Avoca Resources

Company Update BUY

Equity | Australia | Gold & Precious Metals
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Quiet achiever...no reason for share price weakness

Merrill Lynch

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Reiterate BUY - share price weakness not ops related

AVO's share price has dropped by more than 30% in the last month, from a high of $2.29. In our view it is spot gold related and temporary. We have upgraded our valuation by 15% to $2.31/sh on the back of our recent visit. We reiterate our Buy - AVO is trading at a 0.73x NAV, at the lower end of the 1.20x peer average.

Spot gold is oversold - it should run

Spot gold is approaching its one year anniversary of bottoming out at US$652/oz (before rallying to $1023 in March 2008). Similarly the gold RSI is approaching 20, which is a classic signal of being oversold in a declining bear market. We see gold holding at around $800 to $850/oz, before building a base and moving much higher in the coming months. This also signals an opportune time for getting into Aussie gold stocks (with some trading below valuations), and especially AVO which should be in full production by this time.

Full production by year end

As more metallurgical targets are achieved, full production with the high grade stockpile from a 2006 reserve base of 3.4Mt @ 5.3g/t Au is expected to easily achieve previous guidance of between 160koz to 190koz. Costs have been revised to around $400 to $450/oz, up from $379/oz.

Ramp-up targets being achieved

Recent inspection of Higginsville has provided comfort on metallurgical and processing targets being achieved, and in some instances exceeded – a great achievement for a treatment plant only three weeks into commissioning. That being said, and as with all start-ups there is still risk for operational issues to surface. Exploration at Trident and other near mine targets continues to excite, ensuring endless ore sources for near mine mill feed for the future.

Estimates (Jun)

(A$)	2006A	2007A	2008E	2009E	2010E
Net Profit b/f Abnormals	(2)	(4)	(4)	34	76
EPS	(0.011)	(0.023)	(0.018)	0.151	0.337
EPS Change (YoY)	46.5%	-115.9%	20.0%	NM	122.6%
Dividend / Share	0	0	0	0	0
Free Cash Flow / Share	(0.036)	(0.123)	(0.625)	0.064	0.418

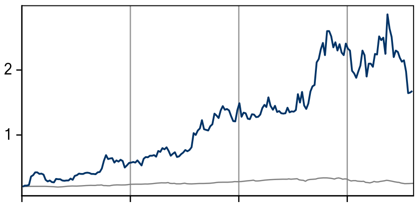
Valuation (Jun)

	2006A	2007A	2008E	2009E	2010E
P/E	NM	NM	NM	11.09x	4.98x
Dividend Yield	0%	0%	0%	0%	0%
EV / EBITDA*	-103.31x	-53.21x	-111.24x	4.65x	2.23x
Free Cash Flow Yield*	-1.43%	-6.38%	-36.43%	3.85%	25.06%

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

Stock Data

Price	A$1.68
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$333 / 222.5
Average Daily Volume	723,350
ML Symbol / Exchange	AVORF / ASX
Bloomberg / Reuters	AVO AU / AVO.AX
ROE (2008E)	-4.1%
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 7 to 8. Analyst Certification on Page 5. Price Objective Basis/Risk on page 5.

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iQprofile SM Avoca Resources

Key Income Statement Data (Jun)	2006A	2007A	2008E	2009E	2010E
(A$ Millions)					
Sales	0	0	0	179	242
Operating Expenses	(2)	(5)	(4)	(87)	(93)
EBITDA	(2)	(5)	(4)	92	149
Depreciation & Amortization	0	0	(1)	(35)	(38)
EBIT	(2)	(5)	(4)	57	111
Net Interest & Other income	0	1	0	(8)	(3)
Associates	NA	NA	NA	NA	NA
Pretax Income	(2)	(5)	(4)	48	108
Tax (expense) / Benefit	0	0	0	(15)	(32)
Net Profit b/f Abnormals	(2)	(4)	(4)	34	76
Non-Recurring Items	0	0	0	0	0
Net Income (Reported)	(2)	(4)	(4)	34	76
Avg F Diluted Shares Outstanding	150	194	218	224	224
Key Cash Flow Statement Data					
EBITDA	(2)	(5)	(4)	92	149
Change in Working Capital	1	3	8	1	0
Deferred Taxation Charge	0	0	0	0	0
Other Adjustments, Net	1	1	4	1	1
Cash Flow from Operations	0	(1)	8	70	115
Capital Expenditure	(6)	(23)	(144)	(56)	(21)
(Acquisition) / Disposal of Investments	0	(2)	0	0	0
Other Cash Inflow / (Outflow)	0	0	0	0	0
Cash Flow from Investing	(6)	(25)	(144)	(56)	(21)
Shares Issue / (Repurchase)	11	76	6	0	0
Cost of Dividends Paid	0	0	0	0	0
Cash Flow from Financing	11	129	36	0	(35)
Free Cash Flow	(5)	(24)	(136)	14	94
Net Debt	(7)	(61)	62	47	(46)
Change in Net Debt	NA	NA	NA	NA	NA
Key Balance Sheet Data					
Property, Plant & Equipment	17	50	201	222	204
Other Non-Current Assets	1	1	3	3	3
Trade Receivables	0	1	5	5	5
Cash & Equivalents	7	109	9	24	82
Other Current Assets	0	0	0	0	0
Total Assets	26	161	220	255	296
Long-Term Debt	0	35	71	36	36
Other Non-Current Liabilities	0	0	8	8	8
Short-Term Debt	0	13	0	35	0
Other Current Liabilities	0	0	8	8	8
Total Liabilities	2	59	108	109	74
Total Equity	24	102	112	146	222
Total Equity & Liabilities	26	161	220	255	296
iQmethod* SM - Bus Performance					
Return on Capital Employed	-8.5%	-4.2%	-0.4%	18.9%	31.9%
Return on Equity	-8.5%	-7.1%	-4.1%	26.3%	41.0%
Operating Margin	NA	NA	-1,804,589.3%	31.8%	45.9%
EBITDA Margin	NA	NA	-979.3%	51.3%	61.7%
iQmethod* SM - Quality of Earnings					
Cash Realization Ratio	-0.1x	0.1x	-1.9x	2.1x	1.5x
Asset Replacement Ratio	126.1x	66.1x	231.8x	1.6x	0.6x
Tax Rate (Reported)	21.4%	6.0%	0.5%	30.0%	30.0%
Net Debt-to-Equity Ratio	-31.4%	-60.2%	55.1%	32.3%	-20.9%
Interest Cover	NA	-7.5x	-1.3x	6.7x	20.7x
Key Metrics					
Franking	0%	0%	0%	0%	0%

* For full definitions of *iQmethod* SM 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 ramping up to full production following a successful gold prour commisioning in mid July 2008. While production performance are risks, we see good value post a successful production ramp up to 160koz to 190koz. Exploration drill results are aslo expected to be an ongoing positive feature in AVO newsflow.

Stock Data

Price to Book Value	3.3x

Valuation

Our base case valuation at a discount rate of 10% has been upgraded by 15% to $3.21/sh. This now includes processing of stockpiles at nameplate capacity for mill throughput (targeted mill throughput has now been achieved at Higginsville and is comfortably running at 130tpd), counterbalanced by a gradual ramp-up in plant recovery. We have assumed worst case scenario for Higginsville cash costs, and opted for the higher end of guidance. As the operation approaches steady state, we expect to develop a firmer view on cash costs.

Exploration spend for near mine exploration targets and deposits has been used as the basis of estimating exploration upside potential.

Table 1: NAV @ 10% discount rate

	A$m	A$/share
Higginsville Gold Project	636.16	2.86
Taxation	-170.61	-0.77
Hedging	0.00	0.00
Exploration	37.91	0.17
Net (Debt)/Cash	11.18	0.05
Total	514.65	2.31

Source: ML estimate

Profit and Loss

Table 2: Financial Statements & Ratio Analysis - YE June 30

Profit and Loss	08A	09E	10E	11E
Sales	0.0	179.1	242.2	255.4
Other Revenue	0.4	0.0	0.0	0.0
Total Revenue	0.4	179.1	242.2	255.4
Operating Costs	0.0	-81.3	-86.8	-89.2
Exploration	-1.1	-1.0	-1.0	-1.0
Other Costs	-3.2	-5.0	-5.0	-5.0
EBITDA	-3.9	91.8	149.4	160.2
Depreciation & Amortisation	-0.6	-34.9	-38.2	-39.7
EBIT	-4.5	56.9	111.2	120.5
Net Interest	0.5	-8.4	-3.3	3.5
Pretax Profit	-4.0	48.5	107.9	124.1
Tax	0.0	-14.5	-32.4	-37.2
Operating NPAT	-4.0	33.9	75.5	86.8
OEI	0.0	0.0	0.0	0.0
NPAT (Normalised for FCA)	-4.0	33.9	75.5	86.8
Significant Items	0.0	0.0	0.0	0.0
Reported NPAT	-4.0	33.9	75.5	86.8
Normalised EPS (¢)	-2.0	15.1	33.7	38.8
Reported EPS (¢)	-1.8	15.1	33.7	38.8
PER (X)	-141.3	17.2	7.7	6.7
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	-849.2%	122.6%	15.0%
EBIT/Sales (%)	n/a	31.8%	45.9%	47.2%
Effective Tax Rate	1%	30%	30%	30%
Interest Cover (X)	-0.1	-0.1	0.0	0.0
Dividend Cover (X)	0.0	0.0	0.0	0.0

Source: ML estimate

AVO production summary

Table 3: Production Statistics

Higginsville Production (oz)	08A	09E	10E	11E
Gold	0	157,153	186,956	191,087
Cash Operating Costs	**08A**	**09E**	**10E**	**11E**
Higginsville (US$/oz)	0	445	376	357
Higginsville (A$/oz)	0	514	464	467
Total Cash Costs	**08A**	**09E**	**10E**	**11E**
Higginsville (US$/oz)	0	657	569	551
Higginsville (A$/oz)	0	760	702	720

Source: ML estimate

Table 4: Valuation comparables

							Price vs VWAP % variance				EPS			P/CFPS (x)			P/E (x)				
	ML	Share	Shares	Market																	
	Symbol	Price	O/S	Cap	EV	Rating	30d	90d	120d	240d	2007A	2008E	2009E	2007A	2008E	2009E	2007A	2008E	2009E	NAV	P/NAV
Australian Gold							30	90	120	240											
Avoca Resources	AVORF	1.68	223	374	330	1 - Buy	-13%	-26%	-25%	-25%	-0.02	-0.03	0.20	-5.22	-1.78	0.05	n/a	n/a	8.3	2.31	0.73
Kingsgate	KSKGF	5.10	93	553	420	1 - Buy	-6%	-3%	2%	3%	-0.23	0.13	0.51	-0.31	0.19	0.06	n/a	37.8	9.9	4.03	1.27
Lihir Gold	LIHRF	2.27	2,189	4,969	4,602	3 - Underperform	-21%	-25%	-30%	-34%	0.06	0.08	0.20	0.37	0.23	0.10	36.2	28.2	11.5	2.40	0.95
Newcrest Mining	NCMGF	24.25	453	13,329	11,495	1 - Buy	-17%	-18%	-22%	-22%	0.58	1.18	1.69	0.19	0.11	0.09	41.8	20.5	14.4	17.97	1.35
Oceana Gold	OCGDF	0.59	162	129	457	1 - Buy	-32%	-61%	-69%	-75%	-0.16	0.23	0.38	0.09	0.01	0.01	n/a	2.5	1.5	2.42	0.24
Sino Gold	SIOGF	4.76	223	1,388	1,130	1 - Buy	-11%	-12%	-20%	-27%	-0.06	0.13	0.29	-0.52	0.25	0.12	n/a	37.5	16.4	5.91	0.81
Market Cap Wt Avge							-17%	-19%	-23%	-25%	0.38	0.79	1.17	0.07	0.12	0.09	35.5	23.5	13.5		1.20
Americas Senior Gold																					
Barrick Gold	ABX	32.77	872	43,312	32,658	1 - Buy	-24%	-22%	-24%	-25%	1.29	2.25	2.58	0.16	0.09	0.09	25.4	14.6	12.7	21.15	1.55
Buenaventura	BVN	20.90	254	8,295	5,702	1 - Buy	-27%	-33%	-36%	-32%	1.08	1.70	2.93	0.75	-0.25	0.16	19.4	12.3	7.1	20.56	1.02
Goldcorp	GG	29.91	712	26,593	24,584	1 - Buy	-28%	-26%	-27%	-20%	0.53	0.80	1.01	0.28	0.19	0.19	56.4	37.4	29.6	17.90	1.67
Kinross Gold	KGC	15.05	615	14,127	10,538	1 - Buy	-26%	-26%	-30%	-25%	0.60	0.64	1.15	0.27	0.14	0.09	25.1	23.5	13.1	10.25	1.47
Newmont Mining	NEM	41.50	454	22,337	24,860	2 - Neutral	-14%	-13%	-14%	-15%	-4.17	2.55	3.21	0.13	0.09	0.07	n/a	16.3	12.9	27.85	1.49
Market Cap Wt Avge							-23%	-22%	-24%	-22%	-0.05	1.73	2.19	0.24	0.10	0.11	27.2	21.1	16.3		1.52
Americas Mid-Tier Gold																					
Agnico-Eagle Mines	AEM	45.83	144	8,512	7,384	1 - Buy	-26%	-30%	-31%	-25%	1.05	0.70	1.37	0.25	0.35	0.16	43.6	65.5	33.5	26.00	1.76
Centerra Gold	YCG	3.95	216	1,084	798	2 - Neutral	-19%	-43%	-57%	-61%	0.19	0.88	1.21	0.11	0.03	0.03	20.8	4.5	3.3	8.25	0.48
Eldorado Gold	EGO	6.75	366	2,679	2,388	2 - Neutral	-16%	-13%	-10%	-2%	0.10	0.28	0.38	0.34	0.17	0.13	67.5	24.1	17.8	4.30	1.57
Gammon Gold	YGAM	8.82	119	1,157	1,097	3 - Underperform	-11%	-5%	-3%	0%	-0.90	0.23	0.43	-0.33	0.13	0.09	n/a	38.3	20.5	4.80	1.84
Golden Star Resources	GSS	1.41	236	422	470	3 - Underperform	-39%	-51%	-56%	-59%	-0.16	0.07	0.30	0.46	0.05	0.02	n/a	20.1	4.7	2.05	0.69
IAMGOLD	IAG	5.41	296	1,675	1,672	2 - Neutral	-12%	-13%	-18%	-27%	-0.14	0.51	0.67	0.17	0.06	0.05	n/a	10.6	8.1	6.70	0.81
Northgate Minerals	NXG	1.76	255	492	442	3 - Underperform	-28%	-39%	-41%	-41%	0.15	0.42	0.32	0.03	0.02	0.03	11.7	4.2	5.5	2.40	0.73
Royal Gold	RGLD	31.95	34	1,193	922	1 - Buy	-7%	0%	2%	3%	0.78	0.80	1.11	0.27	0.22	0.17	41.0	39.9	28.8	20.40	1.57
Yamana Gold	AUY	9.79	668	6,526	7,358	1 - Buy	-27%	-31%	-35%	-33%	0.36	0.74	1.03	0.14	0.10	0.07	27.2	13.2	9.5	7.25	1.35
Market Cap Wt Avge							-22%	-25%	-28%	-25%	0.48	0.62	1.01	0.19	0.19	0.11	34.0	35.1	20.0		1.45
South African Gold																					
AngloGold Ashanti	AULGF	217.51	351	94,402	86,412	2 - Neutral	-14%	-16%	-16%	-20%	7.00	-12.14	34.64	0.10	-4.75	0.05	31.1	n/a	6.3	301.76	0.72
DRDGOLD	DRDGF	4.07	377	2,090	1,982	3 - Underperform	-18%	-31%	-40%	-39%	-0.87	0.48	0.73	45.81	0.06	0.03	n/a	8.5	5.6	3.06	1.33
Gold Fields	GFIOF	69.50	652	63,911	53,144	1 - Buy	-22%	-29%	-33%	-36%	4.37	5.13	10.75	0.17	0.07	0.04	15.9	13.5	6.5	109.01	0.64
Harmony Gold	HGMCF	62.00	398	27,455	29,273	2 - Neutral	-24%	-30%	-33%	-26%	0.43	0.75	5.55	0.14	0.37	0.09	143.4	83.2	11.2	86.90	0.71
Market Cap Wt Avge							-18%	-23%	-24%	-27%	5.06	-4.24	21.88	0.64	-2.31	0.05	42.0	16.9	7.1		0.70

(1) Presented in local currencies

(2) Gold price assumptions: 2008 $925/oz, long-term $800/oz

(3) VWAP = Volume Weighted Average Price

Merrill Lynch Research

Price objective basis & risk

Avoca Resources (AVORF)

Our PO of $3.15/share is 1.36x our NAV of $2.31/share (at 10% WACC over life of mine). The stock is currently trading at 0.73x, well below the current P/NAV for the Australian gold sector of 1.20x. Since AVO is approaching full scale production and is a single mine asset, we continue to set our 12 month PO on a multiple slightly above the Australian gold peer average. Risks to our valuation are exchange rate, gold prices, as well as operating costs for the Higginsville project.

Analyst Certification

I, Anna Kassianos, 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.

Australia-Metals, Mining & Steel Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
BUY				
	Atlas Iron	ATLGF	AGO AU	Mike Harrowell
	Avoca Resources	AVORF	AVO AU	Anna Kassianos
	BlueScope Steel	BLSFF	BSL AU	Mike Harrowell
	Felix Resources Limited	FLRFF	FLX AU	Stuart Howe
	Gloucester Coal	GCRLF	GCL AU	Stuart Howe
	Kingsgate Consolidated Ltd	KSKGF	KCN AU	Anna Kassianos
	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
	OZ Minerals Ltd	OZMLF	OZL AU	Mike Harrowell
	Paladin Energy	PALAF	PDN AU	Olivia Ker
	Panoramic Resources Ltd	SLLYF	PAN AU	Mike Harrowell
	Sims Group	SMUPF	SGM AU	Mike Harrowell
	Sino Gold	SIOGF	SGX AU	Anna Kassianos
NEUTRAL				
	Energy Res Aust	EGRAF	ERA AU	Olivia Ker
UNDERPERFORM				
	Alumina	AWCMF	AWC AU	Vicky Binns
	Alumina Ltd-ADR	AWC	AWC US	Vicky Binns
	Iluka Resources	ILKAF	ILU AU	Mike Harrowell
	Lihir Gold Ltd	LIHRF	LGL AU	Anna Kassianos
	Lihir Gold-ADR	LIHR	LIHR US	Anna Kassianos
	Macarthur Coal Ltd.	MACDF	MCC AU	Stuart Howe
	Minara Resources	MREJF	MRE AU	Mike Harrowell
RESTRICTED				
	BHP Billiton Ltd	BHPLF	BHP AU	Vicky Binns
	BHP Billiton-ADR	BHP	BHP US	Vicky Binns
	Rio Tinto Ltd	RTNTF	RIO AU	Vicky Binns

iQmethod [SM] Measures Definitions

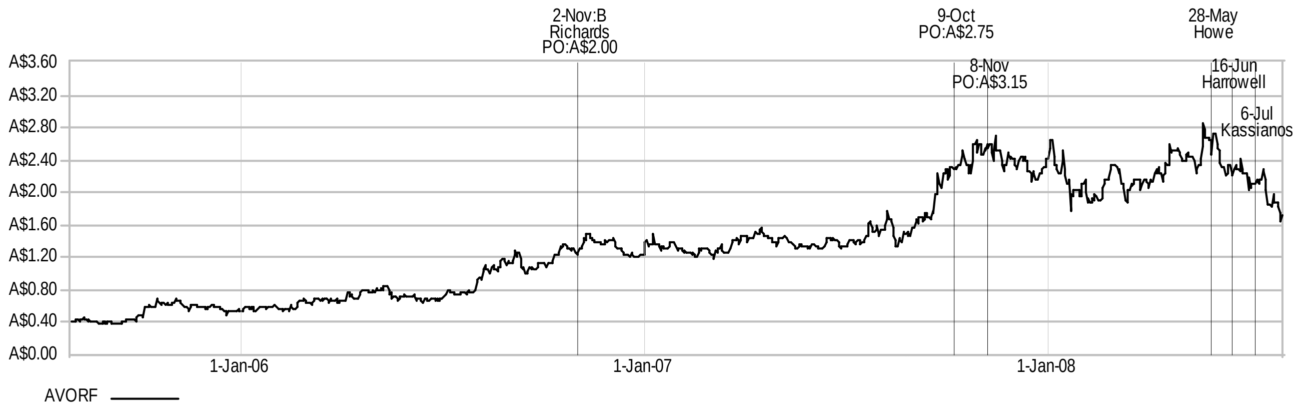
Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
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	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

iQmethod [SM] is the set of Merrill Lynch standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

iQdatabase ® is our real-time global research database that is sourced directly from our equity analysts' earnings models and includes forecasted as well as historical data for income statements, balance sheets, and cash flow statements for companies covered by Merrill Lynch.

Important Disclosures

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 July 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%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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