

UBS Investment Research

Avoca Resources Limited

Getting set for a big FY10

■ Event: Interim results and grade control drilling of 1005 Level

The recent interim loss of \$14.6m was significantly lower than the UBSe breakeven forecast. The largest variances were D&A (\$18m vs. UBSe \$9m) and operating costs (\$40m vs. UBSe \$35m). The D&A discrepancy highlights the need to increase the reserve base ASAP. Avoca has released a series of positive drill results from the 1005m level at the Trident mine. A number of the results have come back with grades significantly higher than the reserve grade of 5.3g/t.

■ Impact: FY10 guided to 180koz at A\$450/oz

With the important 1005m level providing the bulk of the mill feed for FY10, the drilling has reaffirmed the company's guidance of 180koz at cash costs of A\$450/oz for FY10. Subsequently, our forecast has been lifted to 187koz at A\$440/oz (A\$560/oz including royalties). We also anticipate that the high A\$ gold price will enable some of the lower grade near surface mineralisation to be converted into reserves at the end of June.

■ Action: Output and reserves to rise – Buy rating maintained

Despite the global equity rally dampening the recent gold trade, we maintain our Buy rating as output from Trident U/G steps up in FY10 and on expectations of increased reserves over the next 12-18 months. We now assume Trident U/G will provide 1Mtpa to the mill for a 5-year period followed by 5-year tail of 0.5Mt. We assume the remaining mill capacity will be filled by lower grade open pit material.

■ Valuation: \$1.40 (DCF, 6% discount rate)

Our unchanged target price of \$2.20 is derived from a 1.6x NPV multiple.

Highlights (A\$m)	06/07	06/08	06/09E	06/10E	06/11E
Revenues	0	0	147	270	237
EBIT (UBS)	(4)	(3)	18	126	114
Net Income (UBS)	(4)	(1)	6	84	75
EPS (UBS, A\$)	(0.02)	(0.01)	0.03	0.34	0.30
Net DPS (UBS, A\$)	0.00	0.00	0.00	0.00	0.00

Profitability & Valuation	5-yr hist av.	06/08	06/09E	06/10E	06/11E
EBIT margin %	-	-	12.1	46.7	48.0
ROIC (EBIT) %	-	(2.8)	8.2	56.4	51.3
EV/EBITDA (core) x	-	<-100	9.3	2.9	2.7
PE (UBS) x	-	NM	61.0	4.9	5.5
Net dividend yield %	-	0.0	0.0	0.0	0.0

Source: Company accounts, Thomson Financial, UBS estimates. (UBS) valuations are stated before goodwill, exceptional and other special items. Valuations: based on an average share price that year, (E): based on a share price of A\$1.66 on 03 Apr 2009 17:42 EST

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Global Equity Research

Australia

Mining

12-month rating **Buy**
Unchanged

12m price target **A\$2.20/US\$1.55**
Unchanged

Price **A\$1.66/US\$1.17**

RIC: AVO.AX BBG: AVO AU

3 April 2009

Trading data (local/US\$)

52-wk range	A\$2.86-1.05/US\$2.75-0.65
Market cap.	A\$0.40bn/US\$0.29bn
Shares o/s	244m (ORD)
Free float	100%
Avg. daily volume ('000)	1,008
Avg. daily value (A\$m)	1.7

Balance sheet data 06/09E

Shareholders' equity	A\$0.15bn
P/BV (UBS)	2.7x
Net Cash (debt)	(A\$0.07bn)

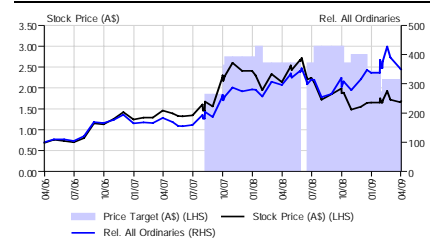
Forecast returns

Forecast price appreciation	+32.9%
Forecast dividend yield	0.0%
Forecast stock return	+32.9%
Market return assumption	7.9%
Forecast excess return	+25.0%

EPS (UBS, A\$)

	06/09E		Cons.	06/08
	From	To		Actual
H1	0.00	(0.07)	-	0.00
H2E	0.09	0.09	-	(0.01)
06/09E	0.09	0.03	0.05	
06/10E	0.24	0.34	0.25	

Performance (A\$)



Source: UBS

www.ubs.com/investmentresearch

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ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 7.

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Interim result

AVO recently released its FY09 interim result showing a loss for H1 of \$14.65m. This was significantly below our forecast of loss of \$0.03m primarily due to slightly higher operating costs through the ramp up phase and a large difference on the modelled D&A charges (Table 1).

Table 1: Interim result (act vs. UBSe)

		Act.	UBSe	% Var	Comment
Revenue	A\$m	50.1	53.7	-7%	Timing differences on delivery
Operating Costs	A\$m	39.9	34.9	14%	Higher costs through ramp up phase
Royalty	A\$m	3.5	1.3	169%	Morgan Stanley royalty effect
EBITDA	A\$m	2.69	12.1	-78%	
D&A	A\$m	18.3	9.1	101%	Actual reserve base smaller than UBSe
EBIT	A\$m	-15.6	3	-620%	
Finance costs	A\$m	-5.4	-3.1	74%	Timing differences on drawdown
Tax	A\$m	6.3	0.0	na	
NPAT	A\$m	-14.6	0.0	na	

Source: Company reports, UBSe

The D&A discrepancy highlights the need for AVO to increase the reserve base at Higginsville. We have assumed a 10-year life for the mining and processing assets and subsequently depreciate the book value over that period. However, based on the actual company reserves, the current mine life is approximately half our forecast so the accounting depreciation period would be around 5-years.

We anticipate that now commissioning is complete, and general cost inflation has reduced, the operating costs on a per tonne basis will come back to our forecast level.

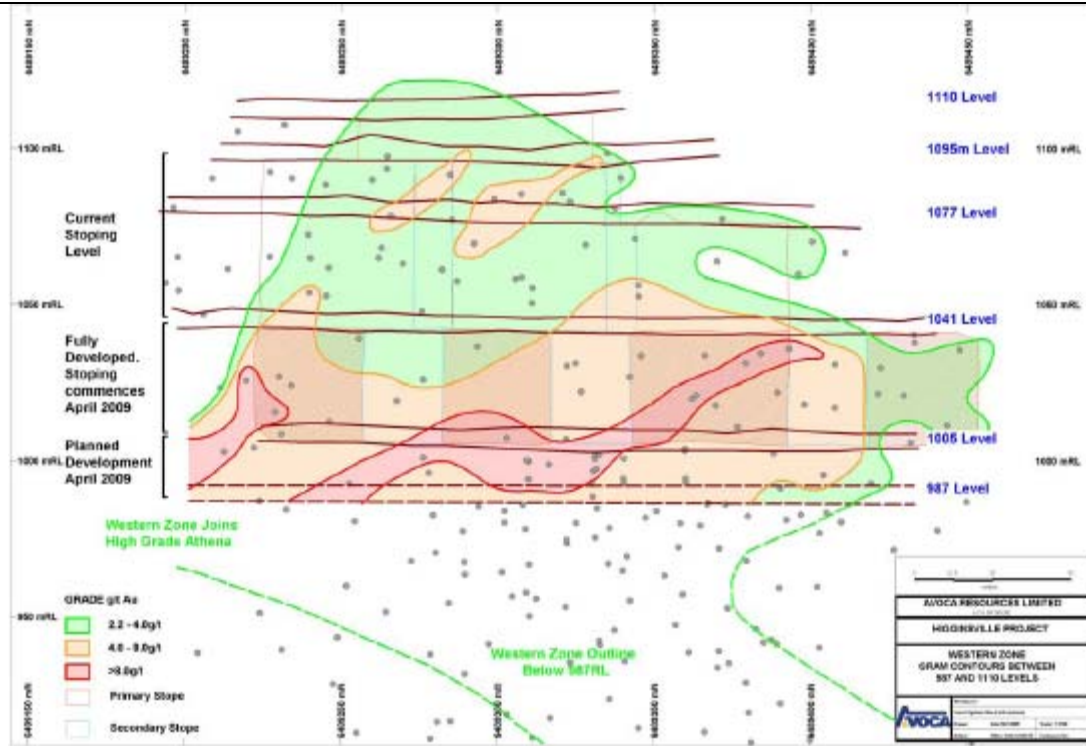
Trident drilling

The geological interpretation of the 1005m level suggests that this is the level where the large lower grade Western Zone structure and smaller high grade Athena zone meet. As such, it is important from a mine scheduling perspective to drill out this region and get a firm understanding of the gold grades and distribution. The importance of the 1005m level is that this will be the primary extraction level for FY10e.

The recent drilling results from the 1005m level at Trident indicate that the production grade in FY10e is likely to be significantly above the global reserve grade of 5.3g/t. We have factored in a grade of 6.25g/t for the year, but see the risk of a positive reconciliation on the grade as high.

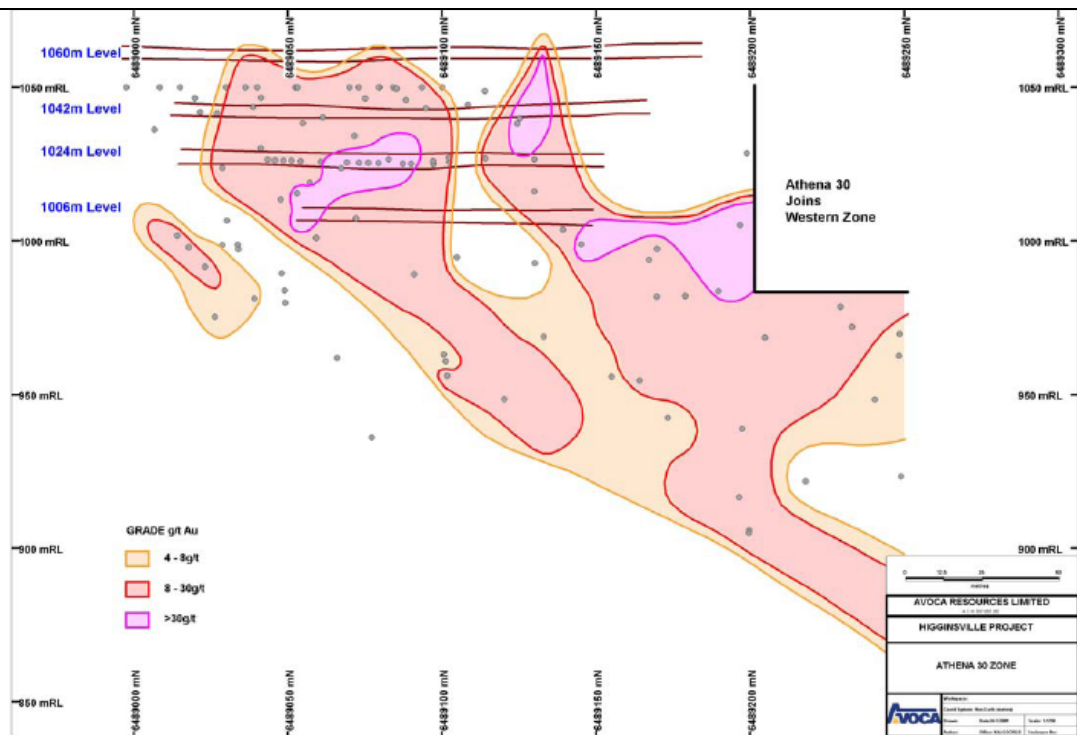
Infill drilling of the Western Zone has confirmed the higher grade and increased widths between the 1005m and 1041m levels (Figure 1). The figure below highlights that a large portion of this resource has a grade between 4g/t – 8g/t or above. Similarly, infill drilling of the Athena lode suggests that a large portion of the resource above the 1005m level has a grade between 8g/t – 30g/t or above (Figure 2).

Figure 1: Western Zone grade contours



Source: Company reports

Figure 2: Athena Lode grade contours



Source: Company reports

Mine plan

Our original mine plan assumed that the company would ultimately fill the Higginsville plant from the Trident underground mine over a 10-year period. We

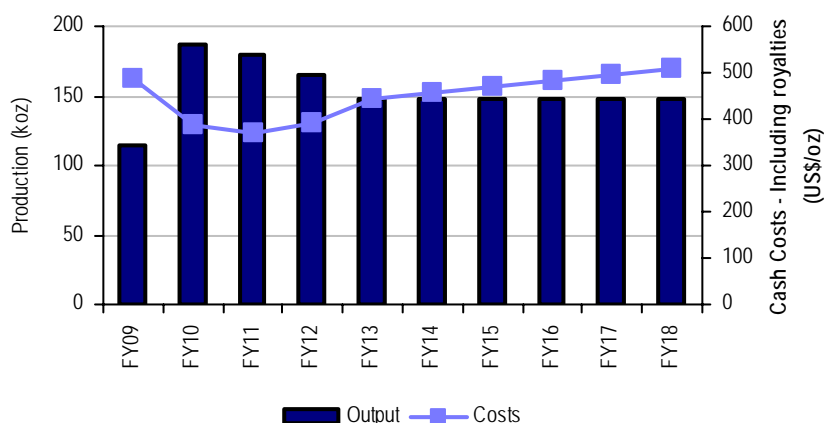
now anticipate that the Trident deposit should be able to provide the required 1Mtpa mill feed for a 5-year period before reducing to ~500ktpa. Subsequently, from year 6 we envisage the company will need to mine the remaining 500ktpa of mill feed from other production sources.

The likely additional sources are the Higginsville open pitable resources (Fairplay,), the underground resources at Chalice and Two Boys and the recently discovered Musket project. We also believe that the company’s tenements in the region will host additional discoveries.

The company is due to hand down the new reserve estimates at the end of June in which we expect a significant increase. However, in our view, the increase will come from the inclusion of the lower grade open pitable material around Higginsville and not the higher grade material from the Trident U/G. We expect the Trident resources and reserves to be increased later in the year.

We now forecast production of 114koz in FY09e increasing to 187koz in FY10e.

Chart 1: Production and cost profile



Source: UBSe

Earnings changes

Based on the interim result and adjusting our depreciation and amortisation schedule, our earnings for FY09e have been cut significantly. However, the higher gold output in FY10e has resulted in a substantial upgrade.

There is no change to our NPV estimate or target price.

Table 2: Summary of earnings changes

June Y/E A\$m	2009			2010			2011			
	New	Old	Var %	New	Old	Var %	New	Old	Var %	
Revenue	148	143	3%	273	213	28%	244	198	23%	
EBITDA	52	58	-11%	150	114	31%	125	102	23%	
EBIT	18	41	-57%	124	96	29%	107	84	27%	
PBT	9	34	-74%	120	93	28%	107	82	31%	
Net Profit	6	24	-73%	84	63	33%	75	55	36%	
EPS A\$	3	9	-70%	34	24	41%	30	21	44%	
DPS Acps	0	0	NM	0.0	0.0	NM	0.0	0	NM	
Ore Mined	kt	951	921	3%	1000	1000	0%	1000	1000	0%
Grade	g/t	4.1	4.1	0%	6.25	5.0	25%	5.6	5.0	12%
Ore processed	kt	1046	1016	3%	1000	1000	0%	1000	1000	0%
Grade	g/t	3.5	3.5	0%	6.0	4.9	23%	5.8	5.0	16%
Gold produced	koz	114	110	3%	187	152	23%	180	156	16%
Cash costs (including royalties)	A\$/oz	690	690	0%	564	588	-4%	541	568	-5%
NPV										
Base - 10 year life		1.40	1.40	0%						
Price Target										
Price Target		2.20	2.20	0%						

Source: UBSe

Investment view

We maintain our Buy rating on AVO due to a strong production for FY10e and the potential for additional exploration success.

Despite a worse than expected interim result, we are not duly concerned due to the successful commissioning of the Higginsville plant during the period. In our view, as the head grade increases to (or above) the overall reserve grade, the operating costs will come down close to the original forecast of A\$450/oz (pre-royalty). Production for FY10e has been guided to 180koz, although based on the recent drilling along the 1005m level, there is potentially some upside to this estimate.

We believe the tenement holding at Higginsville will continue to provide exploration success for the company, although this success will not happen instantaneously.

Avoca Resources Ltd (AVO.AX)

Analyst/s: Jo Battershill/Glyn Lawcock
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03-Apr-09

MARKET INFORMATION						
Rating:	Buy					
Price (as of 03-Apr-09):	1.66					
Price Target (12 months):	2.20					
Issued Capital:	244.1					
Market Capitalisation:	412.1					
Avg. daily turnover (US\$m)	1.2					
Year end:	June					
Website:	www.avocaresources.com					
Major Shareholders:						
INVESTMENT SUMMARY						
(A\$m)	2008	2009E	2010E	2011E		
Net profit [reported] (\$m)	(1.3)	6.4	83.7	75.0		
Net profit [adjusted] (\$m)	(1.3)	6.4	83.7	75.0		
EPS [reported] (\$)	(0.0)	0.0	0.3	0.3		
EPS [adjusted, diluted] (\$)	(0.0)	0.0	0.3	0.3		
EPS Growth (%)	-	-	>200	(10)		
PER [adjusted] (x)	(292.7)	61.0	4.9	5.5		
Dividend (\$)	0.0	0.0	0.0	0.0		
Payout ratio (%)	0	0	0	0		
Dividend Yield (%)	0.0	0.0	0.0	0.0		
FCF Yield (%)	(0.8)	18.1	36.6	30.6		
Franking (%)	0	0	0	0		
Shares [period-average, diluted] (m)	236.6	235.0	247.1	247.1		
VALUATION						
Valuation per share [NAV @6%] (\$)	1.40					
Share Price Target [12 months] (\$)	2.20					
Price/NAV [6% disc rate] (x)	1.19					
Operating Assets [DH09]		A\$m	¢			
Higginsville		435	176			
Exploration		10	4			
Gross Assets		445	181			
Cash & Gold		32	13.4			
Corporate		(31)	(13)			
Debt		(104)	(42)			
Net Asset Value @ 6% discount rate		342	140			
ENTERPRISE VALUE						
(A\$m)	2008	2009E	2010E	2011E		
Enterprise Value	475	495	443	362		
EV/EBITDA (x)	<0	9.5	2.9	2.7		
EV/Operating Free Cash Flow (x)	<0	9.5	2.9	2.9		
EPS SENSITIVITIES						
Commodity	Base	2009E	2010E	2011E		
	Change		EPS Change			
Currency	5c	-70.0%	-14.0%	-14.0%		
US\$ Gold Price	10%	51.0%	19.0%	11.0%		
CASH FLOW						
(A\$m)	2008	2009E	2010E	2011E		
Operating income [EBIT, UBS]	(3)	18	126	114		
Depreciation & Amortisation	0	35	26	18		
Net change in working capital	0	18	(3)	(7)		
Other (operating)	0	0	0	0		
Pre-tax op cash flow	(3)	70	150	125		
Interest (paid) / received	4	(7)	(4)	0		
Tax paid	3	(3)	(36)	(32)		
Other	(2)	(6)	0	0		
Operating cash flow	1	54	110	93		
Capital expenditure	(134)	(65)	(17)	(5)		
Free cash flow	(133)	(10)	93	88		
Net (acquisitions) / disposals	(0)	1	0	0		
Dividends paid (Common)	0	0	0	0		
Shares issued/(repurchased)	6	29	0	0		
COMPANY DESCRIPTION						
Avoca Resources Limited is currently developing the Trident deposit at the 100%-owned Higginsville project in Western Australia. A standalone 1Mtpa plant is being constructed at Higginsville, to be completed in 2008. Current estimates are for a five-year mine life with production of 160-190koz at average cash costs of A\$400/oz; however, Avoca believes a mine life of at least 10 years is more realistic given the highly prospective area and positive exploration results. We expect Avoca to re-rate as it moves into production this year.						
OPERATIONAL ASSUMPTIONS						
	1H09	2H09E	2008	2009E	2010E	2011E
Production						
Trident Production koz	49.01	65.11	0.00	114.12	186.75	179.75
Cash costs						
Trident Cash Costs A\$/oz	736.0	644.0	-	681.0	559.0	538.0
Commodity price assumptions						
US\$ Gold	835.0	970.0	822.0	902.0	944.0	856.0
A\$ Gold	1,097.0	1,496.0	915.0	1,295.0	1,452.0	1,317.0
DIVISIONAL BREAKDOWN [EBIT]						
(A\$m)	1H09	2H09E	2008	2009E	2010E	2011E
PROFIT & LOSS						
(A\$m)	1H09	2H09E	2008	2009E	2010E	2011E
Sales Revenue	50	97	0	147	270	237
Operating Cash Profit	6	55	(0)	60	160	135
Depn & Amortisation	(18)	(16)	(0)	(35)	(26)	(18)
Operating Profit	(13)	38	(0)	26	134	117
Exploration	(0)	(3)	(3)	(3)	(5)	(5)
SGA	(3)	(5)	(7)	(8)	(10)	(10)
EBIT	(16)	33	(3)	18	126	114
Net interest	(5)	(3)	(0)	(9)	(7)	(7)
Profit before tax	(21)	30	(4)	9	120	107
Tax expense	6	(9)	3	(3)	(36)	(32)
Equity Associated NPAT	0	0	0	0	0	0
Minority Interests	0	0	0	0	0	0
Dividends [preferred]	0	0	0	0	0	0
Net Profit [reported]	(15)	21	(1)	6	84	75
Abnormal Gain/(Loss) after Tax	0	0	0	0	0	0
Net Profit [adjusted]	(15)	21	(1)	6	84	75
EBITDA margin (%)			-	40.8	59.1	56.9
Net Interest Cover [EBIT] (x)			(7.5)	2.0	18.6	16.7
Tax Rate (%)			0.0	29.5	30.0	30.0
EBIT/Total Assets (%)			(1.5)	6.0	33.3	25.1
NPAT/Equity (%)			(1.2)	4.8	43.3	27.5
EBIT/Avg Cap Employed (%)			(2.8)	8.2	56.4	51.3
BALANCE SHEET [Selected Items]						
(A\$m)	2008	2009E	2010E	2011E		
Net Working capital	(9)	(17)	(17)	(17)		
Fixed Assets	173	189	180	167		
Net Other	45	51	61	70		
Capital Employed	210	224	224	220		
Net Cash / (Debt)	(94)	(72)	11	90		
Total Equity [incl. minorities]	116	151	235	310		
Minorities	0	0	0	0		
Net Debt / Equity (%)	81.1	47.9	(4.7)	(28.9)		
Book Value per Share(\$)	0.53	0.61	0.95	1.25		

Source: UBS

■ Avoca Resources Limited

Avoca Resources Limited is currently developing the Trident deposit at the 100%-owned Higginsville project in Western Australia. A standalone 1Mtpa plant is being constructed at Higginsville, to be completed in 2008. Current estimates are for a five-year mine life with production of 160-190koz at average cash costs of A\$400/oz; however, Avoca believes a mine life of at least 10 years is more realistic given the highly prospective area and positive exploration results. We expect Avoca to re-rate as it moves into production this year.

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Investment risk inherent in the resource sector includes, but is not limited to movement of commodity price and currency which may differ materially from the assumptions used in this report. Furthermore the sector is subject to political, financial and operational risks, each of which has the potential to significantly impact industry performance.

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UBS Investment Research: Global Equity Rating Allocations

UBS 12-Month Rating	Rating Category	Coverage ¹	IB Services ²
Buy	Buy	51%	36%
Neutral	Hold/Neutral	37%	31%
Sell	Sell	12%	22%
UBS Short-Term Rating	Rating Category	Coverage ³	IB Services ⁴
Buy	Buy	less than 1%	43%
Sell	Sell	less than 1%	36%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 31 March 2009.

UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	Definition
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

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Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

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UBS Securities Australia Ltd: Jo Battershill; Glyn Lawcock; Daniel Morgan.

Company Disclosures

Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
Avoca Resources Limited ^{2, 4, 6, 13}	AVO.AX	Buy	N/A	A\$1.69	02 Apr 2009

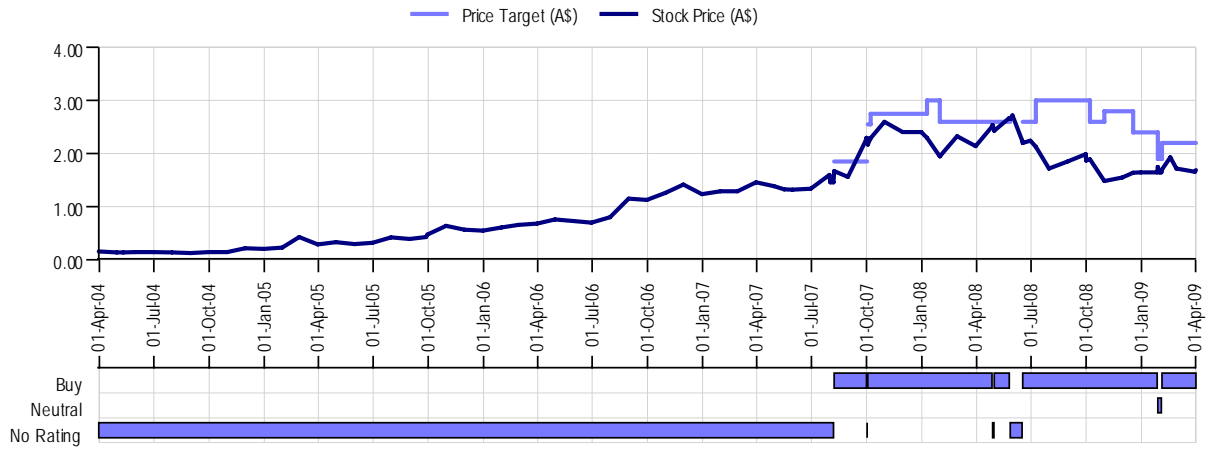
Source: UBS. All prices as of local market close.

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Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

Avoca Resources Limited (A\$)



Source: UBS; as of 02 Apr 2009

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