

# UBS Investment Research

## Avoca Resources Limited

### Full year result pulled down by put options

#### ■ Event: Full year result – hit by derivatives

Avoca Resources reported a full year loss of \$16.3m, significantly below our estimated profit of \$2m and consensus of \$1m. The key variance was an after tax fair value loss of \$9.5m attributable to the company's gold put options and revenue of \$146m being \$6m less than our forecast of \$152m. Cash on hand at the end of the period was \$38.9m. As expected, no dividend was declared.

#### ■ Impact: Increased D&A pushes NPAT lower

Reconciling the full year report highlighted a significant variance between the reported D&A of \$42.4m versus our estimate of \$34m. This is due to our model anticipating a longer mine life than the current reserve base implies. We have subsequently adjusted our figure to match the reported amounts, resulting in NPAT downgrades of 23% in FY10e and 25% in FY11e.

#### ■ Action: Buy maintained – FY10 shaping up for a big year

We maintain our Buy on AVO due to the prospect of a strong FY10e and because of the substantial exploration upside from its tenements. The lower EPS forecasts are a function of AVO's small reserve position pushing up the D&A charges. Subsequently, we believe AVO needs to focus on increasing the reserve position at Higginsville. Drill intercepts over the last two years would suggest substantially more gold will ultimately be mined than the original reserve of 580koz implies.

#### ■ Valuation: \$1.72 (DCF, 10% discount rate)

Our valuation and target price have been increased by 8% and 5% respectively. Our target price of \$2.20 is derived from a 1.3x NPV multiple.

Highlights (A\$m)	06/08	06/09	06/10E	06/11E	06/12E
Revenues	0	146	244	241	198
EBIT (UBS)	(7)	(15)	76	75	45
Net Income (UBS)	(1)	(16)	52	54	36
EPS (UBS, A\$)	(0.01)	(0.07)	0.20	0.21	0.14
Net DPS (UBS, A\$)	0.00	0.00	0.00	0.00	0.00

Profitability & Valuation	5-yr hist av.	06/09	06/10E	06/11E	06/12E
EBIT margin %	-	-10.0	31.0	31.3	22.9
ROIC (EBIT) %	-	(7.4)	42.2	47.9	34.8
EV/EBITDA (core) x	-	16.0	3.6	3.1	3.4
PE (UBS) x	-	NM	8.7	8.3	12.6
Net dividend yield %	-	0.0	0.0	0.0	0.0

Source: Company accounts, Thomson Financial, UBS estimates. (UBS) valuations are stated before goodwill, exceptionals and other special items. Valuations: based on an average share price that year, (E): based on a share price of A\$1.75 on 28 Aug 2009 23:38 EST

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## Global Equity Research

Australia

Mining

12-month rating **Buy**  
**Unchanged**

12m price target **A\$2.20/US\$1.86**  
**Prior: A\$2.10/US\$1.77**

Price **A\$1.75/US\$1.48**

RIC: AVO.AX BBG: AVO AU

31 August 2009

#### Trading data (local/US\$)

52-wk range	A\$2.14-1.05/US\$1.80-0.65
Market cap.	A\$0.45bn/US\$0.38bn
Shares o/s	259m (ORD)
Free float	100%
Avg. daily volume ('000)	919
Avg. daily value (A\$m)	1.6

#### Balance sheet data 06/10E

Shareholders' equity	A\$0.21bn
P/BV (UBS)	2.2x
Net Cash (debt)	A\$0.04bn

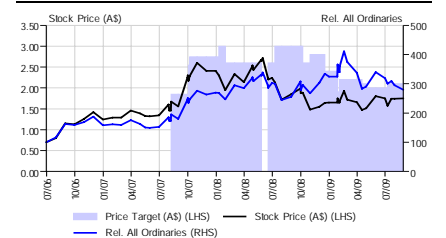
#### Forecast returns

Forecast price appreciation	+25.7%
Forecast dividend yield	0.0%
Forecast stock return	+25.7%
Market return assumption	9.0%
Forecast excess return	+16.7%

#### EPS (UBS, A\$)

	06/10E		Cons.	06/09
	From	To		Actual
H1E	0.12	0.09	-	(0.07)
H2E	0.14	0.11	-	(0.01)
06/10E	0.26	0.20	0.20	
06/11E	0.28	0.21	0.19	

#### Performance (A\$)



Source: UBS

www.ubs.com/investmentresearch

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## Avoca Resources Ltd (AVO.AX)

Analyst/s: Jo Battershill; Glyn Lawcock  
Email: jo.battershill@ubs.com  
31-Aug-09

## MARKET INFORMATION

Rating:	Buy
Price (as of 31-Aug-09):	1.75
Price Target (12 months):	2.20
Issued Capital:	259.1
Market Capitalisation:	453.5
Avg. daily turnover (US\$m):	1.2
Year end:	June
Website:	http://www.avocaresources.com.au
Major Shareholders:	Pala Investments

## INVESTMENT SUMMARY

(A\$m)	2009	2010E	2011E	2012E
Net profit [reported] (\$m)	(16.3)	51.6	54.2	35.7
Net profit [adjusted] (\$m)	(16.3)	51.6	54.2	35.7
EPS [reported] (\$)	(0.1)	0.2	0.2	0.1
EPS [adjusted, diluted] (\$)	(0.1)	0.2	0.2	0.1
EPS Growth (%)	(1132.3)	NM	4.9	(34.1)
PER [adjusted] (x)	<0.0	8.7	8.3	12.6
Dividend (\$)	0.0	0.0	0.0	0.0
Payout ratio (%)	0%	0%	0%	0%
Dividend Yield (%)	0%	0%	0%	0%
FCF Yield (%)	(0.9)	16.2	20.0	15.2
Franking (%)	0.0	0.0	0.0	0.0
Shares [period-average, diluted] (m)	233.5	257.2	257.2	257.2

## VALUATION

Valuation per share [NAV @ 6%] (\$)	1.72
Share Price Target [12 months] (\$)	2.20
Price/NAV [6% disc rate] (x)	1.02

## Operating Assets [DH09]

	A\$m	€
Higginsville	451	175
Exploration	15	6

## Gross Assets

	466	181
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Net Cash	(4)	-2
Corporate costs	(21)	-8
<b>Net Asset Value @ 10% discount rate</b>	<b>441</b>	<b>172</b>

## ENTERPRISE VALUE

(A\$m)	2009	2010E	2011E	2012E
Enterprise Value	515	449	375	303
EV/EBITDA (x)	18.6	3.6	3.1	3.4
EV/Operating Free Cash Flow (x)	297.6	6.1	4.2	4.7

## EPS SENSITIVITIES

Commodity	Base Change	2010E	2011E	2012E
		EPS Change		
Gold price	10%	28.0%	27.0%	36.0%
Currency	5c	-16.0%	-16.0%	-21.0%

## CASH FLOW

(A\$m)	2009	2010E	2011E	2012E
Operating income [EBIT, UBS]	(15)	76	75	45
Depreciation & Amortisation	42	48	46	43
Net change in working capital	29	0	0	0
Other (operating)	0	0	0	0
<b>Pre-tax op cash flow</b>	<b>57</b>	<b>124</b>	<b>121</b>	<b>88</b>
Interest (paid) / received	(5)	(2)	2	6
Tax paid	7	(22)	(23)	(15)
Other	(7)	0	0	0
<b>Operating cash flow</b>	<b>52</b>	<b>100</b>	<b>100</b>	<b>79</b>
Capital expenditure	(55)	(27)	(10)	(11)
<b>Free cash flow</b>	<b>(4)</b>	<b>73</b>	<b>90</b>	<b>68</b>
Net (acquisitions) / disposals	0	0	0	0
Dividends paid (Common)	0	0	0	0
Shares issued/(repurchased)	29	0	0	0

## COMPANY DESCRIPTION

Avoca Resources Limited (AVO) controls 2,700sqkm between the world-class Norseman and St Ives Goldfields in Western Australia. AVO is producing gold from the Trident deposit at the 100%-owned Higginsville project 150km south of Kalgoorlie. Production for CY10 is estimated at +190koz at cash costs of ~A\$475/oz excluding royalties. AVO believes a mine life of at least 10 years is achievable at Higginsville given the highly prospective area and positive exploration results. Future production is expected to be sourced from other deposits in the region including the Chalice and Two Boys projects.

## OPERATIONAL ASSUMPTIONS

Commodity Prices	1H10E	2H10E	2009	2010E	2011E	2012E
Gold price (US\$/oz)	984	1,038	864	1,011	1,044	917
A\$:US\$	0.80	0.80	0.73	0.80	0.80	0.80
<b>Production (koz)</b>						
Higginsville	95	98	130	193	184	173
<b>Cash costs including state royalty</b>						
Higginsville (A\$/oz)	460	456	642	458	473	478
Higginsville (US\$/oz)	368	365	469	366	379	383
<b>Cash costs including private royalty</b>						
Higginsville (A\$/oz)	572	578	701	575	596	579
Higginsville (US\$/oz)	458	462	512	460	477	463

## DIVISIONAL BREAKDOWN [EBIT]

(A\$m)	1H10E	2H10E	2009	2010E	2011E	2012E
Higginsville	39	46	23	85	85	55

## PROFIT &amp; LOSS

(A\$m)	1H10E	2H10E	2009	2010E	2011E	2012E
Sales Revenue	117	127	146	244	241	198
<b>Operating Cash Profit</b>	<b>63</b>	<b>70</b>	<b>54</b>	<b>133</b>	<b>131</b>	<b>98</b>
Depn & Amortisation	(24)	(24)	(42)	(48)	(46)	(43)
<b>Operating Profit</b>	<b>39</b>	<b>46</b>	<b>12</b>	<b>85</b>	<b>85</b>	<b>55</b>
Exploration	(0)	(3)	(3)	(3)	(5)	(5)
SGA	(4)	(2)	(23)	(6)	(4)	(4)
<b>EBIT</b>	<b>34</b>	<b>41</b>	<b>(15)</b>	<b>76</b>	<b>75</b>	<b>45</b>
Net interest	(1)	(1)	(9)	(2)	2	6
<b>Profit before tax</b>	<b>33</b>	<b>41</b>	<b>(23)</b>	<b>74</b>	<b>77</b>	<b>51</b>
Tax expense	(10)	(12)	7	(22)	(23)	(15)
Equity Associated NPAT	0	0	0	0	0	0
Minority Interests	0	0	0	0	0	0
Dividends [preferred]	0	0	0	0	0	0
<b>Net Profit [reported]</b>	<b>23</b>	<b>28</b>	<b>(16)</b>	<b>52</b>	<b>54</b>	<b>36</b>
Abnormal Gain/(Loss) after Tax	0	0	0	0	0	0
<b>Net Profit [adjusted]</b>	<b>23</b>	<b>28</b>	<b>(16)</b>	<b>52</b>	<b>54</b>	<b>36</b>

EBITDA margin (%)	19.0	50.8	50.5	44.7
Net Interest Cover [EBIT] (x)	1.7	(40.9)	38.1	8.0
Tax Rate (%)	NM	30.0	30.0	30.0
EBIT/Total Assets (%)	(5.1)	22.1	18.9	10.4
NPAT/Equity (%)	(10.3)	24.7	20.6	11.9

## BALANCE SHEET [Selected Items]

(A\$m)	2009	2010E	2011E	2012E
Net Working capital	(27)	(27)	(27)	(27)
Fixed Assets	177	155	120	87
Net Other	36	43	50	57
<b>Capital Employed</b>	<b>186</b>	<b>172</b>	<b>143</b>	<b>117</b>
Net Cash / (Debt)	(29)	37	120	181
<b>Total Equity [incl. minorities]</b>	<b>157</b>	<b>209</b>	<b>263</b>	<b>299</b>
Minorities	0	0	0	0
Net Debt / Equity (%)	18.4	(17.8)	(45.7)	(60.8)
Book Value per Share(\$)	0.61	0.81	1.02	1.16

Source: Company accounts, UBS estimates. UBS valuations are stated before goodwill, exceptionals and other special items. Note: For some companies, the data represents an extract of the full company accounts.

Source: UBSe

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## ■ Avoca Resources Limited

Avoca Resources Limited (AVO) controls 2,700sqkm between the world-class Norseman and St Ives Goldfields in Western Australia. AVO is producing gold from the Trident deposit at the 100%-owned Higginsville project 150km south of Kalgoorlie. Production for CY10 is estimated at +190koz at cash costs of ~A\$475/oz excluding royalties. AVO believes a mine life of at least 10 years is achievable at Higginsville given the highly prospective area and positive exploration results. Future production is expected to be sourced from other deposits in the region including the Chalice and Two Boys projects.

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UBS 12-Month Rating	Rating Category	Coverage <sup>1</sup>	IB Services <sup>2</sup>
Buy	Buy	44%	38%
Neutral	Hold/Neutral	39%	36%
Sell	Sell	17%	25%
UBS Short-Term Rating	Rating Category	Coverage <sup>3</sup>	IB Services <sup>4</sup>
Buy	Buy	less than 1%	33%
Sell	Sell	less than 1%	33%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 30 June 2009.

### UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	Definition
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

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**Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

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**UBS Securities Australia Ltd:** Jo Battershill; Glyn Lawcock; Daniel Morgan.

**Company Disclosures**

Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
Avoca Resources Limited <sup>4, 13</sup>	AVO.AX	Buy	N/A	A\$1.75	28 Aug 2009

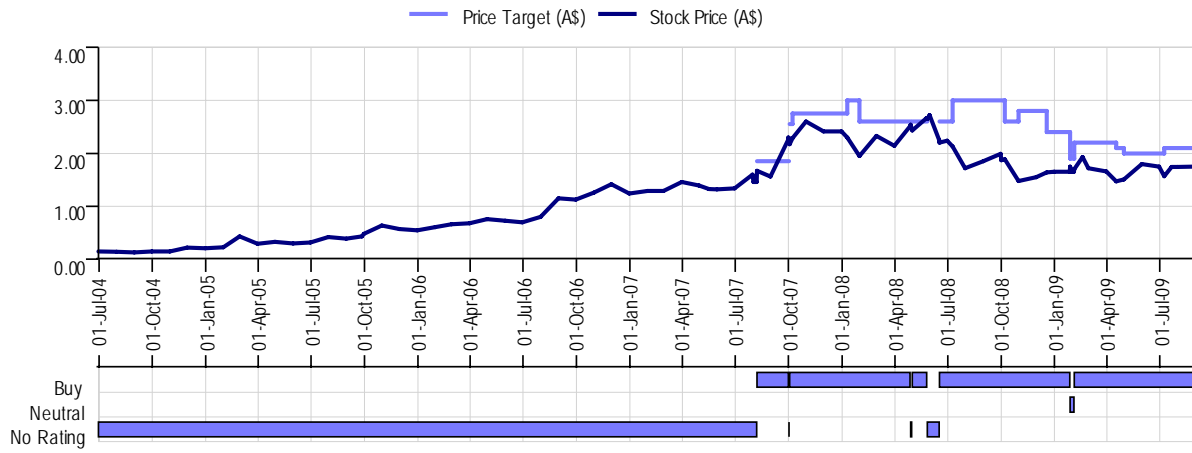
Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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Avoca Resources Limited (A\$)



Source: UBS; as of 28 Aug 2009

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