Avoca Resources 21 Jan 09

AVO

Successful fund raising and production firmly on track

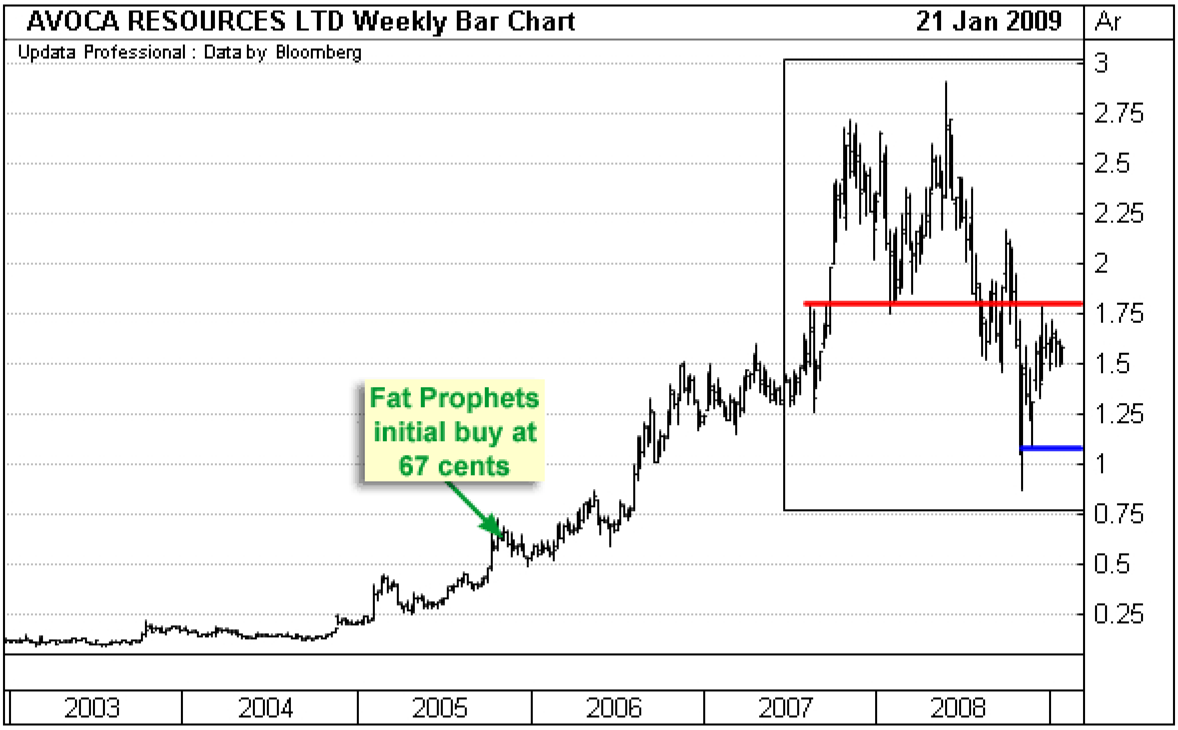
Unlike most of the other new gold industry entrants over recent years, Avoca Resources has made a successful start to production. The company's commissioning process has been virtually painless and trouble-free, without any of the stuff-ups or operational issues that have beset many of its peers. For a lot of gold investors that have been scared off by a string of failed producers, Avoca is a welcome new face on the Australian gold scene.

Fat Prophets initially recommended buying AVO at 67 cents in February 2006 (Fat Mining14). Our last review of this stock was in November (Fat Mining 148).

Since our last review in November, Avoca has posted further gains, reaching a high $1.785 in mid December. Since then, prices have moved sideways in a narrowing band of consolidation, above interim support at $1.47.

While the rebound from October reflects firm investor support for the stock, we remain cautious while resistance in the region of $1.70 to $1.80 caps prices. As evident on the daily chart, prices are yet to break above this region.

From a longer-term perspective, prices have been trending lower since the May all time high of $2.91. In our opinion, a sustained break above $1.80 is required to signal a sustainable attempt to restore broader upward momentum.



As we have previously emphasised, in a gold sector dominated by a string of unfortunate failures resulting from high costs and declining margins, Avoca Resources is a welcome new face on the Australian gold scene.

Encouragingly, there has been a heap of positive corporate news since our last update; with the company confirming the completion of a $30 million share placement to boost working capital and fund its ongoing development activities, as well as confirmation by the company's banking syndicate of the Higginsville project's operational credentials.

To top it all of from an operational perspective, initial December quarter operating statistics show that all is on track with respect to project ramp-up.

First off from a production perspective, the initial December quarter production results from the company's Higginsville gold project in Western Australia are comfortably in line with expectations, as the ramp-up of output continued during the period. Importantly, development commenced on what will be a nice production 'sweet spot', comprising the high-grade 1005 level of the Western Zone.

This area comprises a 25-metre thick ore zone, which was mined at a very robust grade of 9.4g/t gold during the quarter. In all, 242,655 tonnes of ore were mined during the quarter at an average grade of 3.92g/t Au for 30,645 contained ounces. The average gold price received was A$1,192/oz.

Exploration-wise, work at Trident continues to deliver success, with the discovery of a new ore zone called Eos, identified over a 200 metre strike length that lies adjacent to the Western Zone. Recent underground drilling has also confirmed that the Western Zone and the previously-identified Apollo Zone merge to form the same mineralised structure.

In order to maximise the extraction of the high-grade Trident gold reserves, a cemented fill-media is required to be placed into the stope void at the completion of mining of individual stopes. This process quite simply allows for the maximum extraction of the gold-bearing ore, without compromising underground structural integrity.

Studies undertaken by Avoca have demonstrated that the most cost-effective life of mine stope-filling strategy involves the construction of a paste-fill plant that will combine filtered tailings from the treatment plant with cement, which in turn is then pumped underground to fill the open stopes.

The capital cost of the paste-fill plant and associated infrastructure is $15 million, which will be financed through the recently announced ~$30 million share placement, comprising 20.5 million shares at $1.47 each. The residual funds will be used for general working capital.

In other positive news late last year the company received confirmation from its major financiers, Société Genérálé Australia and the Commonwealth Bank, that the Higginsville project had successfully passed all of the requisite performance tests related to project financing.

This means that the project met all of the appropriate criteria with respect to specified mining production and mill throughput rates, ounces produced and cost profiles, during a continuous 30-day period prior to 31 December 2008. The successful completion of the performance tests is yet another key milestone and reinforces the project's operational soundness.

As we have previously indicated, on both a market cap/resource ounce basis and a price/earnings basis, Avoca is not the cheapest gold play on the market. However, there is also an old saying that you get what you pay for.

Avoca currently trades on a prospective price-earnings multiple of around ten times 2009 consensus earnings estimates, falling to six times 2010 consensus forecasts. This premium however reflects the quality of the company's resource base and grade, operating cost profile and management capability. There are few competitors that offer all these key attributes.

The key for Avoca remains its capacity to demonstrate continued operational reliability and consistent ability to meet production targets. We anticipate 2008/09 gold production at Higginsville of around 150,000 ounces at a cash operating cost of around A$600/oz. With Avoca last year purchasing put options over 438,933 ounces of production at a strike price of A$830 per ounce, this gives the company downside price protection over a 34-month period.

The company therefore has a sound financial footing, as well as robust operating margins and attractive exploration upside, to make it the key emerging gold play on the Australian gold scene in recent memory.

Avoca Resources will therefore remain firmly held within the Fat Prophets Mining & Resources Portfolio.

Snapshot AVO

Avoca Resources

Avoca Resources is an emerging gold producer based in Perth. In the six years since listed in 2002, the company has successfully made the transition from junior explorer to producer status, with the recent commissioning of its Higginsville gold project in Western Australia. The Higginsville resource base currently stands at 1.45 million ounces and growing. Annual forecast gold production will be between 160,000 and 190,000 ounces initially over four years at a modest estimated life-of-mine cash operating cost of A$369 per ounce. In our view the Higginsville project has multi-million ounce resource potential. The company has just completed a positive pre-feasibility study that examined the economics of developing the Chalice satellite operation, just 30km away, and has elected to push ahead with a full feasibility study.

Market Capitalisation	**A$348m**