

Avoca Resources (AVO)

Accumulate

Price	\$1.73
Target (12mth)	\$1.85
Expected return	7.0%

Company data & Ratios

Enterprise value	\$440m
Market Cap	\$379m
Issued Capital	249m
Net Cash(Debt)	(\$60m)
Free Float	80%
12 mth price	\$0.88-2.91

Board of Directors

Robert Reynolds (Ch), Rohan Williams (MD), Stephanie Unwin, David Quinlivan, Jan Castro.

Shareholders

Pala Invest. 18.9%, Rex Minerals 8.3%, Comm Bank 6.5%

Resources

1.4moz, 3.7g/t

Reserves

0.6moz, 5.3g/ts

Investment view

AVO is a highly successful explorer and a new Australian producer. The core Higginsville mine in WA is about to hit its straps as grades improve following a long, 6 month ramp-up. Production is planned to be up to 190kozpa and management is confident of a ten year mine life. **This is a quality junior but the current takeover bid for Dioro, until completion, puts its rating back a notch to Accumulate.**

Key operations – Trident mine at Higginsville

The Trident underground mine is located in the proven gold territory of Higginsville, between Kambalda and Central Norseman in WA. Trident was discovered by AVO adjacent to the old Poseidon South mine by exploiting the opportunity of deeper drilling. A new 1.0Mtpa treatment plant was constructed on site and is performing well at full capacity. The ramp up has been slow with low grades mined initially but design parameters are now being achieved. Operating costs are expected to settle down at under \$650/oz.

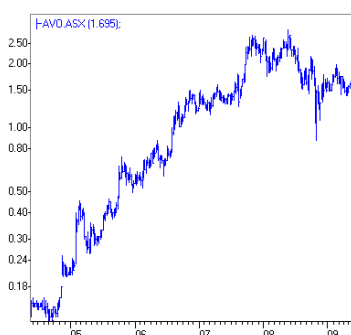
Opportunities – Exploration and Dioro

AVO's exploration expertise is almost certainly going to deliver additional resources and reserves. Nearby, Two Boys (u/g), Chalice (123koz u/g resource), Fairplay (o/c), Musket (o/c), Wills (o/c) as well as extensions to Trident provide opportunities. Underground diamond drilling recently identified the new Eos Lode at Trident. Regionally, prospects are the high grade Vine prospect and Musket. AVO announced a \$49m scrip offer for the strategically compatible Dioro Exploration on 14 April 2009 that operates the Frog's Leg and South Kalgoorlie mines. The takeover would lift AVO's output to over 250kozpa.

Risks – yet to establish track record as a producer

AVO has debt of over \$100m comprising a secured senior debt facility (\$66m) and convertible bonds (\$38m). AVO has yet to establish a track record as a producer but Trident should be operating at design grades and rates in the June quarter. The ramp up has been disappointing with respect to grade which has implications for costs and reflective of the structural variation of Trident's different ore bodies.

Absolute Price



SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Earnings Forecast

Year end June (excl Dioro)	2008a	2009f	2010f	2011f
NPAT (reported) (A\$m)	-1.3	-1.1	65.5	60.1
NPAT (adjusted) (A\$m)	-1.3	-1.1	65.5	60.1
EPS (adjusted) (cps)	-0.6	-0.5	26.0	23.7
EPS growth (%)	na	na	na	-9.0
PER (x)	na	-383.3	6.6	7.3
P/CFPS (x)	na	10.4	4.8	5.2
EV/EBITDA (x)	na	15.9	3.5	2.8
Dividend (¢ps)	0.0	0.0	0.0	0.0
Yield (%)	0.0	0.0	0.0	0.0
ROE (%)	-1.1	-0.7	24.1	16.6

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Avoca Resources (AVO)

Investment Indicators

Production > 160koz pa. The 1.0Mtpa Higginsville mill is capable of producing between 150 and 190koz pa depending on grade, with an average of over 160kozpa.

Cash operating costs, we estimate to be around \$650/oz, including royalties, following completion of the ramp up phase.

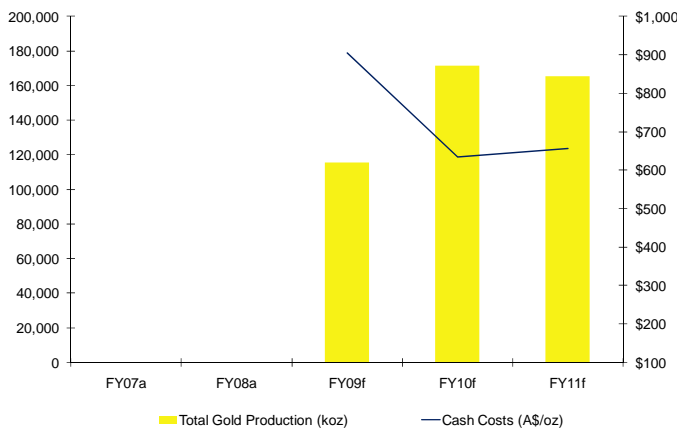
NPV of \$1.17 (SCE base case) gives AVO a share price premium to valuation of just 38% and a target price premium to valuation of 54%.

NPV sensitivity to gold price. AVO's hedging is in the form of put options totalling 364,976oz (end Dec 08) protecting A\$ gold price moves below A\$830/oz and leaving the company fully exposed to gold price upside.

Free cash flow should turn positive as operations reach design rates with FY10 shaping up to be the first full year of positive free cash flow.

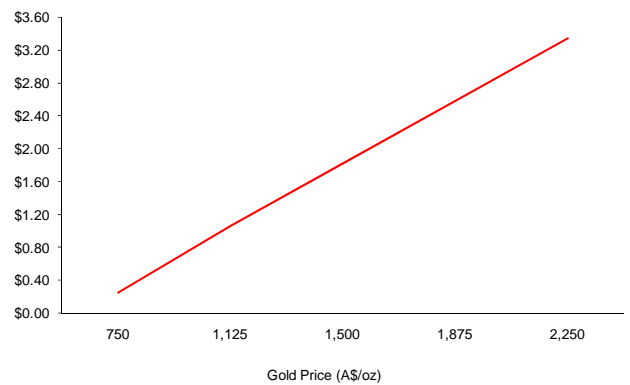
Net debt of \$60m. At the end of March AVO had cash at bank and liquids of \$43m, a senior debt facility of \$66m and 2012 convertible bonds of \$38m. \$15m of the senior debt is due within 12 months. Our projections show net cash building in FY10 and FY11.

Figure 48 - Production and Costs



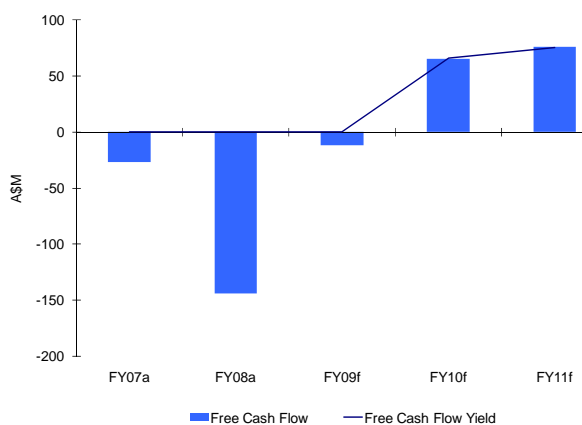
SOURCE: COMPANY AND SOUTHERN CROSS EQUITIES ESTIMATES

Figure 49 - NPV Sensitivity to Gold Price



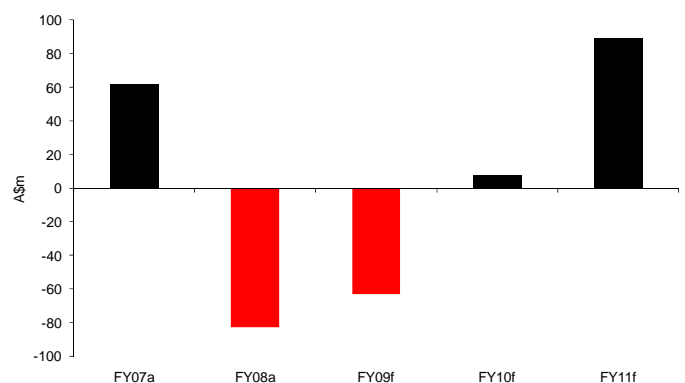
SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Figure 50 - Free Cash Flow and Yield



SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Figure 51 - Net Cash (Debt)



SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Table 6 - Financial summary

Avoca Resources (AVO)						Share price: A\$	\$ 173				
As at 27-May-09						Market Cap: A\$	\$ 430				
PROFIT AND LOSS (A\$)						VALUATION DATA (A\$)					
Y/e Jun 30	2007a	2008a	2009f	2010f	2011f	Y/e Jun 30	2007a	2008a	2009f	2010f	2011f
Sales revenue	0	0	140	229	226	Net profit adj (\$m)	-1	-1	-1	65	60
EBITDA	-3	-3	28	106	104	EPS (c)	-3.1	-0.6	-0.5	26.0	23.7
D&A	0	0	-29	-26	-25	EPS growth (%)	na	na	na	na	-9
Other	-1	0	0	0	0	P/E ratio (x)	na	na	-383.3	6.6	7.3
EBIT	-3	-3	-1	80	79	CFPS (c)	-1.0	0.4	16.6	36.3	33.5
Other income (expenses)	-1	0	0	0	0	Price/CF (x)	-169	426	10.4	4.8	5.2
Net Interest Expense	3	3	-5	-2	1	DPS (c)	0	0	0	0	0
Pre-tax profit	-4	-4	-7	78	80	Yield (%)	0	0	0	0	0
Tax	3	3	6	-12	-20	Franking (%)	0	0	0	0	0
Net Profit	-1	-1	-1	65	60	EV/EBITDA	na	na	17.8	4.0	3.3
Adjustments	0	0	0	0	0	EBITDA margin (%)	na	na	20	46	46
SCEQ adj profit	-1	-1	-1	65	60	Valuation per share:					117
One-off items	0	0	0	0	0	Target price (12 mth):					185
Reported net profit	-1	-1	-1	65	60	Total Return (including yield)					7%
CASHFLOW (A\$)						PROFITABILITY RATIOS					
Y/e Jun 30	2007a	2008a	2009f	2010f	2011f	Y/e Jun 30	2007a	2008a	2009f	2010f	2011f
Receipts from customers	0	0	140	229	226	EBITDA/sales (%)	na	na	20	46	46
Payments to suppliers	-3	-3	-93	-123	-122	EBIT/sales (%)	na	na	-1	35	35
Net interest	4	4	-6	-2	1	Return on assets (%)	-3	-1	0	16	12
Tax paid	0	0	0	-12	-20	Return on equity (%)	-4	-1	-1	24	17
Other	0	0	0	0	0	Return on funds empl'd (%)	-11	-1	0	25	22
Operating cashflow	1	1	41	91	85	Dividend cover (x)	-1	0	0	0	0
Capex	-134	-134	-43	-15	-7	Effective tax rate (%)	6	66	85	16	25
Investments	-1	0	0	0	0	LIQUIDITY AND LEVERAGE					
Asset sales	0	0	0	0	0	Y/e Jun 30	2007a	2008a	2009f	2010f	2011f
Other	-11	-11	-9	-11	-2	Net debt/(cash) (\$m)	-61	83	63	-7	-89
Investing cashflow	-145	-145	-52	-26	-9	Net debt/equity (%)	-60	72	37	-3	-25
Change in borrowings	30	30	20	0	-20	Net interest cover (x)	8	7	0	-34	56
Equity raised	6	6	31	5	6	Current ratio (x)	na	na	3	5	7
Dividends paid	0	0	0	0	0	Inventory turnover	na	na	10	7	7
Other	0	0	0	0	0	Inventory/sales	na	na	7	8	8
Financing cashflow	36	36	51	5	-14	INTERIMS (A\$)					
Net change in cash	-108	-108	40	70	62	Y/e Jun 30 (\$m)	2007a	2008a	2009a	2010f	2011f
Cash at end of period	2	2	42	112	174	Sales revenue	0	0	50	109	116
BALANCE SHEET (A\$)						EBITDA	-2	1	2	48	54
Y/e Jun 30	2007a	2008a	2009f	2010f	2011f	D&A	0	0	-18	-13	-12
Cash	2	2	42	112	174	Other	-1	0	0	0	0
Receivables	2	2	7	11	11	EBIT	-2	1	-17	35	42
Inventories	11	11	11	18	18	Other income (expense)	-1	0	0	0	0
Investments	-1	0	0	0	0	Net interest	1	3	-3	-2	0
Other	17	17	60	142	203	Pre tax profit	-2	0	-21	33	42
Current assets						Tax	0	0	6	-3	-10
PPE	173	173	184	199	206	Net Profit	-2	0	-15	30	31
Investments	0	0	0	0	0	Adjustments	0	0	0	0	0
Intangibles	0	0	41	52	54	SCEQ adj profit	-2	0	-15	30	31
Other	45	45	21	21	21	One-off items	0	0	0	0	0
Non-current assets	218	218	245	271	280	Reported net profit	-2	0	-15	30	31
Total assets	236	236	305	413	483	PRODUCTION (koz)					
Payables	20	20	14	23	23	Y/e Jun 30	2007a	2008a	2009f	2010f	2011f
Debt	84	84	105	105	85	Milled (kt)			921	1000	1000
Provisions	3	3	4	4	4	Grade (g/t)			3.9	5.5	5.3
Other	12	12	10	10	10	Recovery (%)			96.8%	97.0%	97.0%
Total liabilities	120	120	133	142	122	Production (koz)			120	172	165
Shareholders' equity	116	115	172	271	362	Cash Cost (A\$/oz)			904	635	656
Minorities	0	1	0	0	0	ASSUMPTIONS					
Total shareholders funds	116	116	172	271	362	Y/e Jun 30	2007a	2008a	2009f	2010f	2011f
Total funds employed	199	199	235	264	273	Gold Price (US\$/oz)	638	823	872	1,000	1,000
W/A diluted shares on issue	218	218	249	251	254	A\$	0.79	0.89	0.75	0.75	0.75
						Gold Price (A\$/oz)	811	920	1,169	1,333	1,333

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES