12 May 2006

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Athena rising

Recommendation

SPECULATIVE BUY

S&P/ASX 300 = 5297.3

Investment Highlights

- Patersons reiterates its SPECULATIVE BUY recommendation following the release of a maiden inferred resource for Athena Lodes. Our DCF derived valuation is A$0.95/share however we expect AVO to outperform in the lead up to first production with a 12-month price target A$1.06/share.

- Patersons anticipates first ore delivery from Trident in the March Q, with production ramping-up to 115kozpa, over a 7-year mine life. We have assumed pre-production capital expenditure of A$16m.

- We identify potential upside to our assumed production metrics via either underground extensions, or the potential commercialisation of near-mine, open pit resources.

- AVO has budgeted an aggressive H2 CY06 field season, and Patersons envisage the closure of key project milestones (completion of toll treating agreement, completion of Trident BFS and financing, and resource extension drilling) will sustain market attention.

- Whilst the 107koz resource estimate at Athena was lower than Patersons 150koz assumption, we remain comfortable both tonnage and grade will increase with additional in-fill and extensional drilling.

- AVO is operating in a niche space, with only a handful of ASX listed gold explorers on the cusp of transitioning to first production in the coming 12-motnhs.

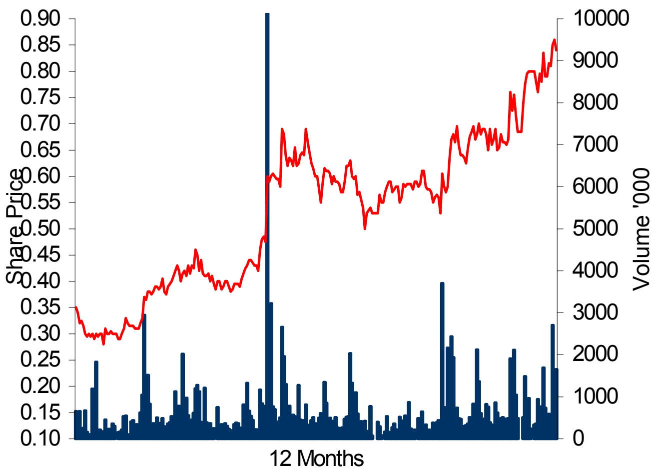
- The company currently has no hedging in place allowing unencumbered exposure to current gold prices, while being operated by an experienced management team with in excess of 20 years experience in the Higginsville field.

Patersons Securities Limited acted as Joint Lead Manager to two Share Placements that raised $10m and $4.7m at $0.40 per share for Avoca Resources Limited in September 2005.

Additionally, Patersons Securities Limited acted as Lead Manager to the Private Placement that raised $2.6m at $0.20 per share for Avoca Resources Limited in November 2004. It received fees for these services.

Company Statistics & Performance

Shares on Issue	146.3m	**Daily Vol.**	651,499
Market Cap.	$117.8m	**Debt**	$0.0m
52 Week Range	$0.28 - $0.86	**Cash**	$7.9m



Investment Summary

Year End June 30	2005A	2006F	2007F	2008F
Reported Earnings				
Net Profit ($m)	(2.1)	(2.0)	8.2	36.6
EPS (cents)	(1.5)	(1.3)	5.6	25.0
PER (x)	(55.3)	(60.1)	14.4	3.2
Normalised Earnings				
Net Profit ($m)	(1.5)	(1.4)	5.7	25.6
EPS (cents)	(1.0)	(0.9)	3.9	17.5
EPS growth (%)	na	na	517.0	348.1
PER (x)	na	(85.8)	20.6	4.6
Cashflow				
Gross Cashflow ($m)	(4.5)	(5.9)	7.2	39.2
GCFPS (cents)	(3.0)	(4.0)	4.9	26.8
PCF (x)	(26.5)	(20.0)	16.3	3.0
Dividend				
Dividend (cents)	0.0	0.0	0.0	0.0
Yield (%)	0.0	0.0	0.0	0.0
Franking (%)	0.0	0.0	0.0	0.0

Investment thesis

- Patersons remains attracted to transitional producers offering near-term, unhedged production.
- We have assumed AVO 'daylights' first underground ore in March Q CY07 noting potential valuation upside should AVO elect to forward sell a proportion of future production at a premium to Patersons gold price assumptions.
- We identify several potential catalysts to drive the share price including:
  - Timely completion of the BFS in August CY06
  - Achieving a financial close on funding options
  - Formal enactment of an off take/toll treating agreement
  - A resource upgrade in H2 CY06 following ongoing definition drilling
  - Positive results from re-optimisation studies at Fairplay and palaeochannel resources

Maiden resource at Athena Lodes

- AVO has released a maiden resource for the Athena Lodes of 386kt @ 8.6g/t Au (107koz contained gold).
- Athena comprises three discreet zones comprising the Athena 30 and Athena 10 lodes, and a sub-horizontal link structure (Athena 45). Athena resources are tabulated below:

Figure 1. Athena Inferred Resources

Lode	kt	g/t Au	koz
Athena 30	269	9.5	82
Athena 10	75	7.7	19
Athena 45	41	4.4	6
Total	**386**	**8.6**	**107**

Source: Avoca Resources

Drivers to increase resources

- Whilst our estimates called for an initial resource of circa 150koz, we continue to be impressed by both lode geometry and grade continuity at Athena (widths averaging circa 4.5-5m), and expect additional drilling to further expand the resource inventory.
- Only 250m of 500m of defined plunge extent is included in the maiden resource estimate and Patersons remains confident, Athena Lodes may ultimately exceed 200koz with additional field work. We cite the following as mechanisms to build Athena:
  - **Increasing drill density:** Limited drill density, and difficulty in mitigating nugget effect has required the Athena resource to be classified as inferred. Confidence in grade continuity is likely to be increased with additional drilling.

- **Increasing top-cut:** Patersons expect AVO will increase the top-cut as resources are elevated to indicated. Increasing the top cut from 100g/t Au to 250g/t Au could conceivably boost Athena grades by +25% to 12.5g/t Au. Given the impressive grade continuity returned to date, we remain confident this order of magnitude is achievable.

- **Expanding the mineralised envelope:** AVO has intersected additional gold bearing structures both down plunge and along strike of the current resource boundary, however drill density remains insufficient at this time for inclusion in the resource. Better results include:

- 7m @ 72g/t Au,

- 3m @ 22g/t Au, and

- 1m @ 137g/t Au.

Modest increase for Trident

- AVO has also boosted the main Trident resource to 3.3Mt @ 4.9g/t Au for a contained 512koz (previously 485koz).

- Resource definition drilling in H2 CY05 allowed AVO to elevate 95% of Western and Eastern Zone mineralisation to indicated status, reflecting increased confidence in the geological model, and confirming the potential for additional, southern extension at Western Zone.

- An additional 16koz was added to Eastern Zone, while a 6% decrease in resource grade (to 4.9g/t) was associated with employing a more stringent top-cut (max 65g/t Au) in-line with AVO's strategy to counter nugget effect.

- AVO expects to complete the Trident Feasibility Study in August CY06 scoping production of circa 100kozpa over a 7-8 year mine life.

- In the interim, refurbishment activities are continuing at Poseidon South where dewatering exposed the underground decline in the March Q. The decline extends to within 250m of the Trident ore body and refurbishments offering AVO significant capital cost savings.

Higginsville Regional

- Strong bullion prices have increased the potential to supplement Trident ore production with regional open pit ores located within AVO's Higginsville tenement area.

FAIRPLAY

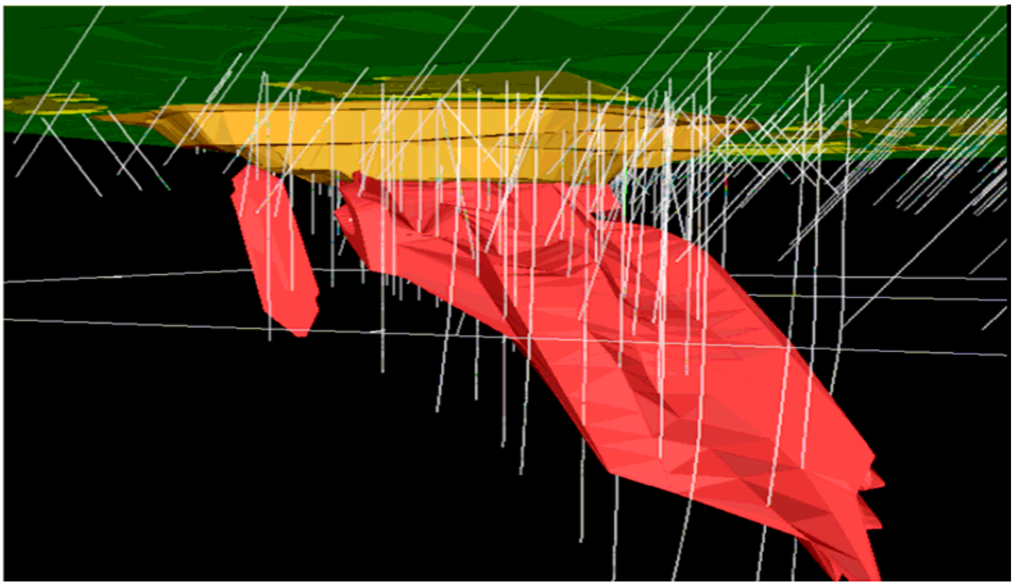
- Fairplay stands as the most likely source of medium-term cash flow, however additional mineralisation is hosted at Fairplay East (63koz), Vine and Pipeline.

- Located 2.5km south of Trident, Resolute Mining Limited mined 26koz from a shallow open pit at Fairplay in the mid-1990's before soft bullion prices led to a premature cessation to mining.

- Figure 2 below, illustrates the high level of work undertaken to date at Fairplay. Given an established production history production history, we identify considerable potential for a restart noting:

- Existing resources of 85koz (1.5Mt @ 1.8g/t Au) are well-defined
- There remains considerable potential to extend resources down plunge, where previous drilling encountered high-grade, 'Athena-style' quartz veining in the hanging wall.
- AVO is planning a dedicated drill campaign to test the strike extent of these structures in the September Q.

Figure 2. Gold Mineralisation beneath Fairplay



Source Avoca Resources

PALAEOCHANNEL RESOURCES

- Previous mining was also conducted by Resolute at several palaeochannel deposits, yielding some 300koz. Like Fairplay, weak bullion prices forced premature closure however; AVO estimates remnant resources of 65koz remain at Pluto, Mitchell 3 and Mitchell 4.
- AVO is progressing re-optimisation studies for these resources.

Avoca Resources Limited AVO ($0.81)

PATERSONS THE AUSTRALIAN STOCKBROKER

12 May 2006

Avoca Resources Limited (AVO) **$0.81** **Year End June 30**

Profit & Loss ($m)	1H/05A	2H/05E	1H/06E	2H/06E
Sales Revenue	**0.0**	**0.0**	**0.0**	**0.0**
Other Income	0.3	0.3	0.1	0.2
Operating Costs	0.1	0.1	0.1	0.0
Depn & Amort	0.0	0.0	0.0	0.0
Exploration Exp.	0.3	1.1	0.5	0.6
Corporate/Admin	0.2	0.8	0.5	0.5
EBIT	**(0.3)**	**(1.8)**	**(1.0)**	**(0.9)**
Interest	0.0	0.0	0.0	0.0
Operating Profit	**(0.3)**	**(1.8)**	**(1.0)**	**(0.9)**
Tax expense	0.0	0.0	0.0	0.0
Minorities	0.0	0.0	0.0	0.0
NPAT	**(0.3)**	**(1.8)**	**(1.0)**	**(0.9)**
Normalised NPAT	**(0.2)**	**(1.2)**	**(0.7)**	**(0.7)**

Profit & Loss ($m)	2005A	2006F	2007F	2008F
Sales Revenue	**0.0**	**0.0**	**35.1**	**103.9**
Other Income	0.5	0.3	0.1	0.8
Operating Costs	0.3	0.1	18.5	44.4
Depn & Amort	0.0	0.0	1.9	5.5
Exploration Exp.	1.3	1.1	1.2	1.2
Corporate/Admin	1.0	1.0	1.0	1.1
EBIT	**(2.1)**	**(1.9)**	**12.6**	**52.5**
Interest	0.0	0.0	0.4	0.2
Operating Profit	**(2.1)**	**(2.0)**	**12.2**	**52.3**
Tax expense	0.0	0.0	4.0	15.7
FX Adjustment	0.0	0.0	0.0	0.0
NPAT	**(2.1)**	**(2.0)**	**8.2**	**36.6**
Normalised NPAT	**(1.5)**	**(1.4)**	**5.7**	**25.6**

Cash Flow ($m)	1H/05A	2H/05E	1H/06E	2H/06E
Adjusted Net Profit	(0.3)	(1.8)	(1.0)	(0.9)
+ Interest/Tax/Expl Exp	0.3	1.1	0.5	0.6
- Interest/Tax/Expl Inc	0.3	4.3	2.9	2.0
+ Depn/Amort	0.0	0.0	0.0	0.0
+/- Other	0.4	0.4	0.0	(0.2)
Operating Cashflow	**0.1**	**(4.5)**	**(3.4)**	**(2.5)**
- Capex (+asset sales)	0.0	0.1	0.0	8.0
- Working Capital Increase	0.0	0.0	0.0	0.0
Free Cashflow	**0.1**	**(4.6)**	**(3.4)**	**(10.5)**
- Dividends (ords & pref)	0.0	0.0	0.0	0.0
+ Equity raised	3.5	0.9	10.1	0.0
+ Debt drawdown (repaid)	0.0	0.0	0.0	6.2
Net Change in Cash	**1.3**	**(3.7)**	**6.7**	**(4.4)**
Cash at End Period	6.3	2.5	9.3	4.9
Net Cash/(Debt)	6.3	2.5	9.3	2.7

Cash Flow ($m)	2005A	2006F	2007F	2008F
Adjusted Net Profit	(2.1)	(2.0)	8.2	36.6
+ Interest/Tax/Expl Exp	1.3	1.1	5.6	17.1
- Interest/Tax/Expl Inc	4.5	4.9	8.5	20.0
+ Depn/Amort	0.0	0.0	1.9	5.5
+/- Other	0.9	(0.1)	0.0	0.0
Operating Cashflow	**(4.5)**	**(5.9)**	**7.2**	**39.2**
- Capex (+asset sales)	0.1	8.1	8.6	1.0
- Working Capital Increase	0.0	0.0	0.0	0.0
Free Cashflow	**(4.5)**	**(13.9)**	**(1.4)**	**38.2**
- Dividends (ords & pref)	0.0	0.0	0.0	0.0
+ Equity raised	4.4	10.1	0.0	0.0
+ Debt drawdown (repaid)	0.0	6.2	1.4	(6.2)
Net Change in Cash	**(2.4)**	**2.4**	**0.0**	**32.0**
Cash at End Period	2.5	4.9	4.9	37.0
Net Cash/(LT Debt)	2.5	2.7	(2.5)	35.7

Production Summary	1H/05A	2H/05E	1H/06E	2H/06E
Gold production (koz)				
Higginsville Gold	0	0	0	0
Total	**0**	**0**	**0**	**0**
Cost summary				
Weighted Ave Cash Costs (A$/oz)	na	na	na	na
Weighted Ave Total Costs (A$/oz)	na	na	na	na
Realised price (US$/oz)	na	na	na	na

Production Summary	2005A	2006F	2007F	2008F
Gold production (koz)				
Higginsville Gold	0	0	38	111
Total	**0**	**0**	**38**	**111**
Cost summary				
Weighted Ave Cash Costs (A$/oz)	na	na	486	402
Weighted Ave Total Costs (A$/oz)	na	na	536	452
Realised price (US$/oz)	na	na	659	683

Balance Sheet ($m)	2005A	2006F	2007F	2008F
Cash/Bullion	2.5	4.9	4.9	37.0
Total Assets	14.7	23.6	28.7	59.1
Total Debt	0.0	0.1	7.4	1.2
Total Liabilities	1.0	0.6	0.1	4.8
Shareholders Funds	13.8	23.0	28.7	54.3
Ratios				
Net Debt/Equity (%)	na	na	856.0%	na
Interest Cover (x)	na	na	na	na
Return on Equity (%)	na	na	0.3	0.7

Valuation	A$m	A$/sh
Higginsville Gold	123.6	0.79
Mt Fisher Gold	7.7	0.05
Exploration	8.6	0.05
Corporate	(2.8)	(0.02)
Unpaid Capital	3.7	0.02
Cash	7.9	0.05
Debt	0.0	0.00
Total @ 5% Discount rate	**148.8**	**0.95**

Reserves & Resources

Resources	**Mt**	**Au Grade**	**Koz**
Trident	3.7	5.20	620
Fairplay	2.5	1.90	150
Palaeochannels	0.9	2.30	66
Other	1.1	1.10	38
Total	**8.1**	**3.34**	**874**

Directors

Name	**Position**
Robert Reynolds	Non-Executive Chairman
Rohan Williams	Managing Director
David Quinlivan	Non-Executive Director
Stephanie Unwin	Non-Executive Director

Substantial Shareholders	**Shares (m)**	**%**
Goldfields Ltd	19.0	14.1
Westpac Custodian Nominees	8.8	6.5
HSBC Custody Nominees	5.8	4.3
Top 20	**58.9**	**43.7**

Insert Excel Model Here

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