

# Resource & drilling updates

## Higginsville resource increased 23% to 1.35Moz Au

AVO has announced a 246koz Au increase (23%) in resources to 1.35Moz Au. Importantly, the resource includes the initial resources from the Wills, Apollo and Poseidon South mineralisation (adding 117koz Au). The Athena resource was upgraded by 25koz Au. The Chalice deposit is now included 72koz Au. AVO expects to release an updated reserves statement in mid-January 2008.

## Drilling extends Trident 500m

AVO also announced that drilling program results extend the known mineralisation at Trident by 500m. The mineralisation encountered is similar to Athena style mineralisation with one intersection associated with visible gold. A surface drilling program will commence in 2008. There is potential the drilling program will provide extension to the current Trident life of mine. AVO has a 2008 surface drilling budget of A\$11m.

## BUY

AVO is an emerging gold producer offering attractive production growth with 170-190kozpa Au rates targeted for FY09. Mine life is around 6 years with strong upside from exploration. Within 18-24 months AVO should be mining in the high grade Athena zone where cash costs may decline to as low as US\$200/oz. We expect that low cash costs will make AVO one of Australia's highest margin gold miners. AVO is trading at 1.2x NAV versus peer average of ~1.7x. We have a price objective of A\$3.15/sh (1.7x NAV).

## Estimates (Jun)

(A\$)	2006A	2007A	2008E	2009E	2010E
Net Profit b/f Abnormals	(2)	(4)	17	57	64
EPS	(0.011)	(0.023)	0.078	0.255	0.287
EPS Change (YoY)	-46.5%	115.9%	-439.4%	226.9%	12.5%
Dividend / Share	0	0	0	0	0
Free Cash Flow / Share	(0.036)	(0.123)	(0.242)	0.270	0.367

## Valuation (Jun)

	2006A	2007A	2008E	2009E	2010E
P/E	NM	NM	27.80x	8.50x	7.56x
Dividend Yield	0%	0%	0%	0%	0%
EV / EBITDA*	-134.37x	-72.33x	11.63x	3.81x	2.87x
Free Cash Flow Yield*	-1.16%	-5.15%	-11.72%	13.07%	17.76%

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 5.



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## Stock Data

Price	A\$2.17
Price Objective	A\$3.15
Date Established	8-Nov-2007
Investment Opinion	C-1-9
Volatility Risk	HIGH
52-Week Range	A\$1.15-A\$2.72
Mrkt Val / Shares Out (mn)	US\$397 / 213.5
Average Daily Volume	493,179
ML Symbol / Exchange	AVORF / ASX
Bloomberg / Reuters	AVO AU / AVO.AX
ROE (2008E)	15.8%
Net Dbt to Eqty (Jun-2007A)	-60.2%
Est. 5-Yr EPS / DPS Growth	NA / NA
Free Float	100.0%



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Refer to important disclosures on page 6 to 7. Analyst Certification on page 5. Price Objective Basis/Risk on page 5.

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

## Key Income Statement Data (Jun)

(A\$ Millions)	2006A	2007A	2008E	2009E	2010E
Sales	0	0	81	165	179
Operating Expenses	(2)	(5)	(40)	(56)	(62)
<b>EBITDA</b>	<b>(2)</b>	<b>(5)</b>	<b>41</b>	<b>110</b>	<b>117</b>
Depreciation & Amortization	0	0	(14)	(27)	(30)
<b>EBIT</b>	<b>(2)</b>	<b>(5)</b>	<b>27</b>	<b>83</b>	<b>87</b>
Net Interest & Other income	0	1	(2)	(1)	5
Associates	NA	NA	NA	NA	NA
Pretax Income	(2)	(5)	25	82	92
Tax (expense) / Benefit	0	0	(7)	(25)	(28)
<b>Net Profit b/f Abnormals</b>	<b>(2)</b>	<b>(4)</b>	<b>17</b>	<b>57</b>	<b>64</b>
Non-Recurring Items	0	0	0	0	0
Net Income (Reported)	(2)	(4)	17	57	64
Avg F Diluted Shares Outstanding	150	194	224	224	224

## Key Cash Flow Statement Data

EBITDA	(2)	(5)	41	110	117
Change in Working Capital	1	3	0	0	0
Deferred Taxation Charge	0	0	0	0	0
Other Adjustments, Net	1	1	1	1	1
<b>Cash Flow from Operations</b>	<b>0</b>	<b>(1)</b>	<b>32</b>	<b>85</b>	<b>95</b>
<b>Capital Expenditure</b>	<b>(6)</b>	<b>(23)</b>	<b>(87)</b>	<b>(25)</b>	<b>(13)</b>
(Acquisition) / Disposal of Investments	0	(2)	0	0	0
Other Cash Inflow / (Outflow)	0	0	0	0	0
<b>Cash Flow from Investing</b>	<b>(6)</b>	<b>(25)</b>	<b>(87)</b>	<b>(25)</b>	<b>(13)</b>
Shares Issue / (Repurchase)	11	76	0	0	0
Cost of Dividends Paid	0	0	0	0	0
<b>Cash Flow from Financing</b>	<b>11</b>	<b>129</b>	<b>(8)</b>	<b>0</b>	<b>(40)</b>
<b>Free Cash Flow</b>	<b>(5)</b>	<b>(24)</b>	<b>(54)</b>	<b>61</b>	<b>82</b>
<b>Net Debt</b>	<b>(7)</b>	<b>(61)</b>	<b>(7)</b>	<b>(68)</b>	<b>(150)</b>
Change in Net Debt	NA	NA	NA	NA	NA

## Key Balance Sheet Data

Property, Plant & Equipment	17	50	122	118	100
Other Non-Current Assets	1	1	1	1	1
Trade Receivables	0	1	1	1	1
Cash & Equivalents	7	109	47	108	150
Other Current Assets	0	0	0	0	0
<b>Total Assets</b>	<b>26</b>	<b>161</b>	<b>171</b>	<b>228</b>	<b>252</b>
Long-Term Debt	0	35	40	0	0
Other Non-Current Liabilities	0	0	0	0	0
Short-Term Debt	0	13	0	40	0
Other Current Liabilities	0	0	0	0	0
<b>Total Liabilities</b>	<b>2</b>	<b>59</b>	<b>51</b>	<b>51</b>	<b>11</b>
<b>Total Equity</b>	<b>24</b>	<b>102</b>	<b>120</b>	<b>177</b>	<b>241</b>
Total Equity & Liabilities	26	161	171	228	252

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

Return on Capital Employed	-8.5%	-4.2%	13.8%	32.2%	28.4%
Return on Equity	-8.5%	-7.1%	15.8%	38.6%	30.8%
Operating Margin	NA	NA	33.9%	50.2%	48.8%
EBITDA Margin	NA	NA	50.8%	66.4%	65.5%

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

Cash Realization Ratio	-0.1x	0.1x	1.8x	1.5x	1.5x
Asset Replacement Ratio	126.1x	66.1x	6.3x	0.9x	0.4x
Tax Rate (Reported)	21.4%	6.0%	30.0%	30.0%	30.0%
Net Debt-to-Equity Ratio	-31.4%	-60.2%	-6.0%	-38.3%	-62.2%
Interest Cover	NA	-7.5x	5.0x	17.3x	73.0x

## Key Metrics

Franking	0%	0%	0%	0%	0%
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\* For full definitions of iQmethod<sup>SM</sup> measures, see page 5.

## 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 3.9x

## Resources update

AVO has announced its December 2007 JORC resource update for the Higginsville Gold Project in Western Australia. The JORC resource has been upgraded 246koz Au (up 23%) to 1.35Moz Au (11.7mt @ 3.6g/t Au). The increase includes the addition of the 78koz Au Chalice deposit.

The new resource includes:

- The addition of 117koz Au from initial resource estimates for Wills (+14koz Au) and for Apollo (+57koz Au) and Poseidon South (+46koz Au) at Trident;
- The addition of 27koz Au from updated resource estimations for the Eastern Zone (+2koz Au) and Athena Lodes (+25koz Au) at Trident;
- The re-estimation of the Fairplay North and Two Boys East Projects (+24koz Au); and
- The 78koz Au Chalice deposit was included;

The updated resource was calculated using a A\$800/oz gold price. The company expects to release a reserves update in January 2008.

## Drilling extends Trident 500m

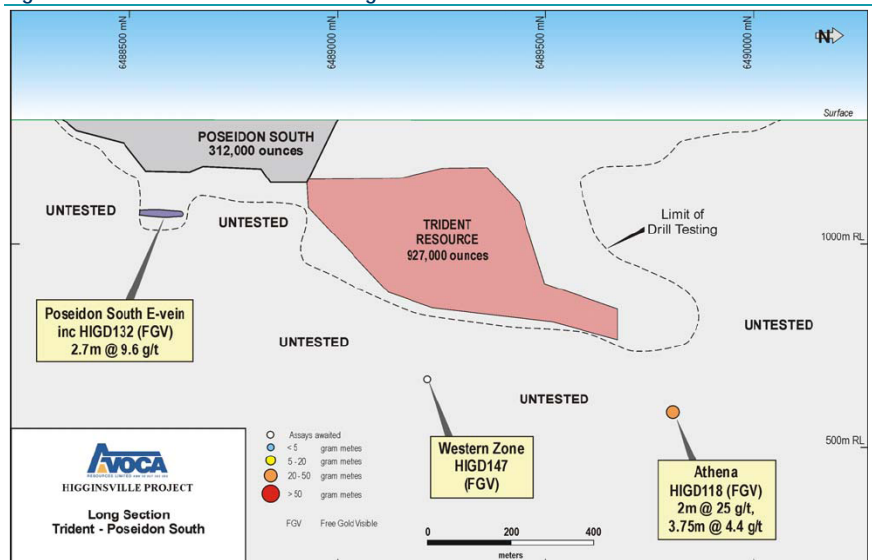
AVO has also announced results from its drilling program at Trident. The drilling results extend the known mineralisation by 500m. The resource remains open at depth and to the north.

A single diamond drill hole 400m north of the current Athena resource boundary intersected two zones of mineralisation. The mineralisation within the hole is similar to the Athena-style mineralisation. The first intersection contained abundant visible gold. Assay results from the two zones returned:

- 2m @ 25g/t Au from 783.5m; and
- 3.75m @ 4.4g/t Au from 799.9m.

AVO will commence a surface drilling program in 2008 to test for additional mineralisation. There is potential that the program will provide a material extension to the Trident life of mine.

Figure 1: Location of successful drilling in relation to Trident resource



Source: AVO

## Gold comps table

Table 1: Global gold comps table

								EV /	EV /				FY/CY08E	
	Price	QRQ Rec	Mkt Cap	P/NAV	P/E	P/CF	Div Yield	Reserve Oz	Resource Oz	FY/CY07E Production (Koz)	Cash Costs (US\$/oz)	FY/CY08E Production (Koz)	Cash Costs (US\$/oz)	Production Hedged
<b>Australasia</b>	<b>A\$</b>		<b>A\$M</b>	(x)	(x)	(x)	%	(US\$/oz)	(US\$/oz)					
Newcrest (NCMGF)	31.67	C-1-8 Buy	14,338	2.04	27.8	15.2	0.2%	359	216	1617	224	1881	183	0%
Lihir (LIHRF/Y)	3.22	C-1-9 Buy	6,133	1.36	27.5	15.9	0.0%	200	117	701	370	850	292	0%
Kingsgate (KSKGF)	4.54	C-2-8 Ntrl	421	1.50	46.2	21.6	0.0%	160	77	86	436	98	460	0%
Sino Gold (SIOGF)	6.35	C-1-9 Buy	1,373	1.41	34.9	23.4	0.0%	388	204	60	492	178	311	30%
Oxiana (OXFLF)	3.59	C-2-7 Ntrl	5,540	1.45	23.3	14.5	2.2%	430	75	102	445	100	505	0%
Avoca Resources (AVORF)	2.23	C-1-9 Buy	332	1.21	28.2	16.8	0.0%	566	209	0	0	100	344	0%
Oceana Gold (OCGDF)	2.33	C-2-9 Ntrl	308	0.87	62.3	7.9	0.0%	122	46	171	574	300	390	38%
			<b>Average</b>	<b>1.72</b>	<b>27.9</b>	<b>15.7</b>		<b>403</b>	<b>163</b>					
<b>North America (Seniors)</b>	<b>US\$</b>		<b>US\$M</b>											
Goldcorp (GG)	31.21	C-1-7 Buy	21,972	2.08	31.8	19.4	0.0%	547	256	2214	154	2695	160	0%
Kinross (KGC)	16.08	C-2-9 Ntrl	9,535	1.94	26.8	15.9	0.0%	276	311	1633	341	2033	334	0%
Newmont (NEM)	46.60	B-2-8 Ntrl	21,063	1.86	22.9	13.2	0.9%	228	170	5348	422	5684	432	0%
Barrick (ABX)	37.39	C-2-7 Ntrl	32,342	2.27	18.7	11.2	0.8%	254	170	8139	353	8261	381	0%
Buenaventura (BVN)	51.00	C-2-7 Ntrl	6,489	2.32	12.5	13.7	0.9%	388		1021	319	1201	303	28%
			<b>Average</b>	<b>2.10</b>	<b>23.2</b>	<b>14.3</b>		<b>330</b>	<b>193</b>					
<b>North America (Mid-caps)</b>	<b>US\$</b>													
Agnico-Eagle Mines (AEM)	45.90	C-2-7 Ntrl	6,242	2.13	56.7	37.0	0.4%	592	362	241	-397	357	50	0%
Centerra Gold Inc. (YCG)	10.98	C-2-9 Ntrl	2,372	1.98	15.7	11.5	0.0%	341	175	548	429	790	367	0%
Eldorado Gold Corp. (EGO)	5.19	C-2-9 Ntrl	1,780	1.42	17.3	10.3	0.0%	249	175	299	266	424	264	0%
Golden Star Resources (GSS)	3.04	C-2-9 Ntrl	708	1.36	23.4	7.2	0.0%	187	127		596	449	393	0%
Hecla Mining Corp. (HL)	8.77	C-2-9 Ntrl	1,052	2.51	21.2	10.9	0.0%	494	358	143	440	143	500	0%
IAMGOLD Corp. (YIMG)	7.78	C-1-7 Buy	2,280	1.36	18.5	9.5	0.4%	531	134	961	421	1018	440	0%
Northgate Minerals Corp. (NXG)	2.96	C-2-9 Ntrl	593	1.16	12.9	5.9	0.0%	163	82	271	-49	230	171	19%
Royal Gold (RGLD)	26.69	C-1-7 Buy	774	1.58	26.5	16.9	1.0%	na	na		0		0	na
Yamana (YYRI)	11.95	C-1-7 Buy	7,851	1.77	12.2	9.9	0.3%	na	na	605	-114	1313	0	na
			<b>Average</b>	<b>1.81</b>	<b>26.3</b>	<b>17.2</b>		<b>293</b>	<b>160</b>					
<b>South Africa</b>	<b>ZAR\$</b>		<b>ZAR\$M</b>											
AngloGold(AULGF)	293.00	C-1-7 Buy	77,528	0.95	19.7	10.0	2.3%	178	66	5615	351	5930	378	31%
DRD (DRDGF)	5.17	C-2-9 Ntrl	1,945	1.18			0.0%	42	6	477	592	365	602	0%
Gold Fields(GFIOF)	100.31	C-1-7 Buy	65,436	0.92	24.8	8.2	1.9%	106	41	4285	376	4294	442	0%
Harmony(HGMCF)	66.80	C-2-9 Ntrl	26,726	1.23	100.3	16.4	0.0%	86	8	2334	407	2229	593	23%
			<b>Average</b>	<b>0.98</b>	<b>34.3</b>	<b>10.2</b>		<b>135</b>	<b>47</b>					
<b>International</b>														
Peter Hambro Min (UK) PTHBF	12.31	C-1-9 Buy	999	1.06	9.2	na	0.0%	22	na	275	115	390	151	0%
Zijin Min Group (China) ZIJMF	4.52	C-2-7 Ntrl	47,519	2.76	16.1	10.6	2.0%	781	na	804	285	844	290	0%
Polyus (Russia) XPLGY	42.50	C-2-9 Ntrl	7,369	1.36	28.5	23.7	0.0%	240	59	1192	343	1249	371	0%
Lingbao Gold			2,185		24.3	59.3		221	152	322	230			

Source: Merrill Lynch estimates

## Price objective basis & risk

### Avoca Resources (AVORF)

AVO is focused on developing the 927koz Au resource Trident project in Western Australia. High grade production commenced in August with an initial 6 year mine life. AVO is trading at 1.2x NAV which is cheap compared to domestic peer average 1.7x. Our price target is A\$3.15ps (1.7x NAV). 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 production rises.

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.

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Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
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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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 November 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%

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