

Bring on the gold pour!

Price weakness = buy opportunity

In trade yesterday, AVO's share price dropped by more than 10% to a 3 month low of \$2.01. In our view, yesterday's sell down was temporary and could well be end of financial year profit taking by investors. We retain our Buy rating on the stock, AVO is trading at 1.19x NAV, which is at the lower end compared to the peer average of 1.60x.

First gold pour imminent

Commissioning at the Higginsville treatment plant is progressing well – we are expecting its first gold pour sometime next week. Future catalysts for AVO include successful delivery on projected physical and cash cost estimates post production ramp-up, and exploration discovery news flow from both the Trident deposit and its JV's.

Estimates (Jun)

(A\$)	2006A	2007A	2008E	2009E	2010E
Net Profit b/f Abnormals	(2)	(4)	(6)	45	74
EPS	(0.011)	(0.023)	(0.026)	0.202	0.332
EPS Change (YoY)	-46.5%	115.9%	14.4%	-867.4%	64.5%
Dividend / Share	0	0	0	0	0
Free Cash Flow / Share	(0.036)	(0.123)	(0.515)	0.194	0.390

Valuation (Jun)

	2006A	2007A	2008E	2009E	2010E
P/E	NM	NM	NM	10.84x	6.59x
Dividend Yield	0%	0%	0%	0%	0%
EV / EBITDA*	-135.64x	-73.11x	-101.40x	4.90x	2.89x
Free Cash Flow Yield*	-1.12%	-4.98%	-23.81%	9.08%	18.24%

* For full definitions of *iQmethod*SM measures, see page 6.

Equity | Australia | Gold & Precious Metals
02 July 2008



Merrill Lynch

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Stock Data

Price	A\$2.19
Price Objective	A\$3.15
Date Established	8-Nov-2007
Investment Opinion	C-1-9
Volatility Risk	HIGH
52-Week Range	A\$1.26-A\$2.91
Mrkt Val / Shares Out (mn)	US\$457 / 218.9
Average Daily Volume	774,912
ML Symbol / Exchange	AVORF / ASX
Bloomberg / Reuters	AVO AU / AVO.AX
ROE (2008E)	-6.0%
Net Dbt to Eqty (Jun-2007A)	-60.2%
Est. 5-Yr EPS / DPS Growth	NA / NA
Free Float	100.0%



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iQprofileSM Avoca Resources

Key Income Statement Data (Jun)	2006A	2007A	2008E	2009E	2010E
(A\$ Millions)					
Sales	0	0	0	176	219
Operating Expenses	(2)	(5)	(6)	(74)	(75)
EBITDA	(2)	(5)	(5)	102	143
Depreciation & Amortization	0	0	(1)	(30)	(34)
EBIT	(2)	(5)	(6)	72	109
Net Interest & Other income	0	1	0	(7)	(3)
Associates	NA	NA	NA	NA	NA
Pretax Income	(2)	(5)	(6)	65	106
Tax (expense) / Benefit	0	0	0	(19)	(32)
Net Profit b/f Abnormals	(2)	(4)	(6)	45	74
Non-Recurring Items	0	0	0	0	0
Net Income (Reported)	(2)	(4)	(6)	45	74
Avg F Diluted Shares Outstanding	150	194	222	224	224

Key Cash Flow Statement Data

EBITDA	(2)	(5)	(5)	102	143
Change in Working Capital	1	3	3	1	0
Deferred Taxation Charge	0	0	0	0	0
Other Adjustments, Net	1	1	1	1	1
Cash Flow from Operations	0	(1)	(2)	77	109
Capital Expenditure	(6)	(23)	(112)	(34)	(22)
(Acquisition) / Disposal of Investments	0	(2)	0	0	0
Other Cash Inflow / (Outflow)	0	0	0	0	0
Cash Flow from Investing	(6)	(25)	(112)	(34)	(22)
Shares Issue / (Repurchase)	11	76	2	0	0
Cost of Dividends Paid	0	0	0	0	0
Cash Flow from Financing	11	129	42	0	(35)
Free Cash Flow	(5)	(24)	(114)	44	87
Net Debt	(7)	(61)	50	7	(81)
Change in Net Debt	NA	NA	NA	NA	NA

Key Balance Sheet Data

Property, Plant & Equipment	17	50	169	172	159
Other Non-Current Assets	1	1	3	3	3
Trade Receivables	0	1	5	5	5
Cash & Equivalents	7	109	38	81	134
Other Current Assets	0	0	0	0	0
Total Assets	26	161	216	263	302
Long-Term Debt	0	35	88	53	53
Other Non-Current Liabilities	0	0	0	0	0
Short-Term Debt	0	13	0	35	0
Other Current Liabilities	0	0	0	0	0
Total Liabilities	2	59	110	111	76
Total Equity	24	102	106	152	227
Total Equity & Liabilities	26	161	216	263	302

iQmethodSM - Bus Performance*

Return on Capital Employed	-8.5%	-4.2%	-0.9%	23.9%	30.2%
Return on Equity	-8.5%	-7.1%	-6.0%	35.0%	39.3%
Operating Margin	NA	NA	-	40.9%	49.9%
			1,949,311.6%		
EBITDA Margin	NA	NA	-1,344.0%	58.1%	65.5%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	-0.1x	0.1x	0.3x	1.7x	1.5x
Asset Replacement Ratio	126.1x	66.1x	179.9x	1.1x	0.6x
Tax Rate (Reported)	21.4%	6.0%	0.4%	30.0%	30.0%
Net Debt-to-Equity Ratio	-31.4%	-60.2%	47.5%	4.5%	-35.5%
Interest Cover	NA	-7.5x	-1.4x	6.8x	14.7x

Key Metrics

Franking	0%	0%	0%	0%	0%
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* For full definitions of iQmethodSM measures, see page 6.

Company Description

Avoca Resources is an emerging gold miner in Western Australia with its Trident deposit. First production is targeted 2H08 with an attractive growth profile and significant upside from exploration.

Investment Thesis

Avoca is a single gold mine developer starting production shortly. While project delivery and production performance are risks, we see good value post a successful commissioning and gold pour.

Table 1: Macro Assumptions

Assumptions	08E	09E	10E
Average Exchange Rate (A\$/US\$)	0.90	0.94	0.87
Gold Price (US\$/oz)	825	968	1,050

Source: ML estimate

Stock Data

Price to Book Value	4.5x
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Higginsville gold pour on track

First gold pour imminent

Mill commissioning with Trident low grade ore is progressing well. All equipment is now operational, including the crusher, ball mill, reactor (Knelson & Acacia), leach tank (and agitators) and elution column. Gold room commissioning is under way. We expect announcement of first gold pour in the next week.

Plant delivered on time and budget

Higginsville plant construction is now complete, meeting the previously advised \$49.2m budget and June 2008 targeted date.

Mine performance exceeding plan

Underground development for high grade mill feed is progressing well. Management advised that 140kt of the targeted 150kt ore stockpile has been mined and ready for treatment. More recently, the development rate has now reached around 4,000 tonnes per day. On the basis of the current rate, we expect the mine to achieve, if not exceed the targeted stockpile by first gold pour.

Power is not a constraint

The 10MW dual diesel / gas-fired power station is now complete and supplying mine and treatment plant power. It is currently being run on diesel, and hence not impacted by the recent excessive gas pricing caused by lack of WA supply.

Valuation

Our base case valuation of A\$1.87/sh is based on a 6 year mine life using a 10% discount rate.

Table 2: NAV @ 10% discount rate

	A\$m	A\$/share
Higginsville Gold Project	545.34	2.49
Taxation	-159.03	-0.73
Hedging	0.00	0.00
Exploration	20.00	0.09
Net (Debt)/Cash	3.87	0.02
TOTAL	410.18	1.87

Source: ML estimates

AVO production summary

Table 3: Higginsville Production Physicals

Higginsville Production (oz)	08E	09E	10E
Gold	0	170,278	180,205
Cash Operating Costs	08E	09E	10E
Higginsville (US\$/oz)	0	374	333
Higginsville (A\$/oz)	0	398	384

Source: ML estimates

Chart 1: Avoca's Higginsville Treatment Plant



Source: AVO

Profit and Loss

Table 4: Profit and Loss

Profit and Loss	07A	08E	09E	10E
Sales	0.0	0.0	176.0	218.7
Other Revenue	0.0	0.4	0.0	0.0
Total Revenue	0.0	0.4	176.0	218.7
Operating Costs	-1.1	0.0	-67.8	-69.3
Exploration	-0.9	-1.1	-1.0	-1.0
Other Costs	-3.0	-4.6	-5.0	-5.1
EBITDA	-5.0	-5.3	102.2	143.2
Depreciation & Amortisation	-0.4	-0.6	-30.2	-34.0
EBIT	-5.3	-5.9	72.0	109.2
Net Interest	0.6	0.1	-7.3	-2.9
Pretax Profit	-4.7	-5.9	64.6	106.3
Tax	0.3	0.0	-19.4	-31.9
Operating NPAT	-4.5	-5.8	45.3	74.4
OEI	0.0	0.0	0.0	0.0
NPAT (Normalised for FCA)	-4.5	-5.8	45.3	74.4
Significant Items	0.0	0.0	0.0	0.0
Reported NPAT	-4.5	-5.8	45.3	74.4
Normalised EPS (¢)	-2.3	-2.8	20.2	33.2
Reported EPS (¢)	-2.3	-2.6	20.2	33.2
PER (X)	-113.0	-98.8	12.9	7.8
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	115.9%	22.2%	-818.7%	64.5%
EBIT/Sales (%)	n/a	n/a	40.9%	49.9%
Effective Tax Rate	6%	0%	30%	30%

Source: ML estimates

Sensitivities

Table 5: Sensitivities

NPAT change for:		08E	09E	10E
+ 1c change in A\$/US\$	A\$m	0.05	-1.29	-1.67
	%	-0.9%	-2.3%	-2.0%
+ US\$10/oz change in gold price	A\$m	0.00	1.15	1.30
	%	0.0%	2.1%	1.6%

Source: ML estimate

Price objective basis & risk

Avoca Resources (AVORF)

Our PO of \$3.15/share is 1.68x our NAV of \$1.87/share (10% WACC over life of mine). This is inline with the current P/NAV for the Australian gold sector. Risks to our valuation are exchange rate, gold prices, as well as operating costs for the Higginsville project.

Analyst Certification

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Australia-Metals, Mining & Steel Coverage Cluster

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	Avoca Resources	AVORF	AVO AU	Mike Harrowell
	BlueScope Steel	BLSFF	BSL AU	Mike Harrowell
	Gloucester Coal	GCRLF	GCL AU	Mike Harrowell
	Lihir Gold Ltd	LIHRF	LGL AU	Mike Harrowell
	Lihir Gold-ADR	LIHR	LIHR US	Mike Harrowell
	Mount Gibson Iro	MTGRF	MGX AU	Mike Harrowell
	Murchison Metals	MUMTF	MMX AU	Mike Harrowell
	Newcrest Mining	NCMGF	NCM AU	Mike Harrowell
	Oceana Gold	OCGDF	OGC AU	Anna Kassianos
	OneSteel	OSTLF	OST AU	Mike Harrowell
	Oxiana	OXFLF	OXR AU	Mike Harrowell
	Paladin Energy	PALAF	PDN AU	Olivia Ker
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	Sims Group	SMUPF	SGM AU	Mike Harrowell
	Sino Gold	SIOGF	SGX AU	Mike Harrowell
	Zinifex	ZFEXF	ZFX AU	Mike Harrowell
NEUTRAL				
	Energy Res Aust	EGRAF	ERA AU	Olivia Ker
UNDERPERFORM				
	Alumina	AWCMF	AWC AU	Vicky Binns
	Alumina Ltd-ADR	AWC	AWC US	Vicky Binns
	Felix Resources Limited	FLRFF	FLX AU	Mike Harrowell
	Iluka Resources	ILKAF	ILU AU	Mike Harrowell
	Kingsgate Consolidated Ltd	KSKGF	KCN AU	Mike Harrowell
	Macarthur Coal Ltd.	MACDF	MCC AU	Mike Harrowell
	Minara Resources	MREJF	MRE AU	Mike Harrowell
RESTRICTED				
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	BHP Billiton-ADR	BHP	BHP US	Vicky Binns
	Rio Tinto Ltd	RTNTF	RIO AU	Vicky Binns

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iQmethodSM Measures Definitions

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
Quality of Earnings		
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
Valuation Toolkit		
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

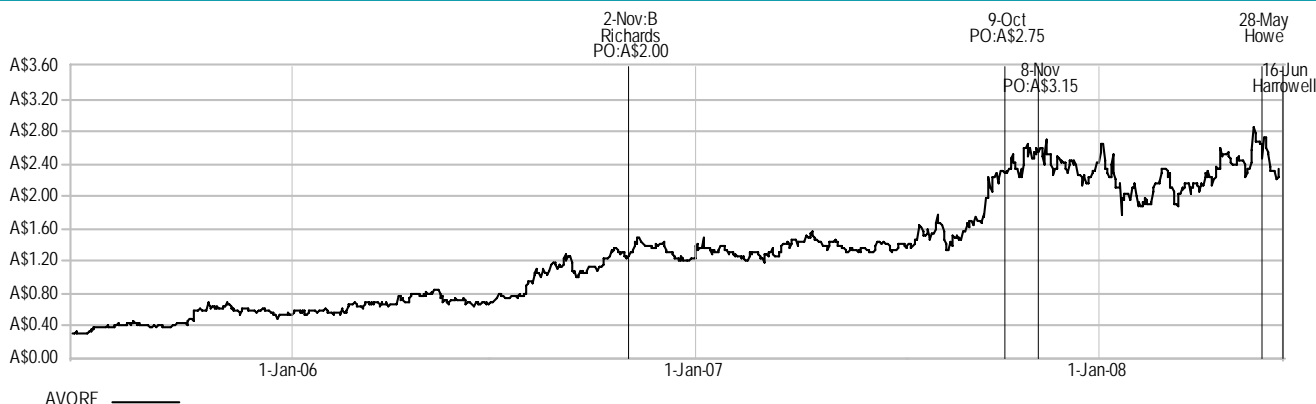
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AVORF Price Chart



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

Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of May 31, 2008 or such later date as indicated.

Investment Rating Distribution: Non-Ferrous Metals/Mining & Minerals Group (as of 01 Jul 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	71	52.99%	Buy	13	20.63%
Neutral	30	22.39%	Neutral	9	39.13%
Sell	33	24.63%	Sell	5	19.23%

Investment Rating Distribution: Global Group (as of 01 Jul 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1664	47.42%	Buy	441	29.46%
Neutral	803	22.88%	Neutral	224	31.46%
Sell	1042	29.70%	Sell	217	22.84%

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