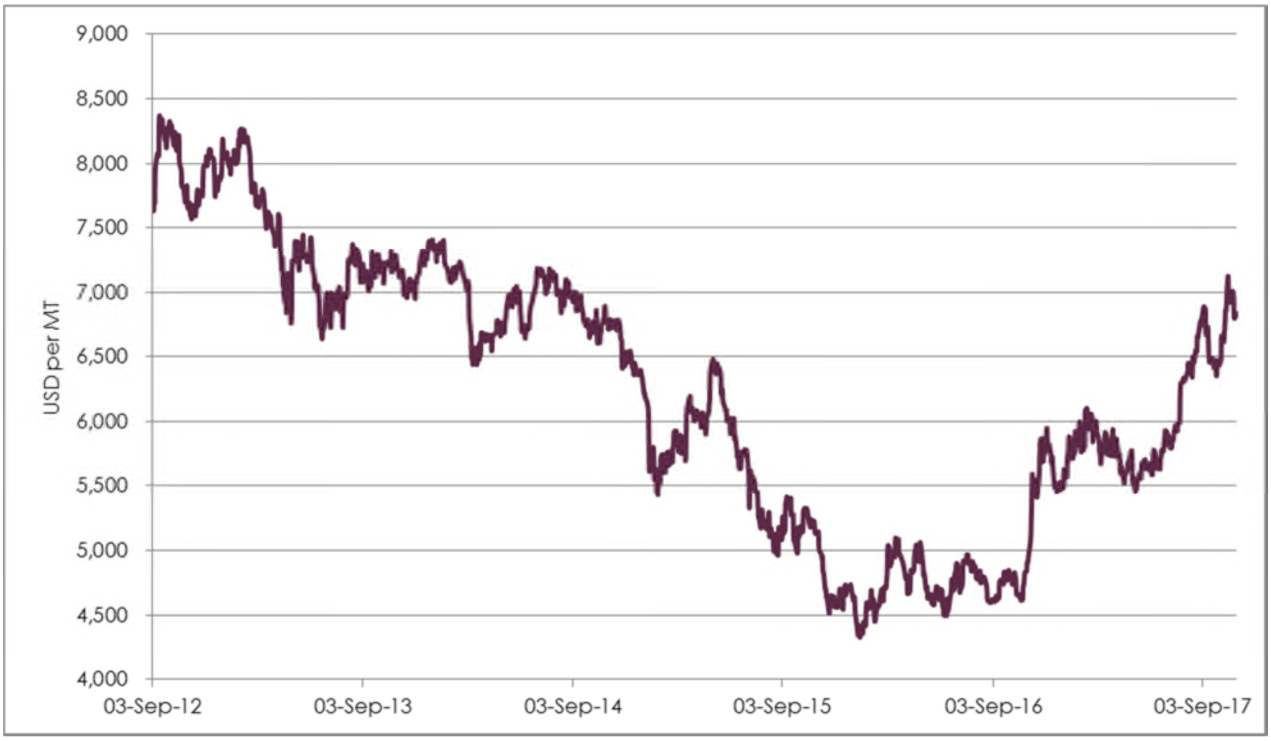
## Industry overview

Copper is one of the world's most versatile and useful metals. It conducts heat and electricity and is widely used in electronic devices and electrical wiring. Australia is one of the world's major copper mining countries, behind Chile, Peru, the United States and China. Australia's copper ore production is expected to increase in 2017-18 as the industry's major players increase output in response to stabilising prices.

In the current year, industry revenue is projected to increase by 5.3% to reach $6.0 billion. Exports are estimated to account for 86.8% of industry revenue for the year, with China, Japan, and India dominating foreign sales. Declines in the Australian dollar over the past five years are expected to increase industry profit, despite lower world copper prices over the period. Global copper production has increased over the past five years as new mining capacity came online.

Industry revenue is expected to decrease at an annualised 1.9% over the five years through 2017-18. This is due to lower global copper prices and weaker demand growth from large emerging economies, such as China and India, that import copper for construction, communications and manufacturing. Although developed countries, such as Japan where copper is used in high-end manufacturing, have supported demand growth, lower world copper prices have offset the revenue from higher production volumes. An overall decrease in prices and copper ore grade contributed to major industry revenue falls in 2012-13 and 2013-14. Industry revenue is forecast to grow at an annualised 3.0% over the next five years, to $6.9 billion in 2022-23. This reflects a forecast increase in output, global demand, and global copper prices as well as a projected decline in the Australia dollar. The importance of copper ore exports to the industry's performance is forecast to increase at a steady rate over the next five years, as foreign demand and copper prices increase.

**FIGURE 3 SPOT COPPER PRICE (USD/MT) – 5 YEARS TO 31 OCTOBER 2017**




*Source: Bloomberg*

Over the five years through 2017-18, industry output is projected to increase at an annualised 0.4%, to 988.7 kilotonnes. Despite this, revenue is expected to fall over the period largely due to lower world copper prices. Industry output fell in 2016-17 due to a power outage and unplanned maintenance at BHP Billiton's Olympic Dam site. Industry volumes are expected to return to growth in 2017-18 on the back of higher domestic prices.

Copper ore output fell in 2014-15 for several reasons. Most notable was the closure of Aditya Birla Minerals Limited's Nifty mine in Western Australia, from April 2014 to August 2014, due to a sinkhole. An electrical fault at BHP Billiton's Olympic Dam mine in South Australia at the beginning of 2014 also lowered output volumes. As the Olympic Dam mine was bought back online in late 2014-15, and OZ Minerals significantly increased their output in 2015, industry volumes increased in 2015-16.

Over the next five years, stronger economic growth in OECD countries is expected to increase global demand for copper. Demand for copper in Japan is projected to grow as construction and manufacturing activity increases. Rising manufacturing production in Germany and forecast growth in the United States will also drive demand over the period. Outside the OECD, India and China are forecast to import substantially more copper over the next five years. The Chinese government has announced plans to reinforce and expand the country's electricity supply, which will increase demand for copper over the period.

Although global copper output is forecast to increase over the next five years, it is projected to only just keep pace with rising demand. As a result, the world price of copper is expected to increase over the five years through 2022-23. Further, the value of the Australian dollar is expected to depreciate over the next five years, increasing copper sales volumes into global markets, and contributing to export growth.

The world price of copper (in US Dollars) determines the revenue industry miners generate from selling their ore in world markets. Although demand from China has been strong in the past five years, greater product substitution and increased supply has put downward pressure on copper prices. The world price of copper is expected to increase in 2017-18, providing the industry with an opportunity to expand. The US Dollar to Australian Dollar exchange rate plays a key role in determining returns for Australia copper miners as generally copper contracts are settled in US Dollars. Lower global copper prices have largely been offset by a weaker Australian dollar over the past 5 years as contracts are paid in US dollars against a depreciated Australian dollar earning the domestic players more revenue.

# Approach

## Valuation Methodology

### Overview

In determining whether the Proposed Share Acquisition is in the best interests of Shareholders we have:

- determined whether the value to Hillgrove shareholders is fair. In other words, we have considered whether the value to Hillgrove shareholders post the Proposed Share Acquisition is likely to be equal to or greater than the value to Hillgrove shareholders before the Proposed Share Acquisition;
- considered the position of Hillgrove shareholders should the Proposed Share Acquisition not proceed;
- considered whether there is a better alternative to Hillgrove shareholders than the Proposed Share Acquisition; and
- considered other factors which we consider to be relevant to the Hillgrove shareholders in their assessment of the Proposed Share Acquisition.

Our method for determining whether the Proposed Share Acquisition is fair is as follows:

- Determine the value to Hillgrove shareholders prior to the Proposed Share Acquisition;
- Determine the value to Hillgrove shareholders post the Proposed Share Acquisition; and,
- If the value to Hillgrove shareholders post-transaction is greater than the value pre-merger, the offer is fair.

We have used two approaches for assessing the values to Hillgrove shareholders before and after the Proposed Share Acquisition. These are:

- Determine the sum-of-the-parts value of the current operating asset (Kanmantoo) (Income Valuation Approach and Asset Valuation Approach); and,
- Determine the market capitalisation of the entity (Market Capitalisation Valuation Approach).

We have used the sum-of-the-parts value of the current operating asset as our primary valuation methodology to determine the value of the cash flows relating to the assets owned by Hillgrove.

We have used the market capitalisation approach as the crosscheck to our primary valuation methodology because it provides direct transaction-based evidence of fair market value, if the market is sufficiently liquid. In using the approach we have taken into consideration the depth of the market for the securities; the volatility of the market price; and whether or not the market value is likely to represent the value if the transaction is successful.

Set out in Appendix 4 is a summary description of the valuation methodologies we have considered.

## Sum of the parts valuation

In order to undertake the sum of the parts assessment, VAA has considered the value of the material assets and liabilities of Hillgrove, in particular:

- The present value of likely expected cash flows from operation of the Kanmantoo mine;
- The potential value arising from underground operation of the Kanmantoo mine on exhaustion of the current open pit operation;
- The potential value from tax losses which may shield the operating profits arising from operation of the Kanmantoo mine;
- The prospective value of a number of exploration areas currently under assessment by Hillgrove, particularly:
  - A number of Indonesian tenements subject to an Option to Acquire agreement;
  - The Mt Rhine prospect;
  - The Kanappa prospect;
  - The Wheal Ellen prospect; and
- The potential value of a pumped hydro electricity generation project which is being investigated at the Kanmantoo mine site;
- Cash and other working capital items; and
- Financial liabilities arising on the Hillgrove balance sheet

The assessment of value of each of the above items is discussed below.

### Kanmantoo mine

The Kanmantoo mine is expected to operate (in its current open-pit form) for approximately 3 years (until exhaustion of current reserves and resources within the current pit design).

A detailed cash flow projection is maintained by Hillgrove as part of its daily operational management.

VAA has reviewed the construction and assumptions of the cash flow projection. A number of assumptions are made which materially impact the outcome of a discounted cash flow analysis, including:

- The amount of remaining reserves and resources within the current pit design;
- Copper feed grade (a function of the likely content of mined and run-of mine ore);
- Copper recovery grade (reflecting the efficiency of the processing plant);
- Copper price (spot and contracted);
- Operating costs; and
- Salvage value of physical assets employed at Kanmantoo.

VAA has performed a range of sensitivity analyses on the Hillgrove cash flow model and has determined that, on balance, the company-prepared projections are likely to be conservative in a number of these key areas. A detailed description of key cash flow assumptions and our analysis is detailed in Appendix 3 – Discounted Cash flow Valuation.

Based on VAA's assessed discount rate, the present value of the expected cash flows from operation of the Kanmantoo mine are $144 million.

### Underground operation of Kanmantoo

The Hillgrove board has considered a proposal to extract copper from known resources situated at a level within the existing ore body which would require underground operation at the Kanmantoo mine.

The analysis undertaken by management is at a preliminary stage and whilst potentially economic, is not at a stage which the AusIMM VALMIN code permits an assessment of cash flows.

Consequently, whilst material value may be capable of realisation, VAA's assessment has not included any potential value from this operational option.

### Tax losses

As a consequence of significant losses incurred in recent years, Hillgrove has estimated that income tax losses amounting to approximately $46 million are available to offset future profits.

These losses are likely to be absorbed over the remaining life of the Kanmantoo open pit operations.

VAA has assessed the likely timing and quantum of tax loss utilisation and determined that the tax losses represent value to Hillgrove shareholders of approximately $14 million employing the same discount rate at which the Kanmantoo cash flows have been assessed as part of the Kanmantoo valuation.

### Exploration prospects

Hillgrove maintains a number of exploration prospects near its existing Kanmantoo mine as well as in West Papua and Sumba Island, Indonesia.

Channel sampling undertaken by Hillgrove at Mt Rhine (EL5628) and extensive soil sampling at both Mt Rhine and the Kanappa project present prospective future exploration targets for investigation, returning peak samples of 34.8% Cu and 4.0g/t Au (different samples) at Kanappa, and 13.1% Cu and 49.8g/t Au (different samples) at Mt Rhine. . The table below summarises the results of the channel sampling at Mt Rhine.

**TABLE 18 MT RHINE CHANNEL SAMPLE (EL5628)**

| Channel Sample | Intersection |
|---|---|
| MRCS001 | 32m at 5.05g/t Au |
| MRCS002 | 16m at 5.36g/t Au |
| MRCS003 | 20m at 7.76g/t Au |
| MRCS004 | 10m at 4.34g/t Au |

*Source: Hillgrove FY16 annual report*

Hillgrove retains two significant majority interests in Indonesia known as the Sumba Project and the Bird's Head Project. Both projects are currently on care and maintenance and Hillgrove is responsible for all exploration and development activities until a decision is made to mine the projects.

The economics of Hillgrove's Australian and Indonesian exploration prospects are however uncertain at this stage and the cash flows from the Projects have not been quantified. The share price of Hillgrove appears to have little or no value ascribed to these projects.

Consequently, no value has been ascribed to the Hillgrove's exploration prospects.

### Pumped hydro electricity generation project

Hillgrove have commissioned a study prepared by Norconsult AS ["Norconsult"] to assess the feasibility of a pumped hydro energy storage ["PHES"] project at the Kanmantoo site.

A PHES project at the Kanmantoo site would utilise the head difference between an upper pond constructed at the site of the decommissioned tailing storage facility and the partially flooded Giant Pit. Initial estimates suggest that the storage volumes and the elevation between the upper and lower ponds of up to 427m could support a project capacity of around 220MW which could produce around 1,320MWh of energy over a 6 hour period[6].

The project benefits from a number of characteristics which support the business case for a PHES at the Kanmantoo site including:

- Favourable topographical and geological features;
- Existing water licence agreements and associated infrastructure to deliver water to the site;
- Existing transmission connection at the site to support existing mining activities; and
- Proximity to the high voltage 132kV transmission infrastructure and Mount Barker substation.

Despite these factors, the project is currently at a concept stage and must clear a number of technical and commercial hurdles as well as accompanying investments before any material value can be attributed to the project.

The National Renewable Energy Laboratory's ["NREL"] (United States) project development framework defines the seven essential elements of an energy development process and activity as:

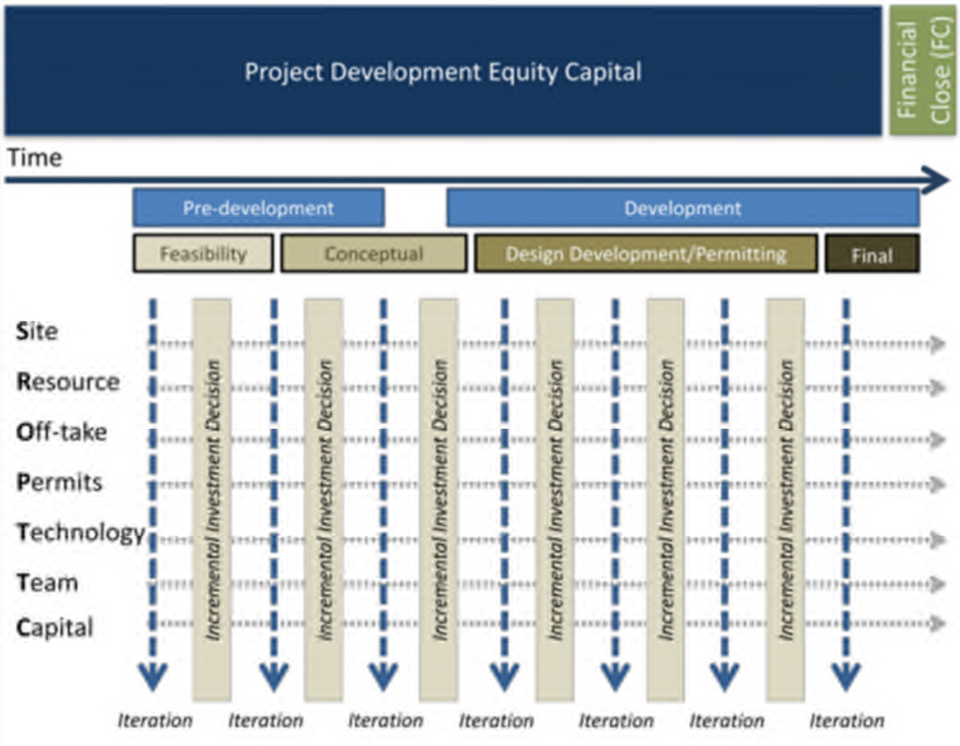
1. Site;
2. Resource (in this case, hydro);
3. Off-take (the buyer of the energy and any other credits);
4. Permits (the relevant development approvals and supporting environmental approvals and connection agreements);
5. Technology (the selected generation technology);
6. Team (the team responsible for project delivery); and
7. Capital[7].

FIGURE 4 below illustrates the iterative nature of both project development activities and on-going investment over the project development lifecycle applying NREL's seven essential elements.

[6] Page 11, Kanmantoo SA Bulk Energy Storage Proposal

[7] A framework for Project Development in the Renewable Energy Sector, National Renewable Energy Laboratory, February 2013

## FIGURE 4 NATIONAL RENEWABLE ENERGY LABORATORY PROJECT DEVELOPMENT FRAMEWORK




At present, the Kanmantoo PHES is at best at a conceptual stage of development with a number of critical work streams to advance the project yet to be commenced which include but are not limited to:

- Resource – enhancement of the existing water licences to supply the PHES;
- Off-take – negotiation of an off-take agreement with a customer, including wholesale and large-scale generation certificate prices and contract term;
- Permits – commencement of the development approval process including the procurement of supporting documents and the connection agreement process; and,
- Technology – procurement of the generation technology and association engineering, procurement and construction services required to construct and install the generation kit.

The Kanmantoo PHES benefits from a range of site-specific benefits which support the business case for the project including:

- Existing and significant head difference between the upper and lower ponds;
- Highly detailed analysis and understanding of the local topography and geology;
- Existing transmission connection and water infrastructure; and,
- Proximity to existing high voltage transmission and substation infrastructure.

However, despite these factors, the project is at a conceptual stage of pre-development with many critical components of the project yet to commence development. In the absence of any material commencement of development activity, it is difficult to estimate the likely time and investment to develop the project and we are unable to ascribe a value to the concept at this time.

## Other assets

Cash: reflects actual cash on hand as at 3 October 2017, hence is post-options conversion. Of this some $250k is restricted cash which is held as deposit to support guarantees.

Receivables: Out of the total of $4.3 million, trade receivables from Freepoint was $2.0 million which reflected the 15% cash that was still outstanding on three drawdowns sold since the last complete ship was settled. The remaining balance is comprised of other receivables ($1.4 million) and prepayments ($0.9 million). The largest item in other receivables is the June BAS return for $1.2 million which includes reclaim of GST on June expenses and the June diesel fuel rebate. This reflects the typical value of the monthly BAS return. Principal prepayments comprises $0.5 million deferred loss on sale and leaseback of containers with Flinders Ports, $167k prepaid insurance premiums, $135k prepaid fees on Petrobond and Electranet bond and $58k prepaid EPA licence fee.

Inventories of $6.4 million as at 30 June include $3.0 million of warehouse stocks which is about the average balance held. This includes all plant spares, parts for maintenance and high turnover consumables such as diesel fuel, reagents and mill balls. ROM stocks were $2.9 million comprising 213,899 tonnes of mined ore stockpiles on the ROM pad carried at cost of $2.3 million plus a further 28,445 tonnes of crushed ore awaiting treatment on the coarse ore stockpile carried at a cost of $0.6 million. In addition, there were 278 tonnes of finished concentrate at site awaiting transport to port ($395k) and 54 tonnes of concentrate at port awaiting drawdown ($77k).

## Financial liabilities

In the pro forma market value assessment, VAA has brought to account all financial liabilities at face value with the exception of the convertible notes, which have been assumed to convert to ordinary equity pursuant to the early redemption notice.

VAA has confirmed that the 30 June 2017 balances have not materially changed to the date of this report.

## Pro forma market value

Based on the 30 June 2017 balance sheet and adjustments to value as set out above, the pro forma market value of Hillgrove as at the date of this report is estimated to be approximately $88.7 million as set out below:

### TABLE 19 PRO FORMA BALANCE SHEET

| Pro forma balance sheet | Amounts<br>$ in million |
|---|---|
| Cash and Cash Equivalents | $1.7 |
| Trade and Other Receivables | $4.3 |
| Inventories | $6.4 |
| **Total current assets** | **$12.4** |
| Property, Plant, and Equipment | $144.7 |
| Exploration Assets | - |
| Pumped Hydro | - |
| Deferred Tax Assets | - |
| **TOTAL NON CURRENT ASSETS** | **$144.7** |
| Trade and Other Payables | ($43.4) |
| Provisions | - |
| Borrowings | ($6.5) |
| Employee Benefits Payable | ($3.9) |
| Deferred Income | ($0.3) |
| **TOTAL CURRENT LIABILITIES** | **($54.1)** |
| Provisions | - |
| Borrowings | ($13.0) |
| Employee Benefits Payable | ($0.9) |
| Deferred Income | ($0.3) |
| **TOTAL NON CURENT LIABILITIES** | **($14.3)** |
| **TOTAL EQUITY** | **$88.7** |

On a fully-diluted basis (i.e. incorporating conversion of 100% of the convertible notes to ordinary equity), this represents a pro forma market value per share of $0.1554.

## Market Capitalisation Valuation Approach

VAA has cross-checked the sum of the parts assessment of the pro forma market value of Hillgrove to the observed and control premium-inclusive share price information.

A market-based estimate of value based on the listed share price is an appropriate method to use because it provides direct transaction-based evidence of fair market value.

### Hillgrove Share Price Value

We have calculated the volume weighted average price ["VWAP"] of Hillgrove's shares over various periods prior to the date 31 October 2017. This is presented in TABLE 20 below.

**TABLE 20 VOLUME WEIGHTED AVERAGE PRICE OF HILLGROVE SHARES**

| HGO volume analysis | Period start date | Price VWAP | Total volume | Volume % of free float | % of free float |
|---|---|---|---|---|---|
| **Total HGO shares outstanding** | | | **415,245,428** | | |
| 1 week to 31-Oct | 25-Oct-17 | 0.08444 | 4,704,298 | 1.13% | 0.23% |
| 1 month to 31-Oct | 02-Oct-17 | 0.08431 | 8,227,055 | 1.98% | 0.09% |
| 6 months to 31-Oct | 02-May-17 | 0.08088 | 27,029,778 | 6.51% | 0.05% |
| 12 months to 31-Oct | 01-Nov-16 | 0.07341 | 77,819,957 | 18.74% | 0.08% |

*Source: Bloomberg, VAA analysis*

Although there has been some volatility in the Hillgrove share price over the past 12 months, the VWAP of Hillgrove shares has been relatively consistent over the various periods as shown in TABLE 20 above.

For the purpose of our valuation, we have adopted a VWAP for the six months to 31 October 2017 for Hillgrove of $0.0809 per share. We have used a VWAP rather than a spot price to limit the effects of unexplained share price volatility. A VWAP is likely to provide a better representation of market value than the price on a particular date.

Based on a (minority, traded) share price of $0.0809 and with 415,845,428 shares on issue, the implied value of 100% of the equity capital of Hillgrove is $33,642 million.

RG111 requires the fair value to be considered assuming 100% ownership of the asset. Listed shares trade on a minority basis. A premium to the observed market price is often paid for a controlling interest in a company. Research indicates that the range for control premia is very wide; from negative to over 100%. We have used a control premium of 30% based on resources sector-specific research:

- Dr Victor Rudenno, in the Mining Valuation Handbook, estimated that the control premia in the resources sector range between 15% and 30%, with an average of 20% (Rudenno, Mining Valuation Handbook, 2nd Edition, 2007, page 219).
- Mergerstat market data on metal mining transactions in 2011 and 2012. When only companies that were predominantly junior explorers were included, the median market premium was circa 17%. If all metal mining transactions in the data set were included, the median rose to circa 27%. The range of all metal transactions was -53.9% to 203%. The data is provided in Appendix 5.

The fair value of 100% of the ordinary equity capital of Hillgrove based on the VWAP is $43.724 million, including a 30% control premium.

# Evaluation of the Proposed Share Acquisition

## Fairness Assessment

Hillgrove's main operating asset is the open pit Kanmantoo copper mine located 55km south east of Adelaide, South Australia. The mine commenced production in 2011 with an initial mine life of seven years which has been extended. While the mine is nearing its end of life the cutback is complete and the copper grades mined at Kanmantoo and the associated copper revenue is forecast to increase markedly. A number of initiatives are underway at the mine to access underground resources at the site. The mine is expected to reach its end of life in 2020.

In addition to the Kanmantoo mine, Hillgrove is exploring the feasibility of a number of projects in its future growth pipeline. These projects include potential underground mining at Kanmantoo, a wholly owned regional exploration project at Kanappa, another wholly owned regional exploration project at Mt Rhine & the pumped hydro concept for Kanmantoo. The cash flows of the other projects under consideration by Hillgrove management have not been determined.

Our view on these projects is that there should be no value ascribed to these projects until a cash flow has been quantified.

Consequently, no value has been ascribed to the future growth pipeline projects.

Using a sum-of-the-parts value of the current operating asset (Kanmantoo) (Income Valuation Approach and Asset Valuation Approach):

- The value on a controlling basis per Hillgrove share prior to the transaction is $0.1554.
- RG 111 requires assessment of value to shareholders on a minority basis after the transaction. The value to Hillgrove shareholders (after deducting a 30% minority discount) is $0.1051 as set out below.

Using the six months Volume Weighted Average Price ["VWAP"] to 31 October 2017 to estimate fair market value:

- The minority value per Hillgrove share before the Proposed Share Acquisition is $0.0809. RG 111 requires consideration of Hillgrove on a controlling basis. If a 30% control premium is added, the value on a controlling basis per Hillgrove share prior to the transaction is $0.1052.

TABLE 21 VALUATION SUMMARY

| Pre proposed transaction | Unit | Share price | Sum of the parts |
|---|---|---|---|
| | | 30% control premium | Controlling basis |
| Hillgrove shareholder value (controlling basis) | $'000 | 43,724 | 88,699 |
| Value per Hillgrove share (controlling basis) | $ | 0.1051 | 0.1554 |

| Post proposed transaction | | Share price | Sum of the parts |
|---|---|---|---|
| | | No control premium | 30% minority discount |
| Expected conversion | shares '000 | 154,795 | n/a |
| Conversion price | $ | 0.0300 | n/a |
| Conversion value | $'000 | 4,644 | n/a |
| Hillgrove shareholder value post proposed transaction (minority basis) | $'000 | 38,278 | 68,230 |
| Value per Hillgrove share post proposed transaction (minority basis) | $ | 0.0671 | 0.1196 |

The value to Hillgrove non-associated shareholders determined using an asset value approach is higher than the value to shareholders using a share price approach. Our primary approach is the sum-of-the-parts approach, therefore the expected value to Hillgrove shareholders before the transaction is $88.699 million or $0.1554 per Hillgrove share, and after the minority discount it is $68.23 million or $0.1196 per Hillgrove share.

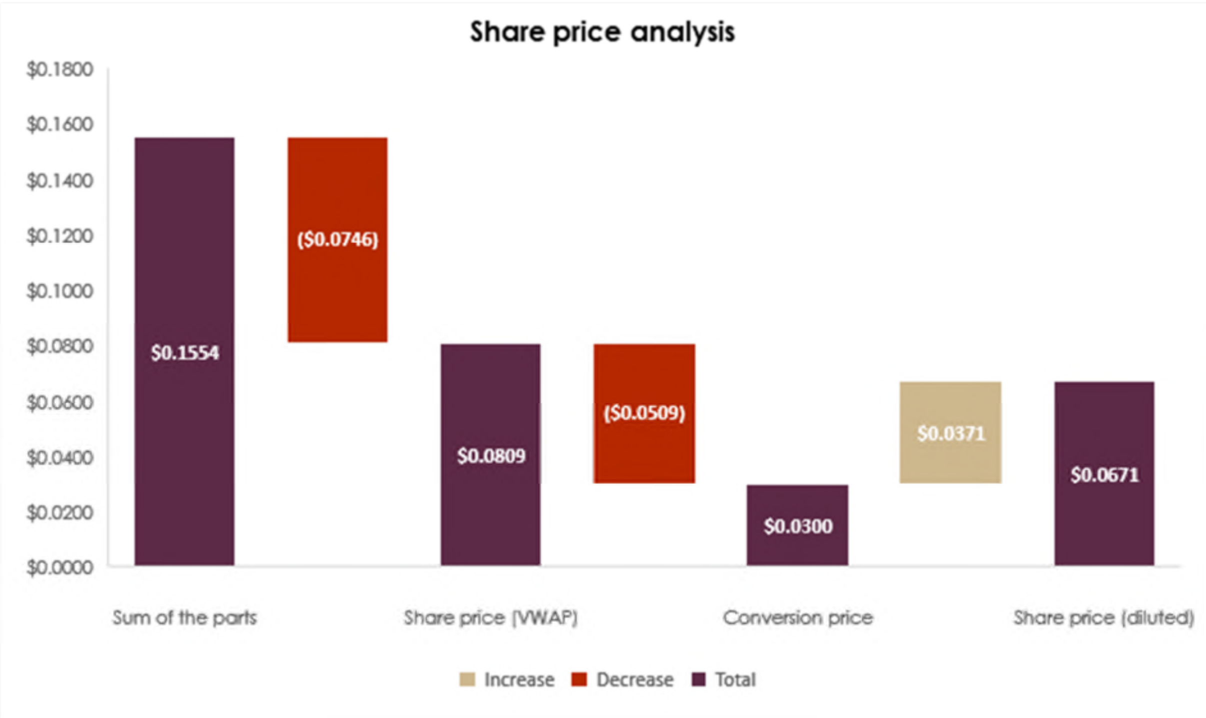
The value to Hillgrove non-associated shareholders post the Proposed Share Acquisition is likely to be less than the value to non-associated shareholders before the Proposed Share Acquisition on a per share basis. This is as a result of the effects of dilution in the event that Ariadne converts 100% of its options to shares. The following reveals the impact of dilution on the non-associated shareholders in the event of 0%, 50% and 100% conversion of the Notes by the non-associated shareholders and 100% conversion of the Notes by Ariadne Capital.

## TABLE 22 POSSIBLE CONVERION OUTCOMES

| Possible conversion outcomes (dated 31 October 2017) | Hillgrove Resources | Ariadne owned | Ariadne ownership |
|---|---|---|---|
| 100% of notes converted by Ariadne | 56,906,065 | 56,906,065 | |
| 0% of notes converted by other holders | - | - | |
| **Total ordinary shares on issue** | **472,751,493** | **148,222,255** | **31.35%** |
| 100% of notes converted by Ariadne | 56,906,065 | 56,906,065 | |
| 50% of notes converted by other holders | 48,944,433 | - | |
| **Total ordinary shares on issue** | **521,695,926** | **148,222,255** | **28.41%** |
| 100% of notes converted by Ariadne | 56,906,065 | 56,906,065 | |
| 100% of notes converted by other holders | 97,888,866 | - | |
| **Total ordinary shares on issue** | **570,640,359** | **148,222,255** | **25.97%** |

FIGURE 5 highlights the impact of 100% conversion of the Notes by the Ariadne Group and non-associated shareholders on the market capitalisation and share price as at 3 November 2017.

## FIGURE 5 HILLGROVE PRE AND POST TRANSACTION SHARE PRICE ANALYSIS



## Reasonableness assessment

RG111 requires that the 'reasonableness' of the Proposed Share Acquisition be separately considered from 'fairness'.

VAA has examined the matters considered by the Hillgrove board in proposing the Early Redemption of the Notes and we set out below our consideration of a range of non-value related issues which in our view provide net benefits to the non-associated shareholders if the Proposed Share Acquisition is approved.

Based on these net benefits, we conclude that the Proposed Share Acquisition is reasonable to the non-associated shareholders:

1. The early redemption notice issued by Hillgrove provides benefits to the company via a significant reduction on hedging and administration costs related to the Notes, as well as reducing constraints imposed on the company whilst the notes are on issue including restrictions on borrowing, pledging assets, raising equity capital and committing to future projects;

2. The conversion by Aridane Capital retains for Hillgrove the cash investment made by Ariadne Capital in acquiring the Notes and therefore reduces the cash funding need to redeem the Notes. Hillgrove does not have cash reserves sufficient to meet a full redemption in any case, and its funding alternatives are limited. Under the covenants of the Notes, Hillgrove is unable to raise any fresh debt and equity (without noteholder approval) until the Notes are redeemed.

3. The conversion by the Ariadne Group strengthens Hillgrove's shareholders' equity and improves its prospects for further capital raisings;

4. Whilst the conversion would lift the Ariadne Group's shareholding from 21.96% to between 25.97% and 31.35% (depending on the extent to which non-associated shareholders elect to convert), the conversion rights were conferred via non-renounceable rights offer on commercial terms that were available to all shareholders and considered appropriate at the time (22 November 2016);

5. On our valuation assessment, conversion is the more likely economic outcome. In any event, The Ariadne Group could almost replicate the shareholding increase, and achieve the same control outcome, within 6 to 18 months utilising the "creep" provisions of the Corporations Act (Item 9 of section 611 provides an exception to the Prohibition where a person's voting power in the Company increases by no more than 3% in 6 months);

6. On our valuation assessment, the rational decision for Noteholders is to convert and therefore Ariadne Capital's increase in percentage holding is likely to be at the lower end of the range and therefore have a limited change in its control and influence. Ariadne already has a blocking stake for a takeover and that does not change, Whilst it technically goes over the threshold to block a special resolution, that relies on the premise that all shareholders vote on resolutions, which is rarely the case;

7. The conversion terms did not impose a conversion control premium on the Noteholders and we do not observe one in the conversion price. However, as noted, the terms were available to all shareholders and in any case, the change in control benefits to Ariadne may be marginal, if non-associated shareholders also elect to convert. On our valuation assessment, conversion is the more likely economic outcome;

8. Ariadne Capital is not seeking a Board position and therefore not looking to exert any fresh influence. In addition, it provides Hillgrove with a strategic shareholder with a strong balance sheet to support future initiatives;

9. If non-associated shareholders reject the Proposed Share Acquisition, it is possible that Ariadne may decide to sell down its interest putting downward pressure on the Hillgrove share price. In addition, funding would be required to meet the Early Redemption obligations;

10. We do not consider that there is a better alternative available to Hillgrove. Other alternatives require the raising of capital to meet the redemption; and,

11. The conversion by Ariadne Capital enhances Hillgrove's capacity to continue to operate as a going concern.

As reported in Hillgrove's FY16 annual report, the Company incurred a net loss of $109.1 million for the year ending 31 December 2016 with Hillgrove's current liabilities exceeding its current assets by $34.4 million[8]. Both the annual report and the independent auditors report (prepared by Deloitte) highlight the uncertainty surrounding Hillgrove's capacity to continue as a going concern if it is cannot maintain the continuing support of its creditors.

In addition to reducing the financing and administrative costs directly associated with the Notes, Hillgrove management have identified additional, non-quantifiable benefits of early redemption which may include but are not limited to the renegotiation of more favourable terms with existing creditors as well as the ability to raise debt funding to increase existing mine efficiencies and accelerate growth options.

There is currently no other offer that would provide superior value to Hillgrove shareholders.

### Other considerations

Hillgrove board and management have advised that additional non-quantifiable benefits of the Proposed Share Acquisition may include but are not limited to the renegotiation of more favourable terms with existing creditors as well as the ability to raise debt funding to increase existing mine efficiencies and accelerate growth options.

Other considerations are listed in the Notice of Meeting Section 7: Advantages and Section 8: Disadvantages.

## Conclusion

In our opinion, the Proposed Share Acquisition is not fair but reasonable to non-associated shareholders and it would be in the interests of non-associated shareholders to vote in favour of the resolution.

## General advice only

This report constitutes general financial product advice only and has been prepared without taking into consideration the individual circumstances of the shareholders of Hillgrove. The decision to accept or reject the Proposed Share Acquisition is a matter for individual shareholders. Shareholders of Hillgrove should consider the advice in the context of their own circumstances and preferences. Shareholders of Hillgrove who are in doubt as to the action they should take in relation to the Proposed Share Acquisition should consult their own professional adviser.

[8] Hillgrove FY16 Annual Report

VAA has prepared a Financial Services Guide in accordance with the Corporations Act, 2001. This is included in Appendix 5 to this report.

Our opinion is made as at the date of this letter and reflects circumstances and conditions as at that date.

# Appendix 1 – Financial Services Guide

Issue Date: March 2014

**Value Adviser Associates Pty Ltd ABN 54 131 852 607** ("Value Adviser Associates" or "we" or "us" or "our" as appropriate) provides general advice in relation securities to retail clients as an authorised representative of Capital Value Securities Pty Ltd ABN 46 123 674 886 ("CVS" or "licensee") AFSL No 311705.

### Financial Service Guide

In the above circumstances we are required to issue you, as a retail client, with a Financial Services Guide [FSG]. This FSG is designed to help retail clients make a decision as to their use of our general security advice.

This FSG includes information about:

1. Who we are and how we and the licensee can be contacted
2. The services we are authorised to provide under the licensee's Australian Financial Services Licence
3. Remuneration that we, the licensee and any associates receive in connection with our general advice
4. The licensee's complaints handling procedures and how you may access them.

The licensee has authorised this FSG.

### Financial services we are authorised to provide

We hold Authorised Representative number 342572 authorising us to provide general security advice on behalf of the licensee.

### General advice

We provide general advice, not personal advice because it has been prepared without taking into account your personal objectives, financial situation or needs.

You should consider the appropriateness of this general advice having regard to your own objectives, financial situation and needs before you act on the advice. Where the advice relates to the acquisition or possible acquisition of a financial product, you should also obtain a product disclosure statement relating to the product and consider that statement before making any decision about whether to acquire the product.

### Benefits that we may receive

We charge fees for providing general advice. These fees will be agreed with, and paid by, the person who engages us. Fees will be agreed on either a fixed fee or time cost basis. Clients may request particulars within a reasonable time after receiving this Guide (and before any financial service is given).

Except for the fees referred to above, neither Value Adviser Associates, CVS nor any of their directors, employees or related entities receive any pecuniary benefit or other benefit directly or indirectly for or in connection with the provision of financial product advice.

## Referrals

We do not pay commissions or provide other benefits to any person for referring customers to CVS or us in connection with the advice that we are authorised to provide.

## Associations and relationships

CVS is ultimately controlled and operates as part of Value Adviser Associates professional advisory practice. Our Directors may be executive directors of CVS.

From time to time, we may provide professional services to financial product issuers in the ordinary course of our business.

## Complaints resolution

***Internal complaints resolution process***

As a holder of an Australian Financial Services Licence, CVS is required to have a system for handling complaints from retail clients to whom it and its representatives provide financial product advice. All complaints must be in writing, addressed to: The Complaints Officer, Capital Value Securities Pty Ltd, Level 2, 65 Southbank Boulevard, Southbank, Vic 3006.

When CVS receives a written complaint it will record the complaint, acknowledge receipt of the complaint within 15 days and investigate the issues raised. As soon as practicable and not more than 45 days after receiving the written complaint, it will advise the complainant in writing of its determination.

***Referral to External Dispute Resolution Proposed Share Acquisition***

A complainant not satisfied with the outcome of the above process, or the licensee's determination, has the right to refer the matter to the Financial Ombudsman Service Ltd ["FOS"]. FOS is an independent company that has been established to provide free advice and assistance to consumers to help in resolving complaints relating to the financial services industry.

Further details about FOS are available from the FOS website www.fos.org.au or by contacting them directly at: Financial Ombudsman Service Ltd. GPO Box 3, Melbourne Victoria 3001 or Toll free 1300 78 08 08 or by facsimile (03) 9613 6399.

**Professional Indemnity insurance**

Value Adviser Associates has Professional Indemnity insurance in place that covers claims in respect of current and former employees and representatives for services provided on behalf of Value Adviser Associates. This insurance satisfies the requirements under the Corporations Act relating to compensation arrangements.

## Contact details

You may contact CVS at level 2, 65 Southbank Boulevard, Southbank Vic, 3006 or by phone (03) 9626 4300 or by facsimile (03) 9626 4301.

## Appendix 2 – Statement of Qualifications and Declarations

Value Adviser Associates is qualified to provide this report. It is the corporate authorised representative of Capital Value Securities (a wholly-owned subsidiary of Value Adviser Associates), which holds an Australian Financial Services Licence under the Act. The Value Adviser Associates personnel responsible for this report have not provided financial advice to Hillgrove in relation to this Proposed Share Acquisition.

Prior to accepting this engagement, Value Adviser Associates considered its independence with respect to Hillgrove with reference to ASIC Regulatory Guide 112: *Independence of experts*. In our opinion, we are independent of Hillgrove and Ariadne Capital.

This report has been prepared specifically for the Hillgrove's non-participating shareholders. Neither Value Adviser Associates nor any member or employee thereof undertakes responsibility to any person, other than the non-participating shareholders, in respect of this report, including any errors or omissions howsoever caused.

The statements and opinions given in this report are given in good faith and the belief that such statements and opinions are not false or misleading. In the preparation of this report Value Adviser Associates has relied upon and considered information believed after due inquiry to be reliable and accurate. Value Adviser Associates has no reason to believe that any information supplied to it was false or that any material information has been withheld from it. Value Adviser Associates has evaluated the information provided to it by Hillgrove, its advisors, as well as other parties, through inquiry, analysis and review, and nothing has come to its attention to indicate the information provided was materially miss-stated or would not afford reasonable grounds upon which to base this report. Value Adviser Associates does not imply and it should not be construed that it has audited or in any way verified any of the information provided to it, or that its inquiries could have verified any matter which a more extensive examination might disclose. The information we have had regard to in the preparation of this report is set out in Appendix 3 – Sources of Information.

The information provided to Value Adviser Associates has been evaluated through analysis, enquiry and review to the extent it considered necessary for the purposes of forming an opinion. Value Adviser Associates does not warrant that its enquiries have identified or verified all the matters that a formal audit or due diligence may disclose. Accordingly, this report and the opinions contained in it should be considered more in the nature of a commercial and financial review rather than a comprehensive audit or due diligence.

Hillgrove has provided an indemnity to Value Adviser Associates for any claims arising out of any miss-statement or omission in any material or information provided to it in the preparation of this report.

This report should be read in its entirety to ensure that no isolated statements, analyses or other factors are construed out of context. The preparation of an opinion is a complex process and subject to professional judgement. The overall opinion is not to partial analysis or summary.

Value Adviser Associates provided draft copies of this report to the independent directors and management of Hillgrove for their comments as to factual accuracy, as opposed to opinions, which are the responsibility of Value Adviser Associates alone. Changes made to this report as a result of this review by the independent directors and management of Hillgrove have not changed the methodology or conclusions reached by Value Adviser Associates.

Value Adviser Associates will receive a professional fee based on time spent in the preparation of this report, estimated at $35,000 (exclusive of GST). This fee is not contingent on the outcome of the Proposed Share Acquisition. Value Adviser Associates will not be entitled to any other pecuniary or other benefit whether direct or indirect, in connection with the making of this report.

Mr Michael Churchill, CEO of VAA, has assumed overall responsibility for this report. He has over 25 years' experience in providing financial advice and valuation advice and has professional qualifications appropriate to the advice being offered. Michael holds a Bachelor of Administration, post graduate Diploma in Financial Analysis and Investment and is a Fellow of CPA Australia, a Senior Fellow of Finsia, a member of the Tax Institute and of the Institute of Company Directors.

Mr Saqib Khan, Senior Manager at VAA, is a corporate finance professional with over 15 years of experience. Saqib has worked with KPMG Saudi Arabia, where he performed business valuations for IPOs, private placements, M&A, divestitures, infrastructure, impairment testing, restructuring, strategic planning, financial reporting, dispute settlement, privatisation and public-private partnerships (PPP) transactions. His work entailed preparing financial models, drafting valuations reports and delivering presentations. Saqib is a member of CPA Australia and is a CFA charter holder.

In the preparation of this report Value Adviser Associates has had regard to relevant Regulatory Guides issued by ASIC. It is not intended that the report should be used for any other purpose than to be sent to the Shareholders of Hillgrove. In particular, it is not intended that this report should be used for any other purpose other than as an expression of its opinion as to whether or not the Proposed Share Acquisition is in the best interest of the Hillgrove's non-participating shareholders.

This report conforms to the requirements of APES 225 "Valuation Services".

The financial forecasts considered in the preparation of this report reflect the judgement of directors and management of Hillgrove based on present circumstances, as to both the most likely set of conditions and the course of action it is most likely to take. It is usually the case that some events and circumstances do not occur as expected or are not anticipated. Therefore, actual results during the forecast period will almost always differ from the forecast and such differences may be material. To the extent that our conclusions are based on forecasts, we express no opinion on the achievability of those forecasts.

Value Adviser Associates consents to the issue of this report in the form and context in which it accompanies the Notice of Extraordinary General Meeting to be sent to the shareholders of Hillgrove.

# Appendix 3 – Discounted Cash flow Valuation

The discounted cash flow valuation was based on a model prepared by management. The financial model has been developed on monthly basis for Kanmantoo mine, and runs from 1 October 2017 to 30 June 2020. VAA has ignored the cash flows for the month of October 2017, given the analysis date of 31 October 2017.

The valuation is based on the following key input assumptions:

- Throughput;
- Copper, Gold and Silver feed grade;
- Copper, Gold and Silver recovery;
- Spot pricing for Copper, Gold and Silver;
- Foreign exchange rate; and,
- Mining and processing costs.

## Valuation assumptions summary

Operations assumptions are divided into the following three key areas as below:

- Throughput;
- Pricing assumptions of Copper, Gold and Silver; and,
- Processing assumptions.

The throughput analysis, as shown in TABLE 23 below, reveals the volumes of Copper, Gold and Silver. Given that our analysis date is as at 31 October 2017. We have ignored the cash flows for October 2017 provided by Management.

**TABLE 23 THROUGHPUT ANALYSIS**

| Throughtput analysis<br>For financial year<br>Quantities (as stated) | Nov'17 to Dec'17 | FY18 | FY19 | FY20 |
|---|---|---|---|---|
| Throughput (tonnes) | 607,588 | 3,650,000 | 3,650,000 | 1,453,684 |
| Copper production (tonnes) | 3,949 | 27,605 | 12,131 | 2,553 |
| Gold production (ounces) | 777 | 3,872 | 3,491 | 1,628 |
| Silver production (ounces) | 7,921 | 72,970 | 41,736 | 12,862 |

*Source: Hillgrove management*

Following commodity prices and exchange rates have been used to forecast the revenue:

**TABLE 24 COMMODITY PRICES AND EXCHANGE RATE SUMMARY**

| Commodity prices | | 31-Oct-17 | 30-Jun-20 |
|---|---|---|---|
| Copper | US$ per tonne | 6,583 | 6,000 |
| Gold | US$ per ounce | 1,200 | 1,200 |
| Silver | US$ per ounce | 17 | 17 |
| Forex | AUD/USD | 0.80 | 0.74 |

*Source: Hillgrove management and VAA analysis*

Management has made certain assumptions for the feed grade and recovery factors for these commodities. Given that the cash flows have been forecast in the management financial model on monthly basis, VAA has summarised the results in TABLE 25 based on yearly averages of the monthly information, without any adjustments to the management assumptions.

**TABLE 25 PROCESSING ASSUMPTIONS**

| Processing assumptions<br>For financial year<br>Quantities (as stated) | Nov'17 to Dec'17 | FY18 | FY19 | FY20 |
|---|---|---|---|---|
| Copper Feed Grade (%age) | 0.71% | 0.82% | 0.37% | 0.21% |
| Copper Recovery (%age) | 92.09% | 92.52% | 88.33% | 84.40% |
| Gold Feed Grade (g/t) | 0.07 | 0.06 | 0.05 | 0.06 |
| Gold Recovery (%age) | 55.00% | 55.00% | 55.00% | 55.00% |
| Silver Feed Grade (g/t) | 0.81 | 1.24 | 0.71 | 0.55 |
| Silver Recovery (%age) | 50.00% | 50.00% | 50.00% | 50.00% |

*Source: Hillgrove management and VAA analysis*

## VAA adjustments to the management financial model

VAA has made the following adjustments to the management financial model:

- The management financial model is based on real cash flows (without inflation). VAA has adjusted the cash flows on a monthly basis, using a yearly inflation of 2.5%.
- Management has made certain commodity prices and exchange rate parity which are reflected under the column labelled "31-Oct-2017" in TABLE 24 above. VAA has adjusted the following inputs:
    - Copper price will reduce on monthly basis from $6,583 in 31 October 2017 to $6000 in 30 June 2020; and,
    - Exchange rate between the Australian Dollar and US Dollar will move from 0.80 in 31 October 2017 to 0.74 in 30 June 2020.

## Forecasts for discounted cash flow analysis

The yearly cash flows forecast which has been summarised from the monthly cash flows provided by Management are shown in TABLE 26.


ValueAdviserAssociates
creating, capturing and communicating value

## TABLE 26 DISCOUNTED CASH FLOW FORECAST SUMMARY

| Discounted cash flow analysis | | | | |
|---|---|---|---|---|
| **For financial year** | **Nov'17 to Dec'17** | **FY18** | **FY19** | **FY20** |
| **AUD** | **$'000** | **$'000** | **$'000** | **$'000** |
| **Revenue** | | | | |
| Copper revenue | 30,824 | 228,642 | 106,714 | 23,723 |
| Gold revenue | 1,062 | 5,606 | 5,629 | 2,822 |
| Silver revenue | 153 | 1,505 | 943 | 316 |
| Less: TC/RC/PP/Bi | (3,016) | (28,829) | (10,790) | (2,476) |
| **Net revenue** | **29,023** | **206,923** | **102,495** | **24,385** |
| | | | | |
| **Expenses** | | | | |
| Mining (Fixed) | (12,609) | (58,655) | 0 | 0 |
| Processing (Fixed) | (4,512) | (25,624) | (27,154) | (11,057) |
| Technical Services | (270) | (2,551) | 0 | 0 |
| Other G&A | (1,058) | (5,816) | (4,348) | (1,346) |
| Transportation | (1,117) | (8,249) | (4,073) | (910) |
| Royalties | (419) | (14,518) | (4,921) | (1,174) |
| **Total expenses** | **(19,986)** | **(115,413)** | **(40,496)** | **(14,486)** |
| | | | | |
| **Other outflows** | | | | |
| Capex | (689) | (4,179) | (4,557) | (12,798) |
| Sale of Plant and Equipment | 0 | 0 | 0 | 24,368 |
| **Other cash outflows** | **(689)** | **(4,179)** | **(4,557)** | **11,570** |
| | | | | |
| **Adjustments** | | | | |
| Reduction in creditors | (2,000) | (35,500) | 0 | (3,500) |
| Tax Payable | 0 | (957) | (6,326) | (770) |
| **TOTAL OTHER ADJUSTMENTS** | **(2,000)** | **(36,457)** | **(6,326)** | **(4,270)** |
| | | | | |
| **CFADS** | **6,348** | **50,874** | **51,116** | **17,199** |
| | | | | |
| Repayment of SAG Loan | 0 | (4,533) | 0 | 0 |
| Performance Bond Line Fee | (6) | (219) | (217) | (90) |
| **Total debt service** | **(6)** | **(4,752)** | **(217)** | **(90)** |
| | | | | |
| **Free cash flows from operations** | **6,342** | **46,122** | **50,899** | **17,108** |
| Add back: Repayment of creditors | 2,000 | 35,500 | 0 | 3,500 |
| Add back: Repayment of SAG loan | 0 | 4,533 | 0 | 0 |
| Add back: Redundancies | 0 | 0 | 0 | 4,000 |
| Less: Salary deferrals | 303 | (975) | (1,345) | 0 |
| Less: Corporate costs | (505) | (2,530) | (1,918) | (598) |
| **Total free cash flows for DCF** | **8,139** | **82,651** | **47,637** | **24,010** |

*Source: Hillgrove management and VAA analysis*

## Discount rates

Management has used the Capital Asset Pricing Model to construct the discount rate for this valuation. TABLE 27 provides the discount rate inputs and calculation. A post-tax, nominal discount rate of 9.6% has been estimated by VAA.

Management has used a discount rate of 8.05% on post-tax, real basis which equates to VAA's estimate of 6.9%. VAA concludes that Management's estimate of 8.05% discount on post-tax, real basis is not unreasonable.

### TABLE 27 DISCOUNT RATE INPUTS AND CALCULATIONS

| Weighted average cost of capital | | | |
|---|---|---|---|
| **Equity** | | | |
| Rf (long) | 3.0% | | |
| MRP | 6.5% | | |
| Be | 1.36 | | |
| **Ke** | | **11.8%** | |
| **Debt** | | | |
| Kd observed | 8.0% | | |
| Tax | 30.0% | | |
| **Kd** | | **5.6%** | |
| Debt ratio | 35.7% | | |
| **WACC** | | **9.6%** | Post-tax, nominal |
| Inflation | 2.5% | | |
| **WACC (Fisher equation)** | | **6.9%** | **Post-tax, real** |

*Source: Hillgrove management and VAA analysis*

**Notes**

1. Long term estimate of risk-free rate has been assumed based on long term average of the Australian Government Bonds.

2. The Market Risk Premium ["MRP] in Australia is commonly estimated at between 6% and 7%. A mid-point estimate of 6.5% has been used in this valuation as the current estimate of the MRP.

3. Management has estimated the equity beta at 1.45. VAA conducted its own research and identified the following list of comparable companies:

### TABLE 28 COMPARABLE COMPANY ASSET BETA CALCULATIONS

| Serial no | Ticker | Raw equity beta | Debt ratio | Asset beta |
|---|---|---|---|---|
| 1 | CAA AU Equity | 1.18 | 0.0% | 1.18 |
| 2 | KCN AU Equity | 0.68 | 10.3% | 0.61 |
| 3 | DRA AU Equity | 0.69 | 0.0% | 0.69 |
| 4 | MRC AU Equity | 1.31 | 17.0% | 1.08 |
| 5 | GMD AU Equity | 1.06 | 0.0% | 1.06 |
| 6 | IRC AU Equity | 1.14 | 0.0% | 1.14 |
| 7 | DHR AU Equity | 0.81 | 5.4% | 0.77 |
| 8 | BCN AU Equity | 0.98 | 0.0% | 0.98 |
| 9 | CAS AU Equity | 0.67 | 0.0% | 0.67 |
| 10 | CMC AU Equity | 1.42 | 26.0% | 1.05 |
| 11 | TAS AU Equity | 1.06 | 3.6% | 1.02 |
| 12 | ARM AU Equity | 1.04 | 0.0% | 1.04 |
| 13 | RCO AU Equity | 0.74 | 0.0% | 0.74 |
| 14 | CAZ AU Equity | 0.74 | 0.0% | 0.74 |
| 15 | BAU AU Equity | 0.76 | 0.0% | 0.76 |
| 16 | AZY AU Equity | 0.95 | 0.0% | 0.95 |
| 17 | TAM AU Equity | 0.65 | 0.0% | 0.65 |
| 18 | BNR AU Equity | 0.78 | 0.0% | 0.78 |
| 19 | AQI AU Equity | 1.01 | 0.0% | 1.01 |
| 20 | CUL AU Equity | 1.04 | 0.0% | 1.04 |
| 21 | JRL AU Equity | 1.07 | 0.0% | 1.07 |
| 22 | USA AU Equity | 0.66 | 0.0% | 0.66 |
| 23 | BAR AU Equity | 0.72 | 0.0% | 0.72 |
| 24 | BML AU Equity | 0.66 | 0.0% | 0.66 |
| 25 | MTH AU Equity | 0.95 | 0.0% | 0.95 |
| 26 | VAN AU Equity | 2.44 | 59.6% | 0.98 |
| 27 | CAP AU Equity | 0.72 | 0.0% | 0.72 |
| 28 | DTM AU Equity | 1.02 | 0.0% | 1.02 |
| 29 | ANL AU Equity | 0.69 | 0.0% | 0.69 |
| 30 | AUC AU Equity | 1.04 | 0.0% | 1.04 |
| 31 | BOA AU Equity | 0.96 | 0.0% | 0.96 |
| | **Concluded mean** | | | **0.89** |
| | **Concluded median** | | | **0.95** |
| | **No of observations** | | | **31.00** |

*Debt ratio = Debt/Value*
*Source: Bloomberg, LLP, VAA analysis*

4. VAA has estimated the asset beta range to be from 0.61 to 1.18 with average and median of 0.89 and 0.95 respectively, and concluded that Management's estimate of 1.45% asset beta is not unreasonable.

5. We have re-levered the asset beta of 0.89 based on the debt ratio of 35.7% which provided us with an estimated equity beta of 1.36. In order to re-lever, we used the market capitalisation as at 27 October 2017 of ~$35 million. The debt ratio at this market capitalisation is estimated to be 35.7%.

## Valuation conclusion

VAA concludes the DCF valuation of $144 million based on the free cash flows from November 2017 to June 2020 at the discount rate of 9.6% on post-tax, nominal basis.

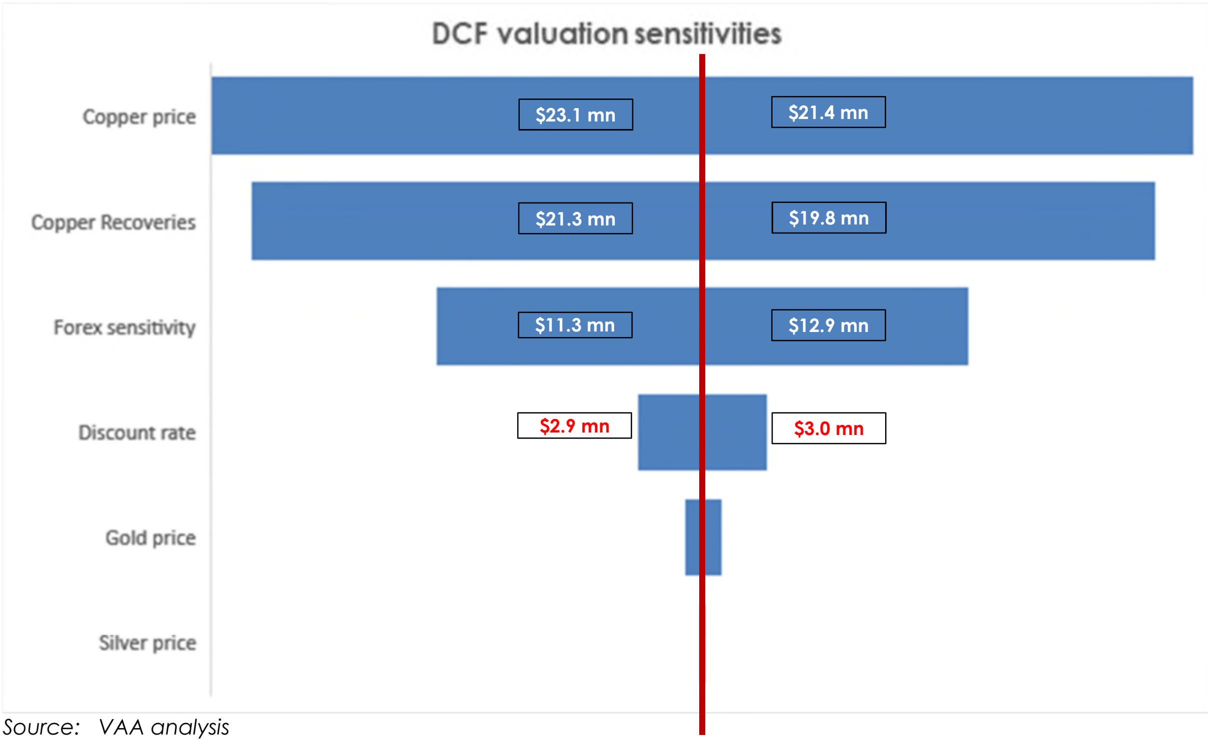
## Key sensitivities

The DCF valuation financial model prepared and provided by Hillgrove estimates valuation sensitivities based on the key input cash flow drivers which are as follows:

- Copper recoveries;
- Commodity pricing for Copper, Gold and Silver; and,
- Foreign exchange (AUD:USD).

VAA has performed sensitivity analysis on the above input parameters, and has presented the results of this analysis in below table:

**FIGURE 6 VALUATION SENSITIVITIES TORNADO**




*Source: VAA analysis*
*Note: The redline on the chart represents the DCF valuation*

It is important to highlight that these sensitivities have been performed in the financial model provided by Hilllgrove. VAA has not conducted an independent review and audit of the management financial model.

# Appendix 4 – Valuation Methodologies

There are a number of valuation methodologies available with which to value a project, a business or the shares in a company. The principal methodologies used are:

- capitalisation of earnings;
- discounted cash flow;
- net realisable asset value;
- market based assessments; and
- recent offers.

Each of these methodologies is appropriate in certain circumstances. The decision as to which methodology to utilise generally depends upon the methodology most commonly adopted in valuing the asset in question and the availability of appropriate information.

## Capitalisation of Earnings

The capitalisation of earnings methodology involves capitalising the earnings of a project, a business or a company at an appropriate multiple, which reflects the risks underlying the earnings together with growth prospects.

This methodology requires consideration of the following factors:

- estimation of future maintainable earnings having regard to historical and forecast operating results, abnormal or non-recurring items of income and expenditure and other factors. Future maintainable earnings is generally based on net profit after tax, EBIT, EBITA or EBITDA;
- determination of an appropriate earnings multiple reflecting the risks inherent in the business, growth prospects and other factors;
- earnings multiples applied to net profit after tax are known as price earnings multiples and are commonly used in relation to listed public companies. Earnings multiples applied to EBIT, EBITA or EBITDA are known, respectively, as EBIT, EBITA or EBITDA multiples, and are commonly used in respect of companies comprising a number of businesses where debt cannot be precisely allocated or in acquisition scenarios where the purchaser is likely to control gearing;
- an adjustment for financial debt, in the event maintainable earnings are based on EBIT, EBITA or EBITDA; and
- an assessment of any surplus assets and liabilities, being those which are not essential to the generation of the future maintainable earnings.

This methodology is appropriate where a company, project or business is expected to generate a relatively stable record of earnings.

## Discounted Cash flow

The discounted cash flow methodology involves calculating the net present value of cash flows that are expected to be derived from future activities. The forecast cash flows are discounted by a discount rate that reflects the time value of money and the risk inherent in cash flows.

This methodology is particularly appropriate in valuing projects, businesses and companies that are in a start-up phase and are expecting considerable volatility and/or growth in earnings during the growth phase, as well as businesses with a finite life. The utilisation of this methodology generally requires management to be able to provide long term cash flows for the subject company, asset or business.

## Net realisable value of assets

The net realisable value of assets methodology involves the determination of the net realisable value of the assets of a business or company, assuming an orderly realisation of those assets. This value may include a discount to allow for the time value of money and for reasonable costs of undertaking the realisation. It is not a valuation on the basis of a forced sale, where assets may be sold at values materially different to their market value.

This methodology is appropriate where a project, a business or company is not making an adequate return on its assets or where there are surplus non-operational assets or in the case of a start-up where returns are not certain.

## Market-based assessments

Market based assessments relate to the valuation of companies or assets that are publicly traded.

For private companies, if a recent genuine offer has been made for a company, business unit or asset, that offer may be used as a basis for valuation of the company, business unit or asset.

## Appendix 5 – Metal Control Premia

| Year | Target | Control Premium |
|---|---|---|
| **Juniors/Explorers** | | |
| 2012 | URSA Major Minerals Inc | 4.60% |
| 2012 | Integra Mining Ltd | 58.10% |
| 2012 | Silvermex Resources Inc | 16.00% |
| 2012 | Eureka Energy Ltd | 36.40% |
| 2012 | Exco Resources Ltd | 55.90% |
| 2012 | Areva SA (La Mancha Resources) | 55.60% |
| 2012 | Aurium Resources Ltd | -44.40% |
| 2012 | Precious Metals Resources Ltd | 6.40% |
| 2012 | Bullion Monarch Mining Inc | 21.30% |
| 2012 | Rift Valley Resources Ltd | 25.30% |
| 2012 | Gold-Ore Resources Ltd | 17.30% |
| 2012 | European Goldfields Ltd | 6.70% |
| 2012 | Minera Andes Inc | 10% |
| 2012 | Magma Metals Ltd | 1.30% |
| 2011 | Ferraus Ltd | 0.90% |
| 2011 | Far West Mining Ltd | -12.80% |
| 2011 | Stuart PeTroleum Ltd | 50.00% |
| 2011 | Medoro Resources Ltd | 36.70% |
| 2011 | Jabiru Metals Ltd | 13.80% |
| 2011 | Anchor Resources Ltd | 90.60% |
| 2011 | Aragon Resources ltd | 27.70% |
| 2011 | Century Mining Corp | -53.90% |
| 2011 | Crescent Gold ltd | 4.00% |
| 2011 | Goldstone Resources Inc | 50.35% |
| 2011 | Simmer & Jack Mines | -26.60% |
| 2011 | Capital Gold Corp | 68.10% |
| **Explorer Median** | | **16.65%** |
| **Other** | | |
| 2012 | Crocodile Gold Group | 83.50% |
| 2012 | Avion Gold Corp | 72.30% |
| 2012 | Norton Gold Fields | 45.90% |
| 2012 | Anvil Mining Ltd | 47.90% |
| 2011 | Territory Resources ltd | 203.00% |
| 2011 | Consolidated Thompson Iron Mines Ltd | 30.50% |
| 2011 | Northgate Minerals Corp | 13.70% |
| 2011 | Gold One international Ltd | 27.90% |
| **Total Median** | | **26.50%** |

*Source: Mergerstat Control Premium Study, Metal Mining, Q1 2012 and Q4 2012*

# Appendix 6 – Sources of Information

In preparing this report, we have had regard to the following sources of information:

**TABLE 29 INFORMATION PROVIDED BY HILLGROVE MANAGEMENT**

| |
|---|
| Hillgrove Resources Limited – Notice of Meeting |
| Hillgrove Resources Limited – Details of Directors' interests as at 3 November 2017 |
| Hillgrove Resources Limited – Top 20 ASX Shareholders as at 3 November 2017 |
| Hillgrove Resources Limited – Kanmantoo Pumped Hydro Energy Storage<br>Adobe PDF file: "*Kanmantoo SA Bulk Energy Storage Proposal incl appendices*" |
| Hillgrove Resources Limited – Shareholdings analysis of Proposed Share Acquisition on the Hillgrove shareholders (the Ariadne Group and non-associated shareholders.<br>Microsoft Excel file: "*Ariadne pre post Conv Impact on Voting Analysis*" |
| Hillgrove Resources Limited – Convertible note redemption indicative timetable |
| Hillgrove Resources Limited – ASX Release dated 9th April 2010 |
| Hillgrove Resources Limited – Un-audited consolidated financial position as at 30 September 2017, 31 August 2017, 31 July 2017, 30 June 2017 and 31 December 2016. |
| Hillgrove Resources Limited – Monthly management DCF cash flows forecast from 31 October 2017 to 30 June 2020<br>Microsoft Excel file: "*171010 Cash Flow Forecast for IER*" |
| Hillgrove Resources Limited – Discussions/comments from the following key executives/consultants of Hillgrove:<br>• Mr Steven McClare, Managing Director<br>• Mr Paul Kiley, CFO<br>• Mr Lachlan Wallace, General Manager<br>• Mr Peter Rolley, Principal Geologist<br>• Mr Peter Hedger, Commercial Manager<br>• Mr Joe Sutanto, Group Finance and Planning Manager |

**TABLE 30 INFORMATION SOURCED BY VAA**

| |
|---|
| Hillgrove Resources Limited Annual Report 2014 |
| Hillgrove Resources Limited Annual Report 2015 |
| Hillgrove Resources Limited Annual Report 2016 |
| Hillgrove Resources Limited Annual Report 2017 |
| Hillgrove Resources Limited Interim Report June 2015 |
| Hillgrove Resources Limited Interim Report June 2016 |
| Hillgrove Resources Limited Interim Report June 2017 |
| ASIC Regulatory Guide 111 Content of Expert Reports, March 2011 |
| ASIC Regulatory Guide 112 Independence of Experts, March 2011 |
| ASIC Regulatory Guide 60 Schemes of Arrangement, December 2009 |
| Bloomberg |

| |
|---|
| Rudenno, Victor, the Mining Valuation Handbook, 2nd Edit, 2007 |
| IBISWorld Industry Report B0803: Copper Ore Mining in Australia, October 2017 |
| Ariadne Australia Limited – Annual report 2014 |
| Ariadne Australia Limited – Annual report 2015 |
| Ariadne Australia Limited – Annual report 2016 |
| Ariadne Australia Limited – Annual report 2017 |

HILLGROVE RESOURCES

**All Correspondence to:**

**By Mail** Boardroom Pty Limited
GPO Box 3993
Sydney NSW 2001 Australia

**By Fax:** +61 2 9290 9655

**Online:** www.boardroomlimited.com.au

**By Phone:** (within Australia) 1300 737 760
(outside Australia) +61 2 9290 9600

# YOUR VOTE IS IMPORTANT

For your vote to be effective it must be recorded **before 12:00pm (ACDT) on Wednesday, 6 December 2017.**

## TO VOTE ONLINE

**STEP 1: VISIT** www.votingonline.com.au/hgogm2017

**STEP 2: Enter your Postcode OR Country of Residence (if outside Australia)**

**STEP 3: Enter your Voting Access Code (VAC):**

.

## BY SMARTPHONE

Scan QR Code using smartphone QR Reader App

## TO VOTE BY COMPLETING THE PROXY FORM

### STEP 1 APPOINTMENT OF PROXY

Indicate who you want to appoint as your Proxy.

If you wish to appoint the Chair of the Meeting as your proxy, mark the box. If you wish to appoint someone other than the Chair of the Meeting as your proxy please write the full name of that individual or body corporate. If you leave this section blank, or your named proxy does not attend the meeting, the Chair of the Meeting will be your proxy. A proxy need not be a securityholder of the company. Do not write the name of the issuer company or the registered securityholder in the space.

**Appointment of a Second Proxy**

You are entitled to appoint up to two proxies to attend the meeting and vote. If you wish to appoint a second proxy, an additional Proxy Form may be obtained by contacting the company's securities registry or you may copy this form.

To appoint a second proxy you must:

(a) complete two Proxy Forms. On each Proxy Form state the percentage of your voting rights or the number of securities applicable to that form. If the appointments do not specify the percentage or number of votes that each proxy may exercise, each proxy may exercise half your votes. Fractions of votes will be disregarded.

(b) return both forms together in the same envelope.

### STEP 2 VOTING DIRECTIONS TO YOUR PROXY

To direct your proxy how to vote, mark one of the boxes opposite each item of business. All your securities will be voted in accordance with such a direction unless you indicate only a portion of securities are to be voted on any item by inserting the percentage or number that you wish to vote in the appropriate box or boxes. If you do not mark any of the boxes on a given item, your proxy may vote as he or she chooses. If you mark more than one box on an item for all your securities your vote on that item will be invalid.

**Proxy which is a Body Corporate**

Where a body corporate is appointed as your proxy, the representative of that body corporate attending the meeting must have provided an "Appointment of Corporate Representative" prior to admission. An Appointment of Corporate Representative form can be obtained from the company's securities registry.

### STEP 3 SIGN THE FORM

The form **must** be signed as follows:

**Individual:** This form is to be signed by the securityholder.

**Joint Holding**: where the holding is in more than one name, all the securityholders should sign.

**Power of Attorney:** to sign under a Power of Attorney, you must have already lodged it with the registry. Alternatively, attach a certified photocopy of the Power of Attorney to this form when you return it.

**Companies:** this form must be signed by a Director jointly with either another Director or a Company Secretary. Where the company has a Sole Director who is also the Sole Company Secretary, this form should be signed by that person. **Please indicate the office held by signing in the appropriate place.**

### STEP 4 LODGEMENT

Proxy forms (and any Power of Attorney under which it is signed) must be received no later than 48 hours before the commencement of the meeting, therefore by **12:00pm (ACDT) on Wednesday, 6 December 2017.** Any Proxy Form received after that time will not be valid for the scheduled meeting.

**Proxy forms may be lodged** using the enclosed Reply Paid Envelope or:

**Online** www.votingonline.com.au/hgogm2017

**By Fax** + 61 2 9290 9655

**By Mail** Boardroom Pty Limited
GPO Box 3993,
Sydney NSW 2001 Australia

**In Person** Boardroom Pty Limited
Level 12, 225 George Street,
Sydney NSW 2000 Australia

### Attending the Meeting

If you wish to attend the meeting please bring this form with you to assist registration.

**Hillgrove Resources Limited**
ACN 004 297 116

☐ **Your Address**
This is your address as it appears on the company's share register. If this is incorrect, please mark the box with an "X" and make the correction in the space to the left. Securityholders sponsored by a broker should advise their broker of any changes. **Please note, you cannot change ownership of your securities using this form.**

# PROXY FORM

## STEP 1 APPOINT A PROXY

I/We being a member/s of **Hillgrove Resources Limited** (Company) and entitled to attend and vote hereby appoint:

☐ the **Chair of the Meeting (mark box)**

**OR** if you are **NOT** appointing the Chair of the Meeting as your proxy, please write the name of the person or body corporate (excluding the registered securityholder) you are appointing as your proxy below

or failing the individual or body corporate named, or if no individual or body corporate is named, the Chair of the Meeting as my/our proxy at the **Extraordinary General Meeting** of **Hillgrove Resources Limited** to be held at **The Pullman Adelaide, 16 Hindmarsh Square, Adelaide SA 5000 on Friday, 8 December 2017 at 12:00pm (ACDT)** and at any adjournment of that meeting, to act on my/our behalf and to vote in accordance with the following directions or if no directions have been given, as the proxy sees fit.

The Chair of the Meeting intends to vote undirected proxies in favour of each of the items of business.

## STEP 2 VOTING DIRECTIONS

* If you mark the Abstain box for a particular item, you are directing your proxy not to vote on your behalf on a show of hands or on a poll and your vote will not be counted in calculating the required majority if a poll is called.

| | | For | Against | Abstain* |
|---|---|---|---|---|
| **Resolution 1** | Approval of Acquisition of Relevant Interest | ☐ | ☐ | ☐ |

## STEP 3 SIGNATURE OF SECURITYHOLDERS

This form must be signed to enable your directions to be implemented.

| Individual or Securityholder 1 | Securityholder 2 | Securityholder 3 |
|---|---|---|
| | | |
| Sole Director and Sole Company Secretary | Director | Director / Company Secretary |

Contact Name…………………………………………….... Contact Daytime Telephone……………………….............................. Date / / 2017