

# Exploration upside

## Price Objective upgrade

We have upgraded our AVO price objective to \$2.75/sh (previously \$2.00/sh). The price objective change reflects mine life upside and AVO's low P/NAV, in our view. The current mine life at Trident is around 6 years. We see potential upside from recent exploration and the updated resource estimate expected in November. Compared to its peers, AVO is trading at a P/NAV discount. While this discount reflects the development nature of AVO's assets, we expect it to close as the company ramps up production.

## Further exploration and success

AVO expects to release a revised resource estimate for its Higginsville Project in November. The company has recently released positive drill results from the project discovering new mineralisation positions and material extensions to known ore surfaces. AVO has also increased its exploration budget for FY08E to \$11m with the aim of developing a 10+ year reserve base at Higginsville.

## BUY

AVO is an emerging gold producer at the junior end with first production from August 2007. The company has attractive production growth with 25koz in 2007 rising to 160koz in 2008E and 180koz in 2009E. Mine life is currently around 6 years with strong potential upside from exploration. AVO is currently trading at around 1.4x NAV versus peer average of 1.8x. Our price target of \$2.75/sh equates to a NAV multiple of 1.7x.

## Estimates (Jun)

(A\$)	2005A	2006A	2007E	2008E	2009E
Net Profit b/f Abnormals	(2)	(2)	(5)	17	47
EPS	(0.020)	(0.011)	(0.026)	0.078	0.212
EPS Change (YoY)	104.2%	-46.5%	141.6%	-403.9%	170.9%
Dividend / Share	0	0	0	0	0
Free Cash Flow / Share	(0.040)	(0.036)	(0.148)	(0.256)	0.226

## Valuation (Jun)

	2005A	2006A	2007E	2008E	2009E
P/E	NM	NM	NM	29.15x	10.76x
Dividend Yield	0%	0%	0%	0%	0%
EV / EBITDA*	-105.98x	-141.34x	-126.18x	11.63x	4.81x
Free Cash Flow Yield*	-1.34%	-1.58%	-8.41%	-16.82%	14.82%

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 6.

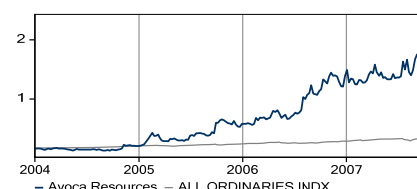


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## Stock Data

Price	A\$2.28
Price Objective	A\$2.00 to A\$2.75
Date Established	9-Oct-2007
Investment Opinion	C-1-9
Volatility Risk	HIGH
52-Week Range	A\$1.13-A\$2.42
Mrkt Val / Shares Out (mn)	US\$304 / 148.9
Average Daily Volume	1,025,638
ML Symbol / Exchange	AVORF / ASX
Bloomberg / Reuters	AVO AU / AVO.AX
ROE (2007E)	-8.7%
Net Dbt to Eqty (Jun-2006A)	-31.4%
Est. 5-Yr EPS / DPS Growth	NA / NA
Free Float	100.0%



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Refer to important disclosures on page 7 to 8. Analyst Certification on page 6. Price Objective Basis/Risk on page 6.

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# iQprofile<sup>SM</sup> Avoca Resources Ltd

Key Income Statement Data (Jun)	2005A	2006A	2007E	2008E	2009E
<b>(A\$ Millions)</b>					
Sales	0	0	0	86	150
Operating Expenses	(2)	(2)	(3)	(42)	(53)
<b>EBITDA</b>	<b>(2)</b>	<b>(2)</b>	<b>(3)</b>	<b>44</b>	<b>97</b>
Depreciation & Amortization	0	0	0	(15)	(27)
<b>EBIT</b>	<b>(2)</b>	<b>(2)</b>	<b>(3)</b>	<b>30</b>	<b>70</b>
Net Interest & Other income	0	0	(2)	(5)	(3)
Associates	NA	NA	NA	NA	NA
Pretax Income	(2)	(2)	(6)	25	67
Tax (expense) / Benefit	0	0	1	(7)	(20)
<b>Net Profit b/f Abnormals</b>	<b>(2)</b>	<b>(2)</b>	<b>(5)</b>	<b>17</b>	<b>47</b>
Non-Recurring Items	0	0	0	0	0
Net Income (Reported)	(2)	(2)	(5)	17	47
Avg F Diluted Shares Outstanding	113	150	192	223	223

## Key Cash Flow Statement Data

EBITDA	(2)	(2)	(3)	44	97
Change in Working Capital	0	1	1	(4)	0
Deferred Taxation Charge	0	0	(1)	0	0
Other Adjustments, Net	1	1	1	1	1
<b>Cash Flow from Operations</b>	<b>(1)</b>	<b>0</b>	<b>(4)</b>	<b>29</b>	<b>75</b>
<b>Capital Expenditure</b>	<b>(4)</b>	<b>(6)</b>	<b>(25)</b>	<b>(87)</b>	<b>(25)</b>
(Acquisition) / Disposal of Investments	(2)	0	0	0	0
Other Cash Inflow / (Outflow)	0	0	0	0	0
<b>Cash Flow from Investing</b>	<b>(6)</b>	<b>(6)</b>	<b>(25)</b>	<b>(87)</b>	<b>(25)</b>
Shares Issue / (Repurchase)	4	11	69	0	0
Cost of Dividends Paid	0	0	0	0	0
<b>Cash Flow from Financing</b>	<b>4</b>	<b>11</b>	<b>130</b>	<b>(8)</b>	<b>0</b>
<b>Free Cash Flow</b>	<b>(5)</b>	<b>(5)</b>	<b>(29)</b>	<b>(57)</b>	<b>50</b>
<b>Net Debt</b>	<b>(3)</b>	<b>(7)</b>	<b>(48)</b>	<b>9</b>	<b>(41)</b>
Change in Net Debt	NA	NA	NA	NA	NA

## Key Balance Sheet Data

Property, Plant & Equipment	12	17	44	114	111
Other Non-Current Assets	0	1	1	1	1
Trade Receivables	0	0	0	0	0
Cash & Equivalents	3	7	109	44	94
Other Current Assets	0	0	0	0	0
<b>Total Assets</b>	<b>15</b>	<b>26</b>	<b>154</b>	<b>160</b>	<b>207</b>
Long-Term Debt	0	0	53	53	0
Other Non-Current Liabilities	0	0	0	0	0
Short-Term Debt	0	0	8	0	53
Other Current Liabilities	0	0	0	0	0
<b>Total Liabilities</b>	<b>1</b>	<b>2</b>	<b>65</b>	<b>53</b>	<b>53</b>
<b>Total Equity</b>	<b>14</b>	<b>24</b>	<b>89</b>	<b>107</b>	<b>154</b>
Total Equity & Liabilities	15	26	154	160	207

## iQmethod<sup>SM</sup> - Bus Performance\*

Return on Capital Employed	-17.4%	-8.5%	-3.3%	14.6%	28.2%
Return on Equity	-19.3%	-8.5%	-8.7%	17.8%	36.2%
Operating Margin	NA	NA	NA	34.2%	47.0%
EBITDA Margin	NA	NA	NA	51.6%	64.7%

## iQmethod<sup>SM</sup> - Quality of Earnings\*

Cash Realization Ratio	0.4x	-0.1x	0.7x	1.7x	1.6x
Asset Replacement Ratio	115.5x	126.1x	95.3x	5.8x	0.9x
Tax Rate (Reported)	0%	21.4%	10.6%	30.0%	30.0%
Net Debt-to-Equity Ratio	-18.4%	-31.4%	-54.0%	8.2%	-26.9%
Interest Cover	NA	NA	-1.5x	3.9x	11.1x

## Key Metrics

Franking	0%	0%	0%	0%	0%
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 \* For full definitions of iQmethod<sup>SM</sup> measures, see page 6.

## Company Description

Avoca Resources is an emerging gold miner in Western Australia with its Trident deposit. First production is targeted 2H07 with an attractive growth profile and significant upside from exploration.

## Stock Data

Price to Book Value 3.8x

## AVO Production Summary

Table 1: Production and cash cost summary

Higginsville Production (oz)	06A	07E	08E	09E
Gold	0	0	99,502	173,333
<b>Cash Operating Costs</b>	<b>06A</b>	<b>07E</b>	<b>08E</b>	<b>09E</b>
Higginsville (US\$/oz)		0	311	223
Higginsville (A\$/oz)		0	392	290

Source: ML estimates

## Profit and loss

Table 2: Profit and loss

Profit and Loss	06A	07E	08E	09E
Sales	0.0	0.0	86.2	149.7
Other Revenue	0.0	0.0	0.0	0.0
Total Revenue	0.0	0.0	86.2	149.7
Operating Costs	-0.5	-1.0	-39.3	-50.3
Exploration	-0.9	-0.6	-1.0	-1.0
Other Costs	-1.0	-1.5	-1.5	-1.6
EBITDA	-2.4	-3.1	44.4	96.9
Depreciation & Amortisation	0.0	-0.3	-14.9	-26.6
EBIT	-2.4	-3.4	29.5	70.3
Net Interest	0.4	-2.2	-4.6	-2.9
Pretax Profit	-2.0	-5.5	24.9	67.4
Tax	0.4	0.6	-7.5	-20.2
Operating NPAT	-1.6	-4.9	17.4	47.2
OEI	0.0	0.0	0.0	0.0
<b>NPAT (Normalised for FCA)</b>	<b>-1.6</b>	<b>-4.9</b>	<b>17.4</b>	<b>47.2</b>
Significant Items	0.0	0.0	0.0	0.0
<b>Reported NPAT</b>	<b>-1.6</b>	<b>-4.9</b>	<b>17.4</b>	<b>47.2</b>
Normalised EPS (¢)	-1.1	-2.6	7.8	21.2
Reported EPS (¢)	-1.1	-2.6	7.8	21.2
PER (X)	-215.0	-89.0	29.3	10.8
DPS (¢)	0.0	0.0	0.0	0.0
Franking (%)	0.0%	0.0%	0.0%	0.0%
Yield (%)	0.0%	0.0%	0.0%	0.0%
EPS Growth	n/a	141.6%	n/a	170.9%
EBIT/Sales (%)	n/a	n/a	34.2%	47.0%
Effective Tax Rate	21%	11%	30%	30%
Interest Cover (X)	-0.2	0.7	-0.2	0.0
Dividend Cover (X)	0.0	0.0	0.0	0.0

Source: AVO and ML estimates

## Sensitivities

Table 3: NPAT Sensitivities

NPAT change for:		07E	08E	09E
+ 1c change in A\$/US\$	A\$m	0.00	-0.76	-1.34
	%	0.0%	-5.4%	-3.1%
+ US\$10/oz change in gold price	A\$m	0.00	0.86	1.56
	%	0.0%	6.1%	3.6%

Source: ML Estimates

## Substantial Shareholders

Table 4: Substantial Shareholders

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Pala Inv	31.2	14.6%
CBA	27.0	12.7%

Source: IRESS

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Table 5: Global comps table

	Price	QRQ Rec	Mkt Cap	P/NAV	P/E	P/CF	Div Yield	EV / Reserve Oz (US\$/oz)	EV / Resource Oz (US\$/oz)	FY/CY07E Production (Koz)	Cash Costs (US\$/oz)	FY/CY08E Production (Koz)	Cash Costs (US\$/oz)	FY/CY08E Production Hedged
<b>Australasia</b>														
	<b>A\$</b>		<b>A\$M</b>	<b>(x)</b>	<b>(x)</b>	<b>(x)</b>	<b>%</b>							
Newcrest (NCMGF)	28.25	C-1-8 Buy	12,787	2.01	24.6	13.6	0.2%	292	176	1617	224	1853	165	0%
Kingsgate (KSKGF)	5.43	C-2-8 Ntrl	503	1.91	59.3	25.5	0.0%	230	111	86	436	107	398	0%
Lihir (LIHRFY)	3.89	C-1-9 Buy	7,409	1.90	34.9	20.0	0.0%	243	141	811	357	900	279	0%
Avoca Resources (AVORF)	2.28	C-1-9 Buy	340	1.41	36.2	16.5	0.0%	576	262	0	0	100	311	0%
Sino Gold (SIOGF)	7.32	C-1-9 Buy	1,327	1.66	25.0	16.9	0.0%	311	209	75	383	245	300	30%
Oxiana (OXFLF)	3.78	C-2-7 Ntrl	5,833	1.48	24.3	15.2	1.6%	407	71	99	446	101	491	0%
Bolnisi Gold (BXLGF)	2.78	C-1-9 Buy	794	1.31	na	na	0.0%	295	219	0	0	36	457	0%
Oceana Gold (OCGDF)	3.30	C-2-9 Ntrl	436	1.22	67.1	10.1	0.0%	148	55	188	490	300	328	38%
Perseverance (PRSVF)	0.14	C-1-9 Buy	126	0.67	-10.0	3.1	0.0%	133	45	127	388	195	419	31%
			<b>Average</b>	<b>1.82</b>	<b>27.7</b>	<b>15.5</b>		<b>210</b>	<b>147</b>					
<b>North America (Seniors)</b>														
	<b>US\$</b>		<b>US\$M</b>											
Goldcorp (GG)	30.43	C-1-7 Buy	21,423	2.43	36.7	20.6	0.0%	536	250	2214	154	2695	158	0%
Kinross (KGC)	15.04	C-1-9 Buy	8,904	2.30	28.4	16.5	0.0%	259	293	1633	341	2033	319	0%
Newmont (NEM)	44.83	B-2-8 Ntrl	20,218	2.21	28.6	14.3	0.9%	223	166	5348	423	6070	421	0%
Barrick (ABX)	40.55	C-2-7 Ntrl	35,076	2.90	24.7	15.0	0.7%	270	181	8202	349	8285	376	0%
Buenaventura (BVN)	48.89	C-2-7 Ntrl	6,221	1.72	13.2	15.7	1.0%	376	376	1024	317	1185	304	28%
			<b>Average</b>	<b>2.50</b>	<b>27.9</b>	<b>16.3</b>		<b>328</b>	<b>193</b>					
<b>North America (Mid-caps)</b>														
	<b>US\$</b>													
Agnico-Eagle Mines (AEM)	51.11	C-2-7 Ntrl	6,849	2.76	48.2	29.9	0.2%	621	380	241	-485	389	-63	0%
Centerra Gold Inc. (YCG)	9.34	C-2-9 Ntrl	2,017	2.22	17.0	11.9	0.0%	290	149	548	429	790	348	0%
Eldorado Gold Corp. (EGO)	6.07	C-2-9 Neutral	2,070	1.96	na	18.4	0.0%	304	213	238	263	378	229	0%
Golden Star Resources (GSS)	3.98	C-2-9 Ntrl	928	1.73	14.2	9.0	0.0%	207	141	253	663	505	449	0%
Hecla Mining Corp. (HL)	8.55	C-2-9 Ntrl	1,026	1.90	21.7	11.9	0.0%	470	341	143	440	143	420	0%
IAMGOLD Corp. (YIMG)	8.48	C-1-7 Buy	2,485	1.60	27.4	11.6	0.4%	585	147	1015	416	1019	420	0%
Meridian Gold Inc. (incl Esquel) (MDG)	2.86	C-2-9 Ntrl	3,319	2.72	34.2	22.2	0.0%	716	522	320	-45	343	-29	0%
Northgate Minerals Corp. (NXG)	2.61	C-2-9 Ntrl	523	1.27	11.1	6.2	0.0%	62	31	280	185	273	98	19%
NA Palladium (1) (YPDL)	8.12	C-2-9 Ntrl	426	1.84	42.7	14.5		162	118	251	83	258	124	
Yamana (YYRI)	11.64	C-1-7 Buy	4,109	1.91	10.0	8.2	0.3%	na	na	609	-114	787	0	na
Royal Gold (RGLD)	33.20	C-2-7 Ntrl	963	2.11	36.0	21.7	0.8%	na	na		0		0	na
			<b>Average</b>	<b>2.24</b>	<b>27.2</b>	<b>18.2</b>		<b>375</b>	<b>252</b>					
<b>South Africa</b>														
	<b>ZAR\$</b>		<b>ZAR\$M</b>											
AngloGold(AULGF)	303.20	C-1-7 Buy	80,227	0.84	13.2	7.5	3.4%	181	67	5693	328	6612	295	31%
DRD (DRDGF)	5.54	C-2-9 Ntrl	2,084	0.71			0.0%	45	7	477	527	416	584	0%
Gold Fields(GFIOF)	121.30	C-1-7 Buy	79,108	1.11	22.2	9.1	2.1%	129	50	4285	376	4544	386	0%
Harmony(HGMCF)	71.99	C-3-7 Sell	28,776	0.91	34.4	14.9	0.0%	85	8	2334	407	2417	522	23%
			<b>Average</b>	<b>0.96</b>	<b>20.3</b>	<b>9.2</b>		<b>143</b>	<b>51</b>					
<b>International</b>														
Peter Hambro Min (UK) PTHBF	12.90	C-1-9 Buy	1,047	1.55	11.6	na	0.0%	23	na	275	115	390	138	0%
Zijin Min Group (China) ZIJMF	4.52	C-2-7 Ntrl	47,519	2.76	17.3	11.1	2.0%	793	na	804	285	844	290	0%
Polyus (Russia) XPLGY	43.00	C-2-9 Ntrl	7,456	1.79	27.2	22.0	0.0%	237	58	1192	276	1249	287	0%

Source: ML estimates

## Price objective basis & risk

### Avoca Resources (AVORF)

AVO is focused on developing the 797koz Au resource Trident project in Western Australia with first production targeted this quarter with an initial 6 year mine life. AVO is trading at just 1.4x NAV which is cheap compared to domestic peer average 1.8x. Our price target is A\$2.75ps, which equates to 1.7x NAV. We believe our price objective is reasonable as the discount to peers reflects the developmental nature of the asset. We believe that this discount will narrow as exploration continues, resources and reserves grow and the project moves into construction and commissioning phase

Risks comprise commodity price and exchange rate movements, potential delays to plant construction and commissioning issues.

## Analyst Certification

I, Andrew Richards, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### *iQmethod*<sup>SM</sup> Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
<b>Quality of Earnings</b>		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
<b>Valuation Toolkit</b>		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

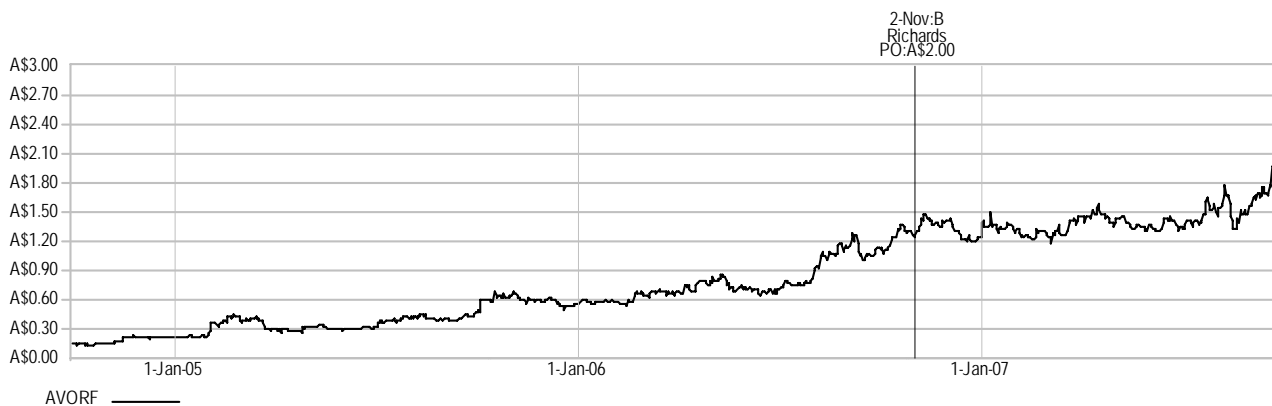
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### AVORF Price Chart



B : Buy, N : Neutral, S : Sell, PO : Price objective, NA : No longer valid

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of September 30, 2007 or such later date as indicated.

### Investment Rating Distribution: Non-Ferrous Metals/Mining & Minerals Group (as of 01 Oct 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	60	52.17%	Buy	15	30.00%
Neutral	44	38.26%	Neutral	14	35.90%
Sell	11	9.57%	Sell	1	14.29%

### Investment Rating Distribution: Global Group (as of 01 Oct 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1701	47.03%	Buy	437	29.15%
Neutral	1611	44.54%	Neutral	425	29.11%
Sell	305	8.43%	Sell	58	21.09%

\* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months.

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