

Avoca Resources Limited

FY09 Result

Materials | Metals & Mining | Australia

Result:

- **NPAT (reported):** loss of \$16.3m (GSJBW loss \$2.5m)
- **NPAT (adjusted):** loss of \$6.8m (GSJBW loss \$2.5m)

Key Take-outs:

- **Underlying result was a little weaker** than we expected.
- Key areas of difference:
 - **Higher D&A** \$42.4m vs GSJBW \$36m
 - **Employee benefits expense:** \$13.6m vs GSJBW \$7m
 - Offset by tax benefit of \$7m vs GSJBW benefit \$1.2m
- **Net operating cash flow** was in line with our forecast, however capex and exploration costs were higher than we expected.
- Together this resulted in **higher net debt** than we forecast at \$47.6m (GSJBW \$39m).

Earnings and Valuation Impact:

- We **have raised our D&A charge going forward to \$230/oz** (from \$220/oz). This together with the higher net debt position results in small earnings downgrades over the forecast period.

Investment View:

- We maintain the BUY recommendation and 12-Month Price Target of \$2.30.
- AVO has a strong, high-grade production profile with Trident now operating at design rates ~45koz - 50koz per quarter.
- AVO looks inexpensive on our estimates FY10 11x PER; 6x PCF; 4x EV/EBITDA but has limited further growth from Trident in the near term. AVO thus needs to increase exploration expenditure at Trident to lengthen the LOM and needs to add an additional production base to diversify production risk and provide growth.
- With the unsuccessful (at this point) bid for Dioro, AVO now has a minority equity stake which we believe is a sub-optimal outcome, but we do believe that AVO was correct not to chase the asset and overpay.

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BUY

Key Information

Stock Code	AVO
Share Price	\$1.75
12 Month Price Target	\$2.30
Expected 12M Total Return	31.4%

Investment Data

Issued Capital	271.4m
Market Capitalisation	\$475m
% of S&P 200 Index	0.0%
Free Float	100%
Turnover	\$25.8m/month
12 Month Price Range	217¢-88¢
Debt/Equity	-16.9%

Investment Arithmetic

Jun year end	09A	10E	11E	12E
Net Profit Rep. (\$m)	2.6	42.0	44.5	51.3
NPAT Pre-NRI's (\$m)	-6.9	42.0	44.5	51.3
EPS Adj. (¢)	-2.9	15.5	16.3	18.8
EPS Growth (%)	nm	nm	5.2	15.3
PER (x)	nm	11.3	10.7	9.3
Relative PER (%)	nm	-30.7	-13.5	-13.0
Dividend (¢)	0.0	0.0	0.0	0.0
Yield (%)	0.0	0.0	0.0	0.0
Franking (%)	0	100	100	100
FCFPS (¢)	16.2	27.4	26.7	28.5
P:FCFPS (x)	10.8	6.4	6.6	6.1
EV/EBITDA (x)	12.2	4.2	3.6	2.8
BV (¢)	67	58	58	58
P/BV (x)	2.6	3.0	3.0	3.0
Av. Full Dil. Shares (m)	233.5	270.6	272.3	272.3

Share Price Chart



Relative Price Performance

	1m	3m	12m
vs. S&P 200:	0.6%	-20.4%	7.2%
vs. MSCI - World:	5.0%	-8.7%	12.4%

Source: Company data, IRESS, and GSJBW Research estimates.

RECOMMENDATION – OUR THINKING

We maintain the BUY recommendation and 12-Month Price Target of \$2.30.

AVO has a strong, high-grade production profile with Trident now operating at design rates ~45koz – 50koz per quarter.

AVO looks inexpensive on our estimates FY10 11x PER; 6x PCF; 4x EV/EBITDA but has limited further growth from Trident in the near term. AVO thus needs to increase exploration expenditure at Trident to lengthen the LOM and needs to add an additional production base to diversify production risk and provide growth.

With the unsuccessful (at this point) bid for Dioro, AVO now has a minority equity stake which we believe is a sub-optimal outcome, but we do believe that AVO was correct not to chase the asset and overpay.

KEY TAKE-OUTS FROM THE RESULT

Bottom line result was lower than we expected

- NPAT (reported): loss of \$16.3m (GSJBW loss \$2.5m)
- NPAT (adjusted): loss of \$6.8m (GSJBW loss \$2.5m)
- Key areas of difference:
 - Higher D&A \$42.4m vs GSJBW \$36m
 - Employee benefits expense: \$13.6m vs GSJBW \$7m
 - Offset by tax benefit of \$7m vs GSJBW benefit \$1.2m

Cash Flow and Balance Sheet

- Net operating cash flow was in line with our estimate at \$51.9m (GSJBW \$51.3m)
- Capex and exploration cost were \$63m (GSJBW \$54m)
- Net debt (including convertible bonds) was \$47.6m (GSJBW \$39m)

EARNINGS AND VALUATION IMPACT

Incorporating today's actuals results in a slight earnings downgrade to FY09. Given our depreciation estimate was lower than AVO's, we have taken this opportunity to lift our depreciation charge to A\$230/oz (was A\$220/oz) which has resulted in earnings downgrades throughout the forecast period.

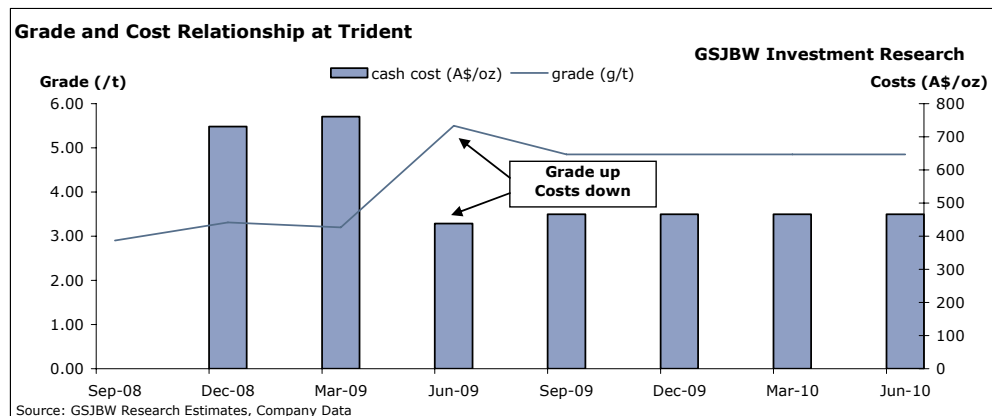
The higher net debt position (including the convertible bonds) has also increased the interest expense from FY10-FY12 and has added to the downgrades we have made to our earnings.

	NPAT (\$m)			EPS (¢)			DPS (¢)		
	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
F.'08a	-1.3	-1.3	0.0%	-0.6	-0.6	0.0%	0.0	0.0	n.a.
F.'09a	-2.5	-6.9	-4.3	-1.1	-2.9	-1.8	0.0	0.0	n.a.
F.'10e	43.5	42.0	-3.5%	16.1	15.5	-3.5%	0.0	0.0	n.a.
F.'11e	46.0	44.5	-3.4%	16.9	16.3	-3.4%	0.0	0.0	n.a.
F.'12e	52.9	51.3	-3.1%	19.4	18.8	-3.1%	0.0	0.0	n.a.
DCF Valuation (¢/share):				Old	New	% Chg.			
Base Valuation				1.26	1.24	-1.9%			
Source: Company data, GSJBW Research estimates									

OUTLOOK AND KEY STOCK DRIVERS

Continuation of solid grades at Trident

Recently, grades at Trident have been very strong as mining has moved to the 1005 level. We expect this to continue over the coming quarters and highlight that during the June quarter there was an 11% overcall on grade. We feel this is the key to performance at the Trident mine and is paramount in driving lower costs.



Gold Price

Gold: we struggle to see the near-term catalyst for a strong run in the gold price. On a medium-term basis, we do see interest in gold picking up as the expansionary monetary policies followed globally by governments suggests a pick-up in inflation and a general lack of faith in "fait currencies".

Unsuccessful Takeover of Dioro Exploration

- We see being a minority shareholder in DIO as a disappointing outcome for AVO. In our view, AVO would have been better off owning all of (or a majority stake in) DIO or having no stake at all. Looking forward, we see a few options:
 - It can look to sell its shares on market or to an improved bid from RMS;
 - It can maintain its minority interest;
 - It can possibly do a deal with La Mancha Resources (a Canadian listed gold company which is DIO's JV partner in DIO's flagship Frog's Leg Operation and own 51%);
 - It may, in time, look to joining AVO, DIO and RMS into one entity.

RESULT DETAILS

AVOCA RESOURCES LIMITED							
PROFIT & LOSS			FY08	1H09	2H09	FY09	% chg on pcp
Revenue:	Sales	A\$m	0.0	50.1	96.3	146.4	
	Other	A\$m	0.3	0.0	0.0	0.0	
EBITDA (pre Equity Accounting)		A\$m	-5.7	2.6	34.7	37.3	-757%
	Depreciation and non-intangible amortisation	A\$m	0.1	18.3	24.2	42.5	
EBIT		A\$m	-5.8	-15.7	10.6	-5.2	-11%
	Net interest expense / (income)	A\$m	-1.9	5.3	3.4	8.7	
Consolidated Pre-tax Profit (pre NRIs)		A\$m	-3.9	-21.0	7.2	-13.8	
Less:	Tax	A\$m	-2.6	-6.3	-0.6	-7.0	
	Consolidated NPAT (pre NRIs)	A\$m	-1.3	-14.7	7.8	-6.9	
	Equity Share of Associate Profits (after tax)	A\$m	0.0	0.0	0.0	0.0	
Less:	Minorities	A\$m	0.0	0.0	0.0	0.0	
	Preference Dividends	A\$m	0.0	0.0	0.0	0.0	
NET PROFIT (pre NRIs)		A\$m	-1.3	-14.7	7.8	-6.9	418%
Non Recurring Items (after tax)		A\$m	0.0	0.0	-9.5	-9.5	
Reported Net Profit (after NRIs)		A\$m	-1.3	-14.7	-1.7	-16.3	
EPS (pre NRI's)		A\$m	-0.6	-6.6	3.6	-2.9	
Reported EPS (post NRI's)		A\$m	-0.6	-6.6	-0.4	-7.0	
P&L RATIOS:							
EBITDA / Sales	%		n.a.	n.a.	n.a.	n.a.	
EBIT / Sales	%		n.a.	n.a.	n.a.	n.a.	
Net interest cover	x		3.0	-3.0	3.1	-0.6	
Tax rate	%		66.0	30.2	-8.7	50.4	
DIVIDENDS:							
Interim / Final	¢ps		0.0	0.0	0.0	0.0	
Franking	%		0.0	0.0	0.0	0.0	
@ corporate tax rate	%		30.0	30.0	30.0	30.0	
CASH FLOW			FY08	1H09	2H09	FY09	% chg on pcp
Receipts from customers		A\$m	0.0	49.9	105.0	154.9	
Payments to suppliers and employees		A\$m	-3.0	-29.1	-68.6	-97.7	
GROSS OPERATING CASH FLOW		A\$m	-3.0	20.8	36.3	57.2	-2014%
Dividends Received:	Associates	A\$m	0.0	0.0	0.0	0.0	
	Other	A\$m	0.0	0.0	0.0	0.0	
Net Interest Paid		A\$m	3.6	-3.6	-1.6	-5.2	
Income Taxes Paid		A\$m	0.3	0.0	0.0	0.0	
Other		A\$m	0.0	0.0	0.0	0.0	
NET OPERATING CASH FLOW		A\$m	0.9	17.2	34.8	52.0	5663%
Capital Expenditure		A\$m	-133.9	-31.5	-23.8	-55.4	
Proceeds from Sale of PP&E		A\$m	0.0	0.0	0.0	0.0	
Net Proceeds from Sale of Investments / Assets		A\$m	0.0	0.0	0.0	0.0	
Exploration		A\$m	-11.0	-4.6	-3.4	-8.0	
Other		A\$m	0.0	0.0	0.0	0.0	
NET INVESTING CASH FLOW		A\$m	-144.9	-36.1	-27.2	-63.4	-56%
Dividends Paid		A\$m	0.0	0.0	0.0	0.0	
Proceeds from Equity Issues		A\$m	6.2	0.2	29.3	29.5	
Proceeds from Convertible Debt		A\$m	0.0	0.0	0.0	0.0	
Payments for Share Buy-back		A\$m	0.0	0.0	0.0	0.0	
Proceeds from borrowings		A\$m	30.0	20.0	16.2	36.2	
NET FINANCING CASH FLOW		A\$m	36.2	20.2	45.5	65.7	81%
NET CHANGE IN CASH		A\$m	-107.8	1.3	53.0	54.3	-150%
CASH FLOW RECONCILIATION:							
EBITDA		A\$m	-5.7	2.6	34.7	37.3	
Net Decrease / (Increase) in Working Capital		A\$m	-3.6	7.6	8.4	16.0	
Other		A\$m	6.3	10.7	-6.8	3.9	
GROSS OPERATING CASH FLOW		A\$m	-3.0	20.8	36.3	57.2	
CASH FLOW RATIOS:							
Gross Operating Cash Flow / EBITDA	%		53%	815%	105%	153%	
Capital Expenditure / Depreciation	x		1,151.7	1.7	1.0	1.3	
Capital Expenditure / Sales	x		n.a.	n.a.	n.a.	n.a.	
Free Cash Flow (pre Dividends)		A\$m	-143.9	-18.9	7.5	-11.4	
(post Dividends)		A\$m	-143.9	-18.9	7.5	-11.4	

Source: Company data

Financial Summary | AVO

Avoca Resources Ltd							Current Price A\$: \$1.75		Mkt Cap.: \$427m		Free Float 100%		Recommendation: BUY		
							GSJBW DCF: \$1.25		ASX Code: AVO		Price Target: \$2.30		Analyst: Stephen Gorenstein		
							Industry: Gold		T'over (mth): \$28m		Data as at:		31-Aug-09		
Investments Statistics							Profit & Loss								
	Year end	June	2008a	2009a	2010e	2011e	2012e	Year end	June	2008a	2009a	2010e	2011e	2012e	
Net Profit (reported)	(A\$m)		-1	-16	42	44	51	Sales Revenue (excl JV & Assoc.)		0	146	220	224	224	
- EPS (Reported) 1	(¢)		-0.6	-7.0	15.5	16.3	18.8	Operating costs		7	109	16	22	20	
- PER (Reported) 1	(X)		n.a.	-25.0	11.3	10.7	9.3	Operating EBITDA		-7	37	106	102	105	
NET PROFIT (Adj.) 2	(A\$m)		-1	-7	42	44	51	D&A		0	42	44	42	39	
- EPS (Adj.) 2	(¢)		-0.6	-2.9	15.5	16.3	18.8	Operating EBIT		-7	-5	62	61	66	
- EPS Growth	(%)		n.a.	400%	n.a.	5%	n.a.	JV & Assoc.		0	0	0	0	0	
- PER (Adj.) 2	(X)		n.a.	n.a.	11	11	9	EBIT		-7	-5	62	61	66	
Dividend	(¢)		0.0	0.0	0.0	0.0	0.0	Net Interest Exp./Rev)		-3	9	3	1	-2	
- Yield	(%)		0.0%	0.0%	0.0%	0.0%	0.0%	PreTax Profit (pre ab's)		-4	-14	59	60	68	
- Franking	(%)		0	0	100	100	100	Tax Expense (pre abs)		-3	-7	18	18	20	
Free Cash Flow	(A\$m)		-10	38	74	73	78	Minorities (after Tax)		0	0	0	0	0	
- P/FCF 4	(X)		n.a.	10.8	6.4	6.6	6.1	Prof. Dividends		0	0	0	0	0	
EV(Adj.)/EBITDA 3	(X)		n.a.	12.2	4.2	3.7	2.9	NET PROFIT (Pre NRI's) 1		-1	-7	41	42	48	
Avg. Shares (diluted)	(mill)		218	234	271	272	272	Abnormal Items (after Tax)		0	-9	1	2	4	
EV Analysis / DCF Valuation							Cash Flow Analysis								
A\$ DCF Valuation: 1.25							Upside DCF: 2.25								
Price / DCF: 1.40							WACC: 10.9%								
Ke: 13.7%							RF: 6.5%								
Kd: 5.3%							MRP: 6.0%								
BETA: 120															
	Year end	June	2008a	2009a	2010e	2011e	2012e	Year end	June	2008a	2009a	2010e	2011e	2012e	
EV (Adj.) 3	(A\$m)		464	456	447	377	300	Operating EBITDA		-7	37	106	102	105	
EV (Adj.) / EBITDA	(X)		n.a.	12.2	4.2	3.7	2.9	change in working cap.		4	20	4	3	3	
EV (Adj.) / Sales	(X)			3.1	2.0	1.7	1.3	Gross Cashflow		-3	57	110	105	108	
EV (Adj.) / Gross CF	(X)			-65.3	8.0	4.1	3.6	2.8	Net Interest Paid		4	-5	-5	-1	2
Balance Sheet							ROE Analysis								
	Year end	June	2008a	2009a	2010e	2011e	2012e	Year end	June	2008a	2009a	2010e	2011e	2012e	
Cash			2	39	113	86	263	EBIT/Sales		(X)	n.a.	-0.04	0.28	0.27	
Property, Plant, Equip			173	177	177	177	177	Pretax Profit/EBIT		(X)	0.55	2.67	0.94	0.99	
Other Assets			61	72	72	72	72	NPAT / Pretax Profit		(X)	0.41	-0.79	11.77	72.50	
Debt			84	87	87	87	87	Sales/Assets		(X)	0.00	0.51	0.61	0.52	
Shareholders Equity			16	57	57	57	57	Assets/Equity		(X)	2.04	183	2.30	2.76	
Net Debt / Equity	(%)		72%	30%	n.a.	n.a.	n.a.	Return on Equity (ROE)		(%)	-1%	-4%	26%	27%	
Net Debt / (D+E)	(%)		42%	23%	n.a.	n.a.	n.a.	ROCE WACC Analysis							
Annual Production							Year end June 2008a 2009a 2010e 2011e 2012e								
Gold	000 oz		0	11	119	111	170	Adjusted NOPAT	(A\$m)	-1	-7	42	44	51	
Cash Costs							Year end June 2008a 2009a 2010e 2011e 2012e								
Trident (excl. royalty)	A\$/oz		0	653	443	488	517	Adj Cap employed	(A\$m)	120	202	168	94	9	
Commodity Prices							Year Average to June 2008a 2009a 2010e 2011e 2012e								
Currency	A\$/US\$		0.89	0.75	0.81	0.79	0.78	ROCE	(%)	-1%	-3.4%	25.0%	47.1%	266.9%	
Gold Price Spot	A\$/oz		919	1167	1163	1242	1318	WACC	(%)	10.9%	10.9%	10.9%	10.9%	10.9%	
Gold Price Received	A\$/oz		0	1115	1163	1242	1318	ROCE Spread	(abs)	-12%	-14%	14%	36%	256%	
Earnings Sensitivity							Year end June 2008a 2009a 2010e 2011e 2012e								
Gold Price (+/-US\$ 1/oz)	A\$m		n.a.	0.9	17	14	11	Change in ROCE	(abs)	14%	-2%	28%	22%	220%	
AUD/USD (+/- 1¢)	A\$m		n.a.	-11	-19	-17	-15								

(1) Net Profit - Adjusted is after share based compensation and pref dividends, and before goodwill amortisation, NRI's and other non-operating AIFRS adjustments.
(2) Net Profit (Adj.) is before goodwill amortisation, NRI's and after Pref. Divs.
(3) EV Includes 100% of M.k.t. Value of minorities
(4) ROE excludes Preference Capital
Source: Company data, IRESS, and GSJBW Research estimates.

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Australia - Research Recommendation Definitions

Sell (S)	Stock is expected to underperform the S&P/ASX 200 for 12 months
Hold (H)	Stock is expected to perform in line with the S&P/ASX 200 for 12 months
Buy (B)	Stock is expected to outperform the S&P/ASX 200 for 12 months

Other Definitions

NR	Not Rated. The investment rating has been suspended temporarily. Such suspension is in compliance with applicable regulations and/or Goldman Sachs JBWere policies in circumstances when Goldman Sachs JBWere is acting in an advisory capacity in a merger or strategic transaction involving the company and in certain other situations
CS	Coverage Suspended. GSJBW has suspended coverage of this company.
NC	Not Covered. GSJBW does not cover this company.

Price Target

Analysts set share price targets for individual companies based on a 12 month horizon. These share price targets are subject to a range of company specific and market risks. Target prices are based on a methodology chosen by the analyst as the best predictor of the share price over the 12 month horizon.

Research Criteria Definitions

The above recommendations are primarily determined with reference to the recommendation criteria outlined below. Analysts can introduce other factors when determining their recommendation, with any material factors stated in the written research where appropriate. Each criterion is clearly defined for the research team to ensure consistent consideration of the relevant criteria in an appropriate manner.

Prior to 20 July 2007, GSJBW had a dual-horizon recommendation system: Short Term & Long Term. The Short Term factors were Relative Earnings Outlook, Earnings Momentum, News Flow, Relative Performance, and Valuation Support. The Long Term factors were Industry Structure, EVA Trend, Growth Option and Price/DCF.

Industry Structure:	Based on Goldman Sachs JBWere industry structure ranking. All industries relevant to the Australian equity market are ranked, based on a combination of Porter's Five Forces of industry structure as well as an industry's growth potential, relevant regulatory risk and probable technological risk. A company's specific ranking is based on the proportion of funds employed in particular industry segments, aggregated to determine an overall company rating, adjusted to reflect a view of the quality of a company's management team.
EVA Trend: ¹	EVA trend forecast for coming 2 years. Designed to reflect "turnaround stories" or to highlight companies Goldman Sachs JBWere analysts believe will allocate capital poorly in the estimated timeframe.
Earnings Momentum:	The percentage change in the current consensus EPS estimate for the stock (year 1) over the consensus EPS estimate for the stock 3 months ago. Stocks are rated according to their relative rank, effectively making it a market relative measure
Catalysts:	A qualitative and quantitative assessment of a company's long term catalysts that the analyst believes should be considered and possibly recognised by the market.
Price:Base Case DCF:	The premium or discount to base case DCF valuation at which the stock is trading relative to the average premium or discount across the market.

For Insurers

EVA Trend: ¹	ROE is used as a proxy for EVA. Rating takes into account the expected level and trend of ROE over the next 2-3 years.
Balance Sheet:	Analyst's assessment of the quality and strength of the insurer's balance sheet, including conservatism of provisioning, sufficiency of capital, and quality of capital.

For REITs

Strategy:	Used instead of industry structure as many REIT investors are intra rather than inter sector focussed.
EPU Growth:	Ranking of Earnings Per Unit growth relative to other listed Real Estate Investment Trusts. Used instead of EVA Trend.
Yield:	Yield relative to the REIT sector average. Used instead of Earnings revision.

For NZ Companies

Relevant Index:	If a research report is published by the New Zealand affiliate of Goldman Sachs JBWere, the recommendation of a company or trust is based on their performance relative to the NZSX 50 Index (Gross) and not the S&P/ASX 200 index.
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¹ EVA is a registered trademark of the U.S. consultancy firm Stern Stewart

Distribution of Recommendations – as at 30 June 2009

Recommendation	Overall	Corporate relationship* in last 12 months
Sell	13%	11%
Hold	66%	66%
Buy	21%	23%

* No direct linkage with overall distribution as the latter relates to the full Goldman Sachs JBWere stock coverage (>250 companies). The above table combines the corporate relationships and recommendations of both Goldman Sachs JBWere Pty Ltd and its affiliate in New Zealand, Goldman Sachs JBWere (NZ) Limited.