

Australasia Australia  
M&M - Gold

Deutsche Bank



26 February 2010

# Avoca Resources

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

## 1H FY10- platform established, focusing on new assets

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### Results as expected and tracking well against guidance

The 1H FY09 result of \$30mn Adj. NPAT from revenue of \$122mn was right on our numbers. While Operating cashflow of \$58mn was 20% ahead of our number. The result confirms, in our view, that Avoca is ready to pursue the next growth stage. It will move to compulsory acquisition on Dioro next week, a key step to add production beyond Trident's ~180kozpa level. Trading at 0.85x NPV, 0.70x TP and 5x FY11 EPS we continue to see upside in Avoca, Buy.

### Attention returns to growth options after prolonged tussle for Dioro

With 101koz produced during 1H, Trident guidance of +190koz should be achieved (DBe 197koz). So we focus on the coming growth options. The processing plant has a design rate of 1Mtpa but is achieving up to 1.2Mtpa. We assume this is sustained as an additional crusher (\$2.8mn) is being added. The Chalice Feasibility study is due this half, with Avoca's in-house work pointing to ~50kozpa from late 2011. We are also watching for a Trident reserve upgrade this half; an increase to +1Moz would support our view that a plus 10yr mine life across the assets is possible. Also we are awaiting a post-ownership review of the Dioro assets.

### Minimal EPS changes, sound fiscal position, low multiples

The result met our forecasts so EPS revision were minimal. Half of the cash position, \$51mn, will go to the cash component of the Dioro bid, but \$67mn op cashflow in 2H enables cash build. Gearing (ND/E) was 12% at 31 Dec but we project Avoca to have net cash in 6 months time. We see Avoca as trading on multiples that are low and stable; 5x PER, 4x P/CFPS, & 3x EV/EBITDA.

### Target price unchanged at \$2.60/sh set at 1.2x NPV

Our DCF assumes 2.0Moz production over 10 years. Our TP is set at 8x PER or a 1.2x 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 at Trident and successful exploration and expansion at Frog's leg. (see p6).

#### Forecasts and ratios

Year End Jun 30	2009A	2010E	2011E	2012E	2013E
Sales (AUDm)	146	309	352	296	245
EBITDA (AUDm)	28	149	176	158	112
Net Profit (AUDm)	-16	75	103	93	64
EPS (AUD)	-0.07	0.27	0.36	0.33	0.21
OLD EPS (AUD)	-0.07	0.27	0.36	0.32	0.21
% Change	-0.0%	0.5%	1.1%	1.1%	1.2%
EPS Growth (%)	-1,014.2	-	33.7	-9.2	-36.0
PER (x)	-	6.7	5.0	5.5	8.6
EV/EBITDA (x)	17.5	3.4	2.4	1.9	2.2
DPS (net) (AUD)	0.00	0.00	0.00	0.00	0.00

Source: Deutsche Bank estimates, company data

<sup>1</sup> Pre-exceptionals/extraordinaries

<sup>2</sup> Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B

## Results

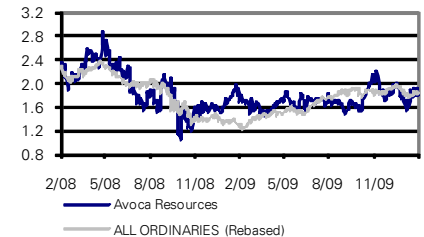
### Buy

Price at 26 Feb 2010	1.79
Price target - 12mth	2.60
52 week range (AUD)	2.20 - 1.44
ALL ORDINARIES	4,651

### Key changes

Sales (FYE)	308 to 309	↑	0.3%
EBIT margin (FYE)	33.2 to 34.7	↑	4.6%
Net profit (FYE)	75.4 to 74.8	↓	-0.9%

### Price/price relative



Performance (%)	1m	3m	12m
Absolute	0.0	-15.2	6.5
ALL ORDINARIES	-1.9	-1.6	41.1

### Stock data

Market cap (AUDm)	496
Market cap (USDm)	438
Shares outstanding (m)	277.0
Daily volume (USDm)	3.23
Free float	0.00

### Key indicators (FY1)

ROE (%)	35.0
ROA (%)	-107.9
Net debt/equity (%)	-11.8
Book value/share (AUD)	0.94
Price/book (x)	1.9
Net interest cover (x)	30.3
EBIT margin (%)	34.7

Deutsche Bank AG/Sydney

All prices are those current at the end of the previous trading session unless otherwise indicated. Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies. Deutsche Bank does and seeks to do business with companies covered in its research reports. Thus, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision. Independent, third-party research (IR) on certain companies covered by DBSI's research is available to customers of DBSI in the United States at no cost. Customers can access IR at <http://gm.db.com/IndependentResearch> or by calling 1-877-208-6300. DISCLOSURES AND ANALYST CERTIFICATIONS ARE LOCATED IN APPENDIX 1. MICA(P) 106/05/2009

Model updated: 26 February 2010

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

Reuters: AVO.AX

Bloomberg: AVO AU

**Buy**

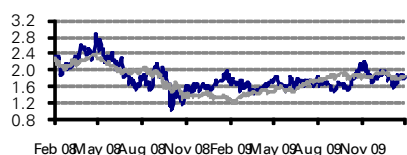
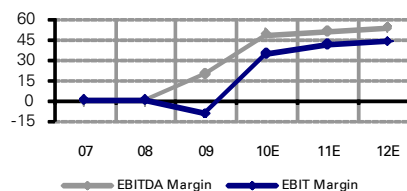
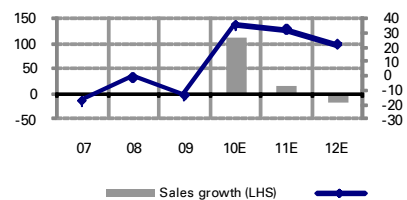
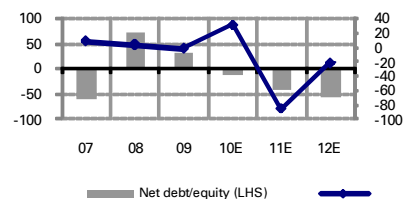
Price (26 Feb 10) AUD 1.79

Target price AUD 2.60

52-week Range AUD 1.44 - 2.20

Market Cap (m) AUDm 496  
USDm 438**Company Profile**

Avoca Resources Limited

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

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brendan.fitzpatrick@db.com

Fiscal year end 30-Jun

**Financial Summary**

	2007	2008	2009	2010E	2011E	2012E
DB EPS (AUD)	-0.02	-0.01	-0.07	0.27	0.36	0.33
Reported EPS (AUD)	-0.02	-0.01	-0.07	0.29	0.36	0.33
DPS (AUD)	0.00	0.00	0.00	0.00	0.00	0.00
BVPS (AUD)	0.49	0.53	0.61	0.94	1.31	1.63

**Valuation Metrics**

Price/Sales (x)	nm	nm	2.8	1.6	1.4	1.7
P/E (DB) (x)	nm	nm	nm	6.7	5.0	5.5
P/E (Reported) (x)	nm	nm	nm	6.3	5.0	5.5
P/BV (x)	2.8	4.2	2.9	1.9	1.4	1.1
FCF yield (%)	nm	nm	nm	18.3	26.1	22.5
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0	0.0
EV/Sales	na	na	3.3	1.7	1.2	1.0
EV/EBITDA	-40.8	-67.7	17.5	3.4	2.4	1.9
EV/EBIT	-38.1	-66.6	-33.2	4.8	2.9	2.3

**Income Statement (AUDm)**

Sales	0	0	146	309	352	296
EBITDA	-5	-7	28	149	176	158
EBIT	-5	-7	-15	107	145	127
Pre-tax profit	-5	-4	-23	110	147	133
Net income	-4	-1	-16	79	103	93

**Cash Flow (AUDm)**

Cash flow from operations	-1	1	52	125	139	121
Net Capex	-17	-134	-55	-35	-6	-6
Free cash flow	-19	-133	-4	91	133	115
Equity raised/(bought back)	76	6	29	2	0	0
Dividends paid	0	0	0	0	0	0
Net inc/(dec) in borrowings	53	30	19	-20	-10	-15
Other investing/financing cash flows	0	0	0	0	0	0
Net cash flow	102	-108	37	60	113	90
Change in working capital	10	-3	16	-4	0	0

**Balance Sheet (AUDm)**

Cash and cash equivalents	109	2	39	99	213	303
Property, plant & equipment	33	173	177	173	148	124
Goodwill	0	0	0	0	0	0
Other assets	NA	NA	NA	NA	NA	NA
<b>Total assets</b>	<b>161</b>	<b>236</b>	<b>287</b>	<b>375</b>	<b>473</b>	<b>549</b>
Debt	48	84	87	68	58	43
Other liabilities	11	36	44	40	40	40
<b>Total liabilities</b>	<b>59</b>	<b>120</b>	<b>130</b>	<b>108</b>	<b>98</b>	<b>83</b>
<b>Total shareholders' equity</b>	<b>102</b>	<b>116</b>	<b>157</b>	<b>267</b>	<b>375</b>	<b>466</b>
Net debt	-61	83	48	-31	-155	-260

**Key Company Metrics**

Sales growth (%)	nm	nm	nm	112.0	14.1	-16.1
DB EPS growth (%)	na	75.6	-1,014.2	na	33.7	-9.2
Payout ratio (%)	nm	nm	nm	0.0	0.0	0.0
EBITDA Margin (%)	nm	nm	19.1	48.2	50.0	53.3
EBIT Margin (%)	0.0	0.0	-10.0	34.7	41.1	43.1
ROE (%)	-17.4	-1.2	-13.7	35.0	32.0	21.9
Net debt/equity (%)	-60.2	71.6	30.3	-11.8	-41.3	-55.8
Net interest cover (x)	7.5	2.2	-1.7	30.3	-86.9	-22.5

**DuPont Analysis**

EBIT margin (%)	0.0	0.0	-10.0	34.7	41.1	43.1
x Asset turnover (x)	0.0	0.0	0.6	0.9	0.8	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	0.7	0.7
<b>= ROA (post tax) (%)</b>	<b>-2.8</b>	<b>-0.7</b>	<b>-6.2</b>	<b>23.9</b>	<b>24.2</b>	<b>18.2</b>
x Financial leverage (x)	6.3	1.8	2.2	1.6	1.3	1.2
<b>= ROE (%)</b>	<b>-17.4</b>	<b>-1.2</b>	<b>-13.7</b>	<b>37.1</b>	<b>32.0</b>	<b>21.9</b>
annual growth (%)	na	93.2	-1,046.7	na	-13.8	-31.5
x NTA/share (avg) (x)	0.1	0.5	0.5	0.8	1.1	1.5
<b>= Reported EPS</b>	<b>-0.02</b>	<b>-0.01</b>	<b>-0.07</b>	<b>0.29</b>	<b>0.36</b>	<b>0.33</b>
annual growth (%)	na	75.6	-1,014.2	na	26.1	-9.2

Source: Company data, Deutsche Bank estimates

**AVOCA OPERATIONAL AND FINANCIAL SUMMARY DATA**

DB Commodity & Currency forecasts	2007A	2008A	2009F	2010F	2011F	2012F	2013F
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
<b>Trident</b>							
Ore mined, kt	10	142	960	1,067	1,100	1,100	1,100
Head grade, g/t	1.5	4.0	4.3	5.7	5.3	5.2	5.2
Ore milled, kt	-	22	1,107	1,214	1,200	1,200	1,200
Feed grade, g/t	-	-	3.8	5.2	5.0	4.9	4.8
Recovery, %	0%	0%	97%	97%	97%	97%	97%
PRODUCTION, koz	-	-	131	198	186	182	180
<b>Frogs legs</b>							
Ore mined, kt	-	-	-	65	260	260	260
Head grade, g/t	-	-	-	5.3	5.3	5.3	5.3
Ore milled, kt	-	-	-	65	260	260	260
Feed grade, g/t	-	-	-	5.3	5.3	5.3	5.3
Recovery, %	-	-	-	93%	93%	93%	93%
PRODUCTION, koz	-	-	-	10	41	41	41
<b>South Kalgoorlie</b>							
PRODUCTION, koz	-	-	-	16	63	-	-
<b>TOTAL PRODUCTION, koz</b>	<b>0</b>	<b>0</b>	<b>131</b>	<b>224</b>	<b>290</b>	<b>223</b>	<b>221</b>

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
<b>Frogs legs</b>								
Total cash cost	A\$/oz	-	-	526	548	567	573	578
<b>South Kalgoorlie</b>								
Total cash cost	A\$/oz	-	-	996	-	-	-	-
<b>CAPEX, A\$M</b>								
Trident - Development		-	-	63	18	6	6	6
Trident - Sustaining		8	8	8	8	6	6	6
Exploration		5	5	10	10	10	10	10
<b>TOTAL</b>		<b>13</b>	<b>13</b>	<b>81</b>	<b>36</b>	<b>22</b>	<b>22</b>	<b>22</b>

SENSITIVITY ANALYSIS		(EPS Change (%) for a 10% change in)					
AUDUSD				-8%	-20%	-18%	-23%
Gold				22%	22%	20%	25%

RESERVES & RESOURCES	HD_10	VALUE	A\$/oz	US\$/oz
P&P Reserves	.5Moz	EV/Reserve	1,112	810
M&I Resources	2.8Moz	EV/Resource	201	147

NPV (HD10)	A\$m	A\$/sh	(%)
Trident	423	1.48	71%
Hedging	0	0.00	0%
Corporate/Other	(6)	(0.02)	-1%
Other	65	0.23	11%
Exploration	50	0.18	8%
Investments	0	0.00	0%
net debt	(27)	(0.09)	-4%
<b>TOTAL</b>	<b>601</b>	<b>2.10</b>	<b>100%</b>
<b>WACC</b>	<b>9.2%</b>	<b>Shares</b>	<b>285M</b>

**TRADING HISTORY - PRICE**



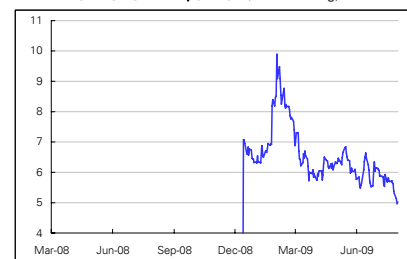
**TRADING HISTORY - P/NAV (12mth rolling, consensus)**



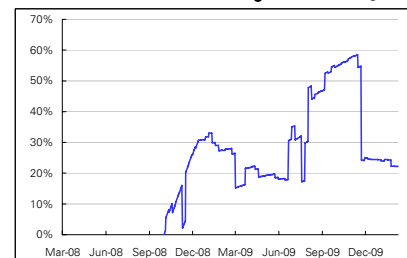
**TRADING HISTORY - PER (12mth rolling, consensus)**



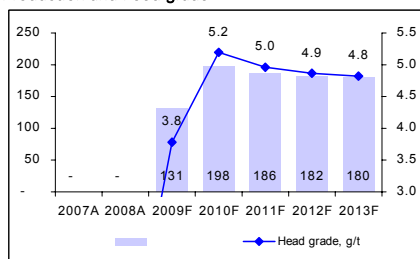
**TRADING HISTORY - P/CFPS (12mth rolling, consensus)**



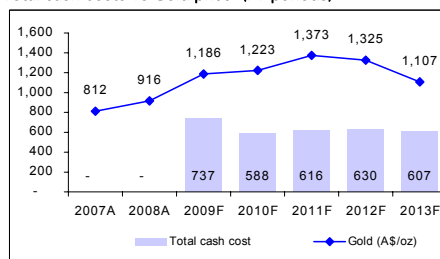
**TRADING HISTORY - Profit margin (12mth rolling, cons)**



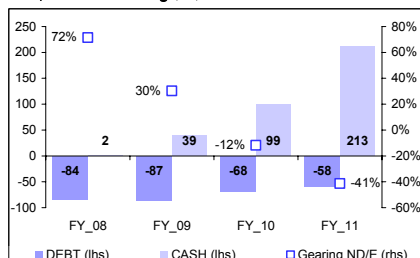
**Production and Feed grade**



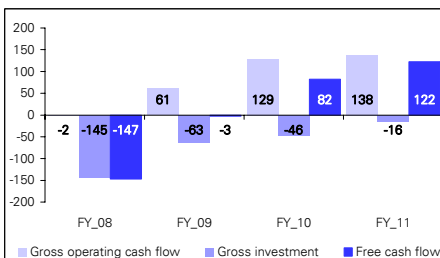
**Total cash costs vs Gold price (FY periods)**



**Debt, Cash & Gearing (%)**



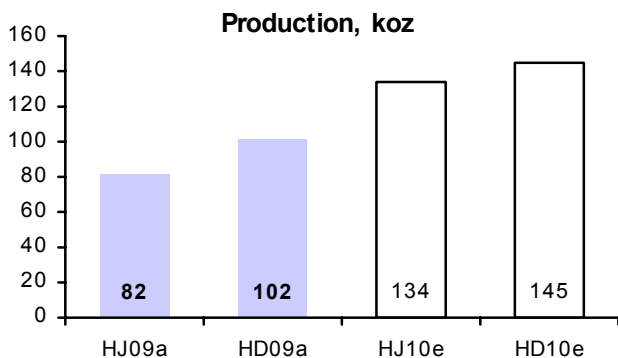
**Investment and Cashflows**



Source: Company data, DB estimates, Datastream

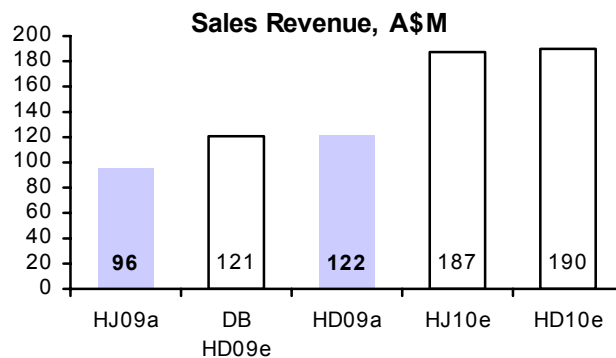
# 1H FY10 – Results in line

**Figure 1: Frog’s leg production added to our model**



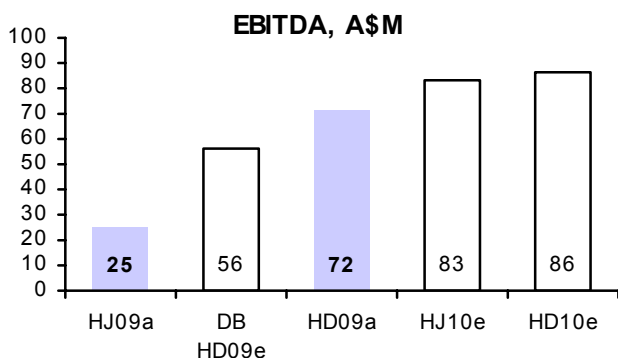
Source: Deutsche Bank, company data

**Figure 2: Revenue to step up on Dioro acquisition...**



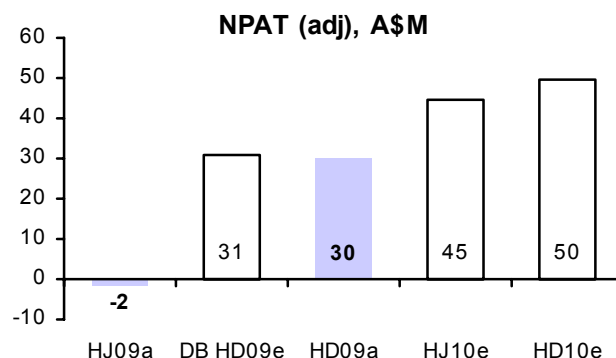
Source: Deutsche Bank, company data

**Figure 3: ... which flows down to EBITDA...**



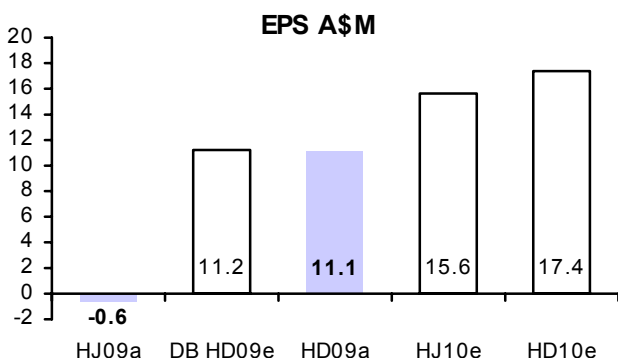
Source: Deutsche Bank, company data

**Figure 4: ... and NPAT**



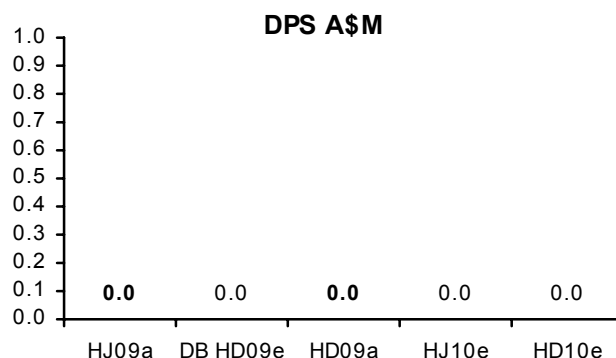
Source: Deutsche Bank, company data

**Figure 5: EPS growing also**



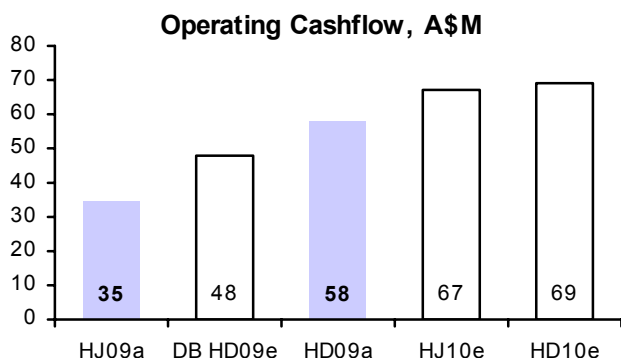
Source: Deutsche Bank, company data

**Figure 6: No dividends paid, as expected**



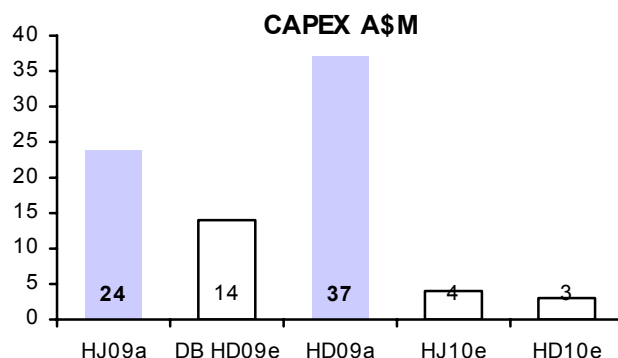
Source: Deutsche Bank, company data

**Figure 7: Cashflow now exceeds Capex**



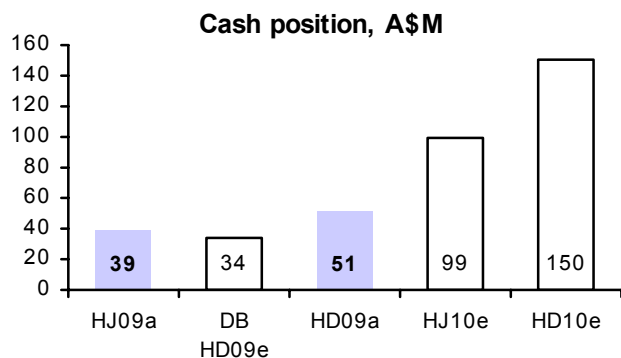
Source: Deutsche Bank, company data

**Figure 8: Minimal Capex until Chalice Study complete**



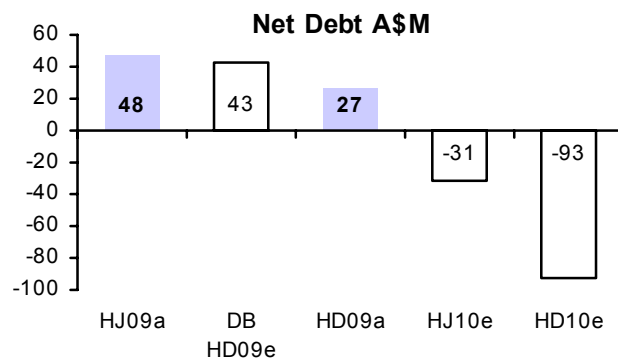
Source: Deutsche Bank, company data

**Figure 9: Cash position projected to build**



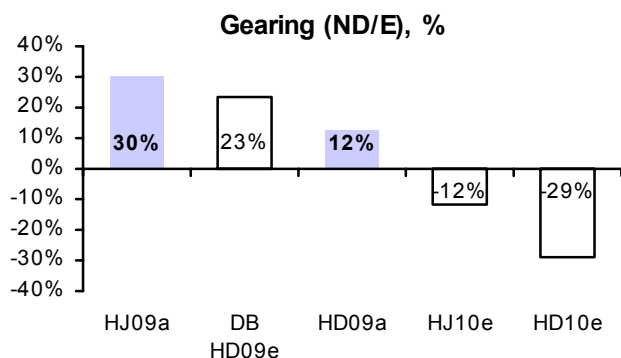
Source: Deutsche Bank, company data

**Figure 10: Net Debt turns negative this quarter...**



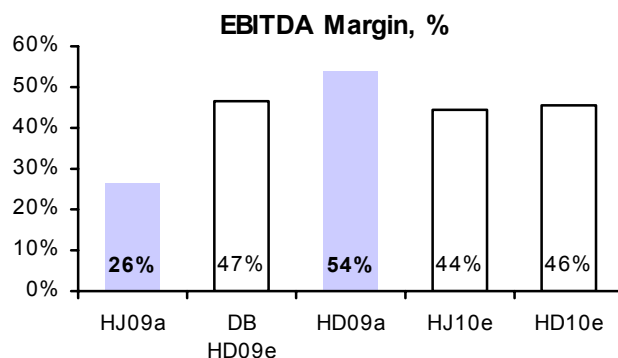
Source: Deutsche Bank, company data

**Figure 11: ... leading to negative gearing**



Source: Deutsche Bank, company data

**Figure 12: EBITDA margins ease on Dioro asset costs**



Source: Deutsche Bank, company data

# 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 \$2.05/sh valuation using a life-of-mine DCF. Our target price is set at a 1.25x 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 8x, 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%).

**Figure 13: 12 month multiples – low and staying low**

	FY10	12mth rolling	FY11	FY12
EPS, A\$ cps	27	33	36	33
PER at Target price \$2.60	10	8	7	8
PER at Last price \$1.79	7	<b>6</b>	5	5
CFPS, A\$ cps	45	47	49	42
P/CFPS at Last price \$1.79	4	<b>4</b>	4	4
EBITDA, A\$m	149	166	176	158
EV/EBITDA	4	<b>3</b>	2	2

Source: Deutsche Bank

## 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. With the Dioro acquisition all but secured the key risks associated with those assets are similar to those of Trident - maintaining stable production and building the resource base and projected mine life.

**Figure 14: Spot price scenario – minimal variance**

		FY10	FY11	FY12	
<b>BASE CASE</b>	Gold, US\$/oz	875	1085	1206	
	AUDUSD	0.75	0.89	0.88	
	NPV	EPS, A\$ cps	27	36	33
	<b>\$2.15</b>	PER at Last price \$1.79	7	5	5
<b>SPOT PRICES</b>	Gold, US\$/oz	875	1076	1121	
	AUDUSD	0.75	0.89	0.90	
	NPV	EPS, A\$ cps	26	29	29
	<b>\$2.20</b>	PER at Last price \$1.79	7	6	6

Source: Deutsche Bank

# Appendix 1

## Important Disclosures

Additional information available upon request

### Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Avoca Resources	AVO.AX	1.79 (AUD) 26 Feb 10	8

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

## Important Disclosures Required by U.S. Regulators

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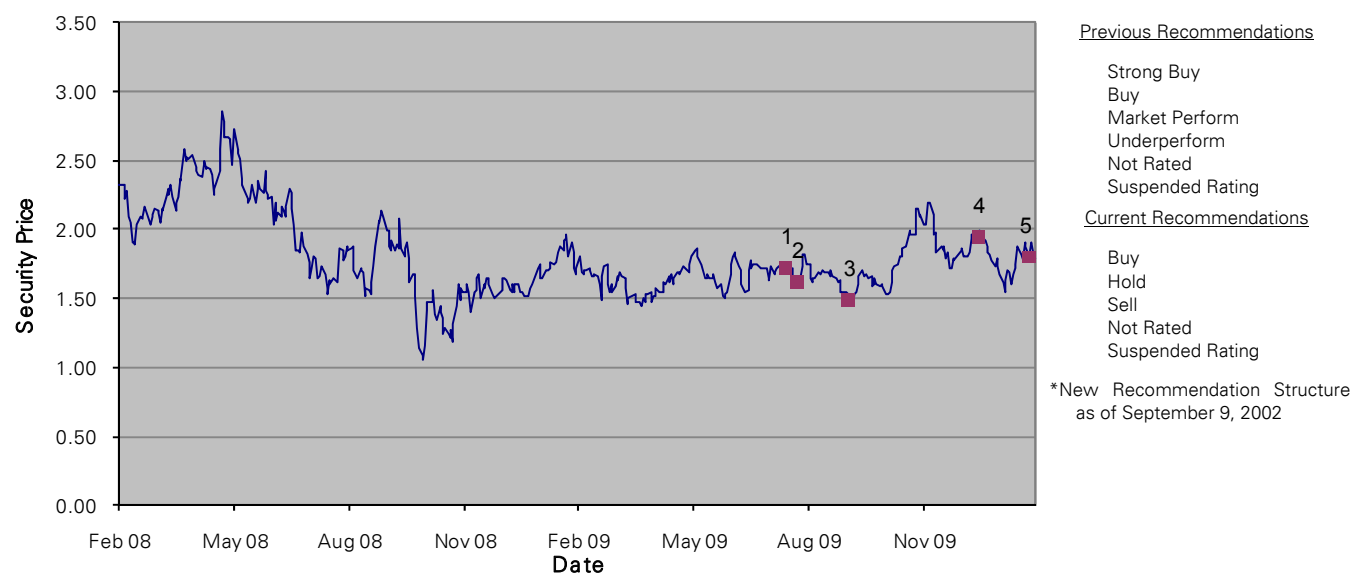
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### Historical recommendations and target price: Avoca Resources (AVO.AX)

(as of 2/26/2010)



1.	12/8/2009:	Buy, Target Price Change AUD2.10	4.	12/1/2010:	Buy, Target Price Change AUD2.40
2.	21/8/2009:	Buy, Target Price Change AUD2.00	5.	22/2/2010:	Buy, Target Price Change AUD2.60
3.	1/10/2009:	Buy, Target Price Change AUD2.30			

**Equity rating key**

**Equity rating dispersion and banking relationships**

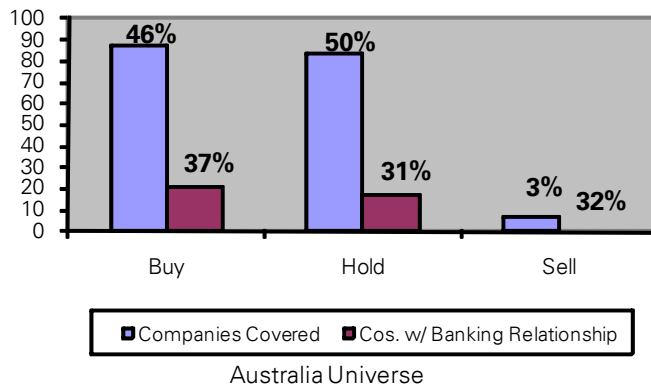
**Buy:** Based on a current 12- month view of total shareholder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield ) , we recommend that investors buy the stock.

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**Hold:** We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

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- Ratings definitions prior to 27 January, 2007 were:
  - Buy: Expected total return (including dividends) of 10% or more over a 12-month period
  - Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period
  - Sell: Expected total return (including dividends) of -10% or worse over a 12-month period



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