

Australasia Australia
M&M - Gold

29 January 2010

Avoca Resources

Reuters: **AVO.AX** Bloomberg: **AVO AU** Exchange: **ASX** Ticker: **AVO**

Dec 09 Result - on track for +190Koz in FY10

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Higginsville Project now producing consistently at +50koz/qtr

As pre-announced on 8 Jan, AVO produced 51.0koz Au in DecQ (original DBE 48.1koz) at an operating cash cost of A\$458/oz (DBE A\$450/oz). The Higginsville treatment plant processed 300kt at a grade of 5.3g/t & a 97% recovery. Sales for DecQ were 52.6koz (original DBE 48.1koz) at an average price of A\$1,208 (DB inline). The company now appears on track to achieve its +190koz production guidance for FY10 (DBE 198koz). At 0.7x our \$2.40 TP, AVO remains our preferred pick in the small/mid cap gold sector. Buy.

Higher mining grades at Trident; plant operating above nameplate capacity

Ore mined at Trident was 235koz, 47koz lower than SepQ. However, grades increased from 5.7g/t to 6.2g/t. The Western Zone continued to be the dominant source of stoping production (83% of stoping ounces), with Athena next at 12%. Overall 6.5g/t grade from Western Zone was 15% above planned mine grade. Drilling of Athena returned positive results on the Athena 10, 30 & 40 Lodes, while Apollo drilling returned high-grade results indicating a similar mineralisation to Western Zone. The treatment plant continued to operate above 1.2Mtpa (vs. 1.0Mtpa nameplate). During DecQ, the crusher upgrade study was completed, with the decision to install a quaternary crusher to augment the 3-stage circuit.

Maiden Chalice UG reserve; mining of Fairplay pit to commence in January

During the DecQ, AVO announced a 52% increase in total resource at Chalice UG to 192koz. On 27 Jan, the company released an initial reserve estimate of 118koz, which represents an 84% conversion of the 140koz indicated resource. This reserve allows AVO to develop a second UG mine at Higginsville. In addition, the company announced that Stage 1 contract mining of the Fairplay open pit will commence at end January, to mine ore within 30m below the existing pit floor.

Valuation \$1.80/sh, TP \$2.40/sh set at 1.35x NPV for 10x PER at TP

Our DCF assumes 1.8Moz production over 10 years. Our TP is set at 10x PER or a 1.35x multiple, reflecting the low operating costs but only a 10yr mine life. Key downside risk to our mine life assumption is consistency of grade at depth. Successful resolution of AVO's 2nd bid for Dioro Exploration is also key (see p4).

Forecasts and ratios

Year End Jun 30	2009A	2010E	2011E	2012E	2013E
Sales (AUDm)	146	242	255	241	200
EBITDA (AUDm)	28	116	133	127	90
Net Profit (AUDm)	-16	67	87	81	55
EPS (AUD)	-0.07	0.24	0.31	0.29	0.19
% Change	-0.0%	0.8%	0.0%	0.0%	0.0%
PER (x)	-	6.6	5.2	5.5	8.7
EV/EBITDA (x)	17.5	4.0	2.9	2.3	2.8

Source: Deutsche Bank estimates, company data

¹ Pre-exceptionals/extraordinaries

² Multiples and yields calculations use average historical prices for past years and spot prices for current and future years

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Deutsche Bank



Results

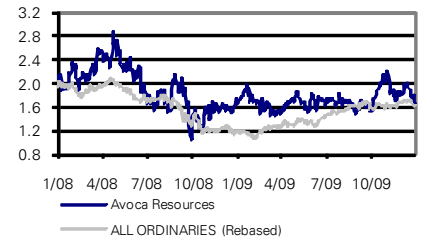
Buy

Price at 29 Jan 2010	1.62
Price target - 12mth	2.40
52 week range (AUD)	2.20 - 1.44
ALL ORDINARIES	4,698

Key changes

Sales (FYE)	240 to 242	↑	0.8%
EBIT margin (FYE)	33.2 to 33.2	↑	0.1%
Net profit (FYE)	66.8 to 67.3	↑	0.8%

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-12.9	6.2	-1.8
ALL ORDINARIES	-3.3	2.7	35.7

Stock data

Market cap (AUDm)	446
Market cap (USDm)	400
Shares outstanding (m)	275.5
Daily volume (USDm)	2.18
Free float	0.00

Key indicators (FY1)

ROE (%)	33.3
ROA (%)	-90.2
Net debt/equity (%)	-9.5
Book value/share (AUD)	0.87
Price/book (x)	1.9
Net interest cover (x)	69.4
EBIT margin (%)	33.2

Model updated: 29 January 2010

Running the numbers**Australasia****Australia****M&M - Gold****Avoca Resources**

Reuters: AVO.AX

Bloomberg: AVO AU

Buy

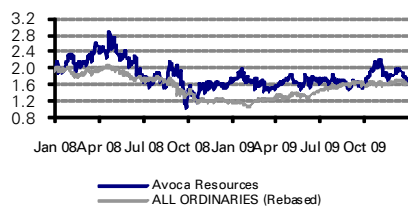
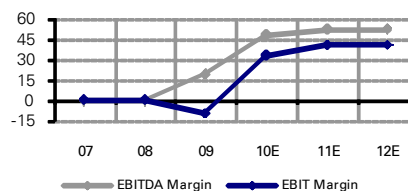
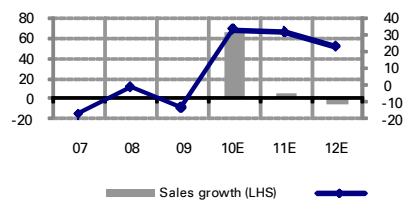
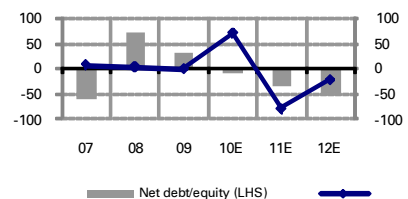
Price (29 Jan 10) AUD 1.62

Target price AUD 2.40

52-week Range AUD 1.44 - 2.20

Market Cap (m) AUDm 446
USDm 400**Company Profile**

Avoca Resources Limited

Price Performance**Margin Trends****Growth & Profitability****Solvency****Brendan Fitzpatrick**

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Fiscal year end 30-Jun

Financial Summary

	2007	2008	2009	2010E	2011E	2012E
DB EPS (AUD)	-0.02	-0.01	-0.07	0.24	0.31	0.29
Reported EPS (AUD)	-0.02	-0.01	-0.07	0.24	0.31	0.29
DPS (AUD)	0.00	0.00	0.00	0.00	0.00	0.00
BVPS (AUD)	0.49	0.53	0.61	0.87	1.16	1.41

Valuation Metrics

Price/Sales (x)	nm	nm	2.8	1.8	1.8	1.8
P/E (DB) (x)	nm	nm	nm	6.6	5.2	5.5
P/E (Reported) (x)	nm	nm	nm	6.6	5.2	5.5
P/BV (x)	2.8	4.2	2.9	1.9	1.4	1.2
FCF yield (%)	nm	nm	nm	18.0	22.8	20.6
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0	0.0
EV/Sales	na	na	3.3	1.9	1.5	1.2
EV/EBITDA	-40.8	-67.7	17.5	4.0	2.9	2.3
EV/EBIT	-38.1	-66.6	-33.2	5.7	3.6	2.9

Income Statement (AUDm)

Sales	0	0	146	242	255	241
EBITDA	-5	-7	28	116	133	127
EBIT	-5	-7	-15	81	104	98
Pre-tax profit	-5	-4	-23	79	105	103
Net income	-4	-1	-16	67	87	81

Cash Flow (AUDm)

Cash flow from operations	-1	1	52	98	108	98
Net Capex	-17	-134	-55	-18	-6	-6
Free cash flow	-19	-133	-4	80	102	92
Equity raised/(bought back)	76	6	29	0	0	0
Dividends paid	0	0	0	0	0	0
Net inc/(dec) in borrowings	53	30	19	-20	-10	-30
Other investing/financing cash flows	0	0	0	0	0	0
Net cash flow	102	-108	37	50	82	52
Change in working capital	10	-3	16	-16	0	0

Balance Sheet (AUDm)

Cash and cash equivalents	109	2	39	89	171	223
Property, plant & equipment	33	173	177	159	136	114
Goodwill	0	0	0	0	0	0
Other assets	NA	NA	NA	NA	NA	NA
Total assets	161	236	287	330	399	439
Debt	48	84	87	67	57	27
Other liabilities	11	36	44	24	24	24
Total liabilities	59	120	130	91	81	51
Total shareholders' equity	102	116	157	239	318	388
Net debt	-61	83	48	-23	-115	-197

Key Company Metrics

Sales growth (%)	nm	nm	nm	66.3	5.1	-5.3
DB EPS growth (%)	na	75.6	-1,014.2	na	28.5	-6.3
Payout ratio (%)	nm	nm	nm	0.0	0.0	0.0
EBITDA Margin (%)	nm	nm	19.1	48.0	52.1	52.4
EBIT Margin (%)	0.0	0.0	-10.0	33.2	40.8	40.7
ROE (%)	-17.4	-1.2	-13.7	33.3	31.2	22.7
Net debt/equity (%)	-60.2	71.6	30.3	-9.5	-36.1	-50.7
Net interest cover (x)	7.5	2.2	-1.7	69.4	-79.8	-22.5

DuPont Analysis

EBIT margin (%)	0.0	0.0	-10.0	33.2	40.8	40.7
x Asset turnover (x)	0.0	0.0	0.6	0.8	0.7	0.6
x Financial cost ratio (x)	0.9	0.6	1.6	1.0	1.0	1.0
x Tax and other effects (x)	0.9	0.3	0.7	0.8	0.8	0.8
= ROA (post tax) (%)	-2.8	-0.7	-6.2	21.8	23.7	19.3
x Financial leverage (x)	6.3	1.8	2.2	1.5	1.3	1.2
= ROE (%)	-17.4	-1.2	-13.7	33.3	31.2	22.7
annual growth (%)	na	93.2	-1,046.7	na	-6.3	-27.3
x NTA/share (avg) (x)	0.1	0.5	0.5	0.7	1.0	1.3
= Reported EPS	-0.02	-0.01	-0.07	0.24	0.31	0.29
annual growth (%)	na	75.6	-1,014.2	na	28.5	-6.3

Source: Company data, Deutsche Bank estimates

AVOCA OPERATIONAL AND FINANCIAL SUMMARY DATA

	2007A	2008A	2009F	2010F	2011F	2012F	2013F
DB Commodity & Currency forecasts							
AUDUSD	0.79	0.90	0.75	0.89	0.88	0.85	0.81
Gold (US\$/oz)	638	824	875	1,085	1,206	1,125	900
Gold (A\$/oz)	812	916	1,186	1,223	1,373	1,325	1,107
MINING							
Ore mined, kt							
Trident	10	142	960	1,067	1,100	1,100	1,100
Head grade, g/t							
Trident	1.5	4.0	4.3	5.7	5.3	5.2	5.2
MILLING							
Ore milled, kt							
Trident	-	22	1,107	1,214	1,200	1,200	1,200
Feed grade, g/t							
Trident	-	-	3.8	5.2	5.0	4.9	4.8
Recovery, %							
Trident	0%	0%	97%	97%	97%	97%	97%

PRODUCTION, koz							
Trident	-	-	131	198	186	182	180
Growth				51%	-6%	-2%	-1%

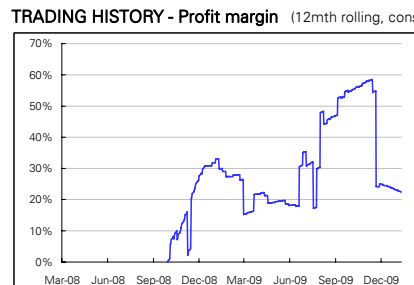
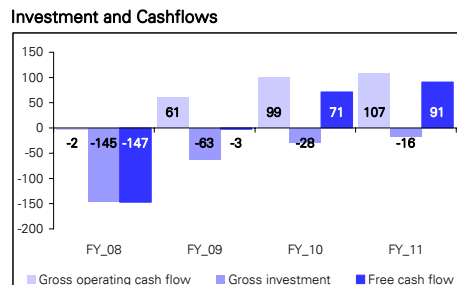
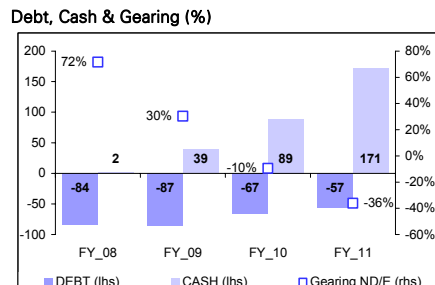
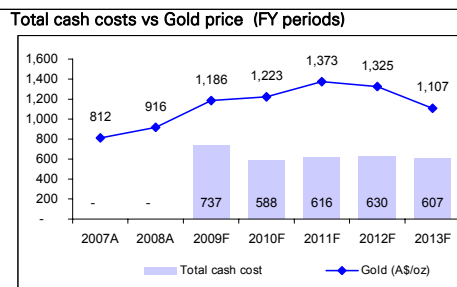
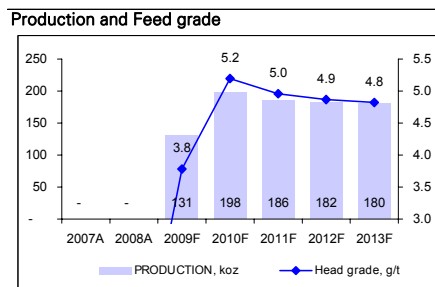
TRIDENT COSTS								
Underground mining	A\$/t mined	-	-	12	46	43	44	45
Processing	A\$/t milled	-	-	9	26	25	26	26
General and Admin	A\$/t milled	-	-	3	7	7	7	7
Operating cash costs	A\$/t milled	-	-	71	73	72	74	74
Operating cash costs	A\$/oz	-	-	650	449	464	486	495
Total cash cost	A\$/oz	-	-	737	588	616	630	607

CAPEX, A\$M								
Trident - Development		-	-	63	18	6	6	6
Trident - Sustaining		8	8	8	8	6	6	6
Exploration		5	5	10	10	10	10	10
TOTAL		13	13	81	36	22	22	22

SENSITIVITY ANALYSIS (EPS Change (%) for a 10% change in)								
AUDUSD					-13%	-19%	-19%	-23%
Gold					14%	21%	21%	26%

RESERVES & RESOURCES				VALUE				
P&P Reserves	.6Moz			EV/Reserve	A\$/oz	843	US\$/oz	614
M&I Resources	.8Moz			EV/Resource	A\$/oz	611	US\$/oz	445
				(equity share, 2009)				

	A\$m	A\$/sh	(%)
NPV (HD10)			
Trident	409	1.48	82%
Hedging	0	0.00	0%
Corporate/Other	(53)	(0.19)	-11%
Other	63	0.23	13%
Exploration	50	0.18	10%
Investments	0	0.00	0%
net debt	(19)	(0.07)	-4%
TOTAL	493	1.80	100%
WACC	10.5%	Shares	259M



Source: Company data, DB estimates, Datastream

Investment thesis

Outlook

Avoca Resources operates the Trident underground gold mine at Higginsville, 150km southeast of Kalgoorlie in the Eastern Goldfields of Western Australia. The mine is now running at design levels, having been commissioned in late 2008 and ramped up through 2009. The key to forming a positive outlook on the company is accepting the projections of a +8yr mine life. Having gained insights and confidence into the geology, operations and exploration work, we have determined to factor in 10yrs of production. We have a positive view of the operating cash costs (less than A\$500/oz) and the forward multiples. Buy.

Valuation

We derive a \$1.80/sh valuation using a life-of-mine DCF. Our target price is set at a 1.35x NPV multiple. This is below the midpoint of the 1x-2x range achieved by gold equities; it reflects the early stage of production and only 10yr mine life. The TP gives a 12-month rolling PER of 8.5x, the midpoint of the 4x-12x peer group range. At the TP P/CFPS would be 6x, against the 2x-8x peer range. We use a 10.5% WACC (Beta 1.25, Re 12.2%, Rd 8.0%, Gearing 25%).

Risks

With the mine and mill now operating at or above design capacities, we believe much of the operational risk has dissipated. Looking ahead, the key downside risk concerns our expectation that +8yrs of mine life can be delivered and there will be consistency of grade below the 1005 level where mining is currently underway. Recently AVO has engaged in attempted M&A activity, a scrip deal for Dioro Exploration; the initial offer closed but with significant take-up (45%). AVO has recently announced a second bid now that its smaller rival, Ramelius Resources, has declared its competing bid for Dioro final. AVO's offer is for \$0.65 and 0.325 Avoca shares for every Dioro share, a total consideration of ~\$46mn for the remaining stake. We see moving a step closer to resolving this issue as a positive as it has distracted the market since the first bid was announced in April.

Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Avoca Resources	AVO.AX	1.62 (AUD) 29 Jan 10	NA

*Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies.

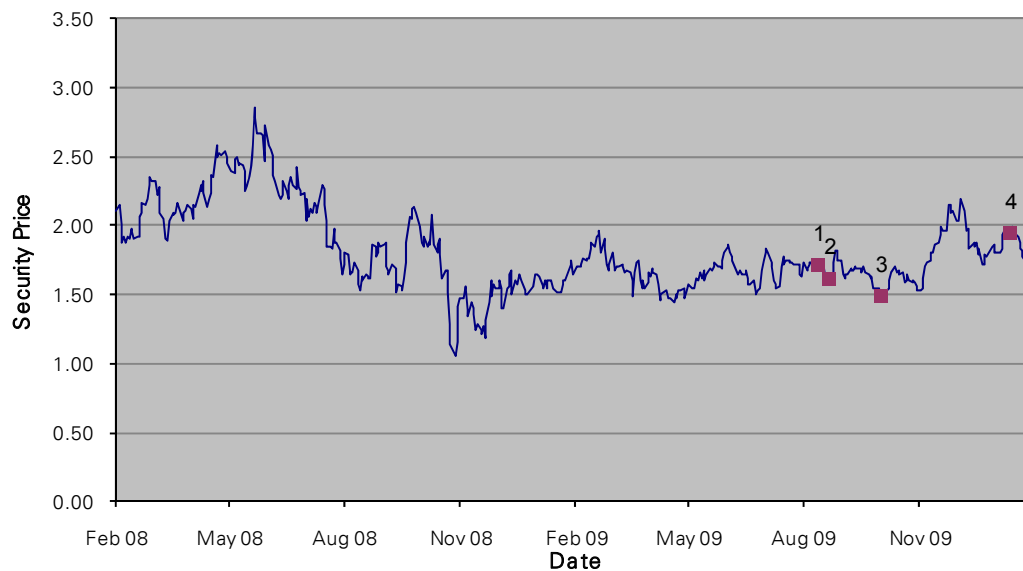
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Historical recommendations and target price: Avoca Resources (AVO.AX)

(as of 1/29/2010)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

*New Recommendation Structure as of September 9, 2002

1.	12/8/2009:	Buy, Target Price Change AUD2.10	3.	1/10/2009:	Buy, Target Price Change AUD2.30
2.	21/8/2009:	Buy, Target Price Change AUD2.00	4.	12/1/2010:	Buy, Target Price Change AUD2.40

Equity rating key Equity rating dispersion and banking relationships

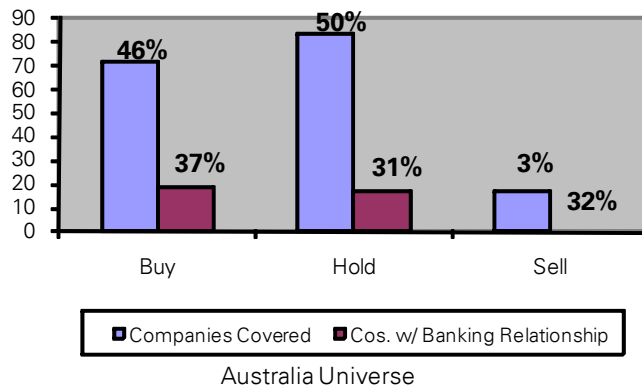
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