

Tuesday, 12 February 2008

## Avoca Resources (AVO)

### Update

The company presented today at the RIU Explorers' Conference in Perth.

- AVO is presently mining and stockpiling ore at surface. Its new treatment facility is to be commissioned in June.
- Recent development activities in the Eastern zone of the underground have encountered very wide (up to 43m) intersections of high grade (10 gpt) gold. This is likely to impact favourably on mine operating costs.
- The company has forecast gold production of 170,000 oz for FY 2008/09 with 190,000 oz the year following.
- The company is unhedged.
- AVO has not updated the 200t feasibility opex of A\$369/oz.
- The resource of 1.35m ounces has not been updated; AVO expects a material increase with the new tonnes at Trident.
- On the exploration front, AVO has made a "blind" discovery at Wills which is located 25 km north of the new processing plant (see map). It has completed a shallow infill drilling program which has delineated a small (14,000oz) low grade (1.8 gpt) over 1 km in strike length. This appears to be real upside below this resource and bedrock drilling will start in Qtr 3.

### In Brief

#### Recommendations

|                  |                  |
|------------------|------------------|
| Short Term:      | Accumulate       |
| Long Term:       | Speculative Buy  |
| Risk:            | High             |
| Price:           | <b>\$1.88</b>    |
| Valuation Range: | \$1.86 to \$2.30 |

#### Snapshot

|                      |         |
|----------------------|---------|
| Monthly Turnover (m) | 14.5    |
| Market Cap (m)       | \$414.0 |
| Shares Issued (m)    | 219.1   |
| 52 Week High         | \$2.72  |
| 52 Week Low          | \$1.15  |
| Sector               | Gold    |

#### INVESTMENT VIEW

On present forecasts, AVO now represents a relatively low price entry into the operating gold mine sector in Australia where there is not a lot of choice.

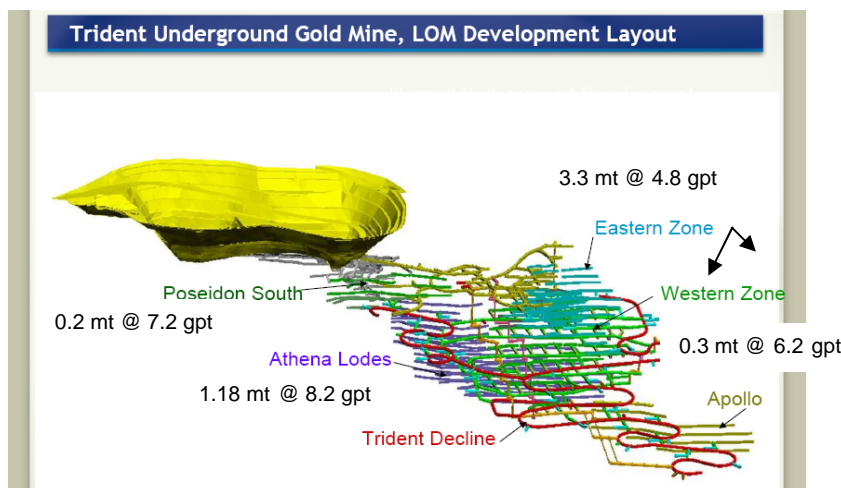
#### Investment Fundamentals

| Year end June            | FY08    | FY09 | FY10 |
|--------------------------|---------|------|------|
| Reported NPAT (\$m)      | (4.1)   | 43.5 | 59.1 |
| EPS (¢)                  | (2.0)   | 19.0 | 25.0 |
| PE Ratio (x)             | (108.1) | 10.1 | 7.4  |
| DPS (¢)                  | 0       | 8.7  | 11.8 |
| Dividend Yield (%)       | 0       | 2.0  | 2.7  |
| Franking (%)             | 0       | 0    | 0    |
| Spot Gold (US\$/oz)      | 785     | 785  | 785  |
| Exchange Rate (A\$/US\$) | 0.89    | 0.86 | 0.84 |
| Consensus Earnings (\$m) | (2.0)   | 41.0 | 53.6 |

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The AVO share price has retreated 27% from its recent high of \$2.59. Any exploration upside/premium has now been removed.

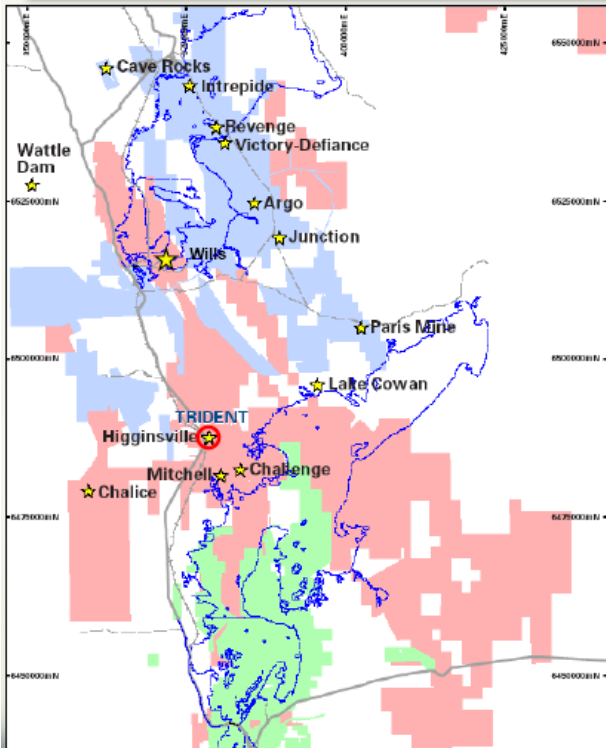
The company is in a sound financial position, will bring on a high grade gold operation at a very competitive opex and is unhedged. The present resource (to be upgraded shortly) is sufficient for a 10 year life with significant exploration upside from both brownfield and greenfield discoveries.



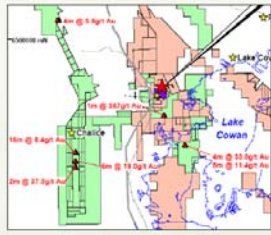
Source of charts Avoca Resource presentation

□ **Background on AVO**

- Will have cash in the bank at the time of production start with a debt draw of \$50m.
- AVO has an extensive tenement position between St Ives in the north (+15m oz) and Norseman in the south (+6m oz).



**Chalice Leases (part of Higginsville Project)**




- Acquired July 2007 for 56M scrip.
- Includes Chalice mine which produced 556Koz at 5.6 g/t gold.
- Underground resource of 79Koz @ 5.3 g/t gold.
- Second UG mine?
- Chalice and Trident very similar geologically.
- Numerous drill-ready targets:
- New Avoca drilling includes 3m @ 18 g/t gold.
- Thick low grade mineralisation 1.5km south of Chalice

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- To finalise the overall extent, there's Wills.

**New Wills Discovery**



- New discovery called Wills Prospect.
- Blind discovery in area of no previous workings or drilling.
- Coherent mineralised blanket developed at 17-23m below surface.
- Infill drilling completed, bedrock drilling to commenced in October.
- 25km north of new 1 Mtpa Higginsville plant.

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- Gold production will start in the September quarter and build to 190,000 oz pa.
- The project will be commissioned on time and budget.
- Gold production is expected to be unhedged. The estimated present cash margin will be US\$500/oz! (that's with gold at +US\$900/oz).

Inherent in this calculation is a relatively low cash opex of US\$324/oz but a royalty structure that is high at US\$100/oz.

- The overall resource at "Higginsville" is 1.35m oz (11.7 mt grading 3.6 gpt) but this masks some high grade (+5 gpt to 7gpt) ore that will be mined in the first 3 years.
- In addition, once the operation is generating cash, we expect the exploration spend to accelerate.
- In July 2007, AVO acquired the Chalice leases for \$6m which included an underground gold resource of 79,000 oz (5.3 gpt). AVO sees distinct geological similarities between Trident and Chalice.

| <b>Avoca Resources</b>                            |           |              |              |               |               |                |                |
|---|-----------|--------------|--------------|---------------|---------------|----------------|----------------|
| Share price                                       | AVO       |              |              | \$ 1.88       | \$ 1.88       | \$ 1.88        | \$ 1.88        |
| Valuation   |           |              |              | \$ 1.86       | \$ 2.20       | \$ 2.30        |                |
| Mkt Cap   | \$m       |              |              | \$ 418        | \$ 439        | \$ 439         |                |
| Enterprise value                                  |           |              |              | \$ 468        | \$ 529        |                |                |
| Ent.Value/resource per oz                         | A\$/oz    |              |              | \$ 390        | \$ 392        | \$ -           |                |
|   | US\$/oz   |              |              | \$ 326        | \$ 347        | \$ -           |                |
| Resource(Higginsville)                            | m.oz      |              |              | 1.20          | 1.35          | 1.62           |                |
| of which Resource(trident)                        |           |              |              | 0.80          | 0.93          |                |                |
| Year Ending .                                     | FY        | 2005         | 2006         | 2007          | 2008E         | 2009E          | 2010E          |
| Issued Ordinary Shares                            | m         | 120          | 150          | 210           | 219           | 219            | 222            |
| Unlisted Conv. Bonds(coupon 6%/conv price \$1.75) |           |              |              | 0.2           | 0.2           | 0.2            | 0.2            |
| Unlisted Options                                  |           | 6.1          | 13.0         | 13            | 15            | 15             | 12             |
| Fully diluted                                     |           | 126.1        | 163.0        | 223.1         | 234.3         | 234.3          | 234.3          |
| Realised Exchange rate                            |           | 0.76         | 0.75         | 0.84          | 0.89          | 0.86           | 0.84           |
| <b>Spot Gold</b>                                  | \$US/oz   | <b>450</b>   | <b>604</b>   | <b>690</b>    | <b>785</b>    | <b>785</b>     | <b>785</b>     |
| Spot Gold   | A\$/oz    | 592          | 805          | 821           | 882           | 909            | 932            |
| Hedged Price(put options)                         | \$US/oz   |              |              |               | 824           | 824            | 824            |
| Realised Price                                    | A\$/oz    | 0            | 0            |               |               | 909            | 932            |
| Hedging as a prop. of production                  |           |              |              |               |               | 0%             | 0%             |
| Silver  | \$US/oz   | 8.00         | 12.25        | 13.43         | 15.28         | 15.28          | 15.28          |
| Copper  | \$US/lb   | 1.32         | 1.32         | 1.32          | 1.32          | 1.32           | 1.32           |
| Spot Exchange Rate                                | \$/A/\$US | 0.760        | 0.750        | 0.840         | 0.890         | 0.864          | 0.842          |
| hedged rate                                       | \$/A/\$US | 0.75         | 0.74         | 0.83          | 0.88          | 0.86           | 0.83           |
| <b>Gold production</b>                            | oz        | <b>0</b>     | <b>0</b>     | <b>0</b>      | <b>0</b>      | <b>168,420</b> | <b>191,352</b> |
| hedged gold production                            |           | 0            | 0            | 0             | 0             | 0              | 0              |
| Silver Production                                 |           | 0            | 0            | 0             | 0             | 0              | 0              |
| Gold Resource Base                                | m.oz      | 0.6          | 0.6          | 0.6           | 0.6           |                |                |
| Higginsville                                      |           | 0.4          | 0.5          | 0.5           | 0.5           |                |                |
| Chalice   |           |              |              | 0.1           | 0.1           |                |                |
| Apollo Discovery                                  |           |              |              |               |               |                |                |
| <b>Financials</b>                                 |           |              |              |               |               |                |                |
| Sales Revenue                                     | A\$m      | 0.0          | 0.0          | 0.0           | 0.0           | 153.8          | 179.3          |
| opex  |           | 0.0          | 0.0          | 0.0           | 0.0           | 71.5           | 83.4           |
| <b>EBITDA</b>                                     |           | <b>0.0</b>   | <b>0.0</b>   | <b>0.0</b>    | <b>0.0</b>    | <b>87.0</b>    | <b>103.1</b>   |
| D & A   |           | 0.0          | 0.0          | 0.0           | 0.0           | 25.6           | 26.3           |
| <b>EBIT</b>                                       |           | <b>-2.9</b>  | <b>-4.0</b>  | <b>-3.2</b>   | <b>-2.7</b>   | <b>68.0</b>    | <b>89.1</b>    |
| <b>Net Profit (pre Abnormals)</b>                 | A\$m      | <b>(2.9)</b> | <b>(3.6)</b> | <b>(4.1)</b>  | <b>(4.1)</b>  | <b>43.5</b>    | <b>59.1</b>    |
| -Half year result                                 |           |              |              |               |               |                |                |
| EPS   | cents     | -2           | -2           | -2            | -2            | 19             | 25             |
| EPS Growth  | %         |              | -4%          | -18%          | -5%           | (12)           | 36%            |
| <b>P/E ratio</b>                                  | x         | <b>-81.3</b> | <b>-84.5</b> | <b>-102.8</b> | <b>-108.1</b> | <b>10.1</b>    | <b>7.4</b>     |
| Gross Cash Flow                                   | \$m       | (2.9)        | (4.0)        | (3.7)         | (4.1)         | 69.1           | 85.3           |
| GCFPS   | cents     | -2.31        | -2.47        | -1.66         | -1.73         | 29.48          | 36.42          |
| <b>P/GCF</b>                                      |           |              | 0.00         | (113)         | -108.11       | 6.36           | 5.15           |
| Dividend  | \$m       | 0.0          | 0.0          | 0.0           | 0.0           | 8.7            | 11.8           |
| DPS   | c         | 0.0          | 0.0          | 0.0           | 0.0           | 3.7            | 5.0            |
| DPS -second half                                  |           |              |              |               |               |                |                |
| <b>Dividend Yield</b>                             | %         |              |              |               |               | 2.0%           | 2.7%           |
| Franking  | %         | 0.0          | 0.0          | 0.0           | 0.0           | 0.0            | 0.0            |

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