

UBS Investment Research

Avoca Resources Limited

Growth starting to take shape

■ Event: December quarterly production report

AVO released its full quarterly report confirming the pre-released production of 51koz at cash costs of A\$458/oz for the December period. The period was the third successive quarter at an annualised rate of +200koz suggesting the unchanged production guidance of +190koz should be easily attainable. Subsequent to the end of the period, the company announced an initial reserve of 118koz for the Chalice deposit and the upgraded offer for Dioro Exploration (DIO) opened.

■ Impact: Minor changes to EPS, Chalice reserves provide upside

The quarterly report resulted in very minor changes to our production and earnings profiles. The initial reserve and mine plan for the Chalice deposit indicates potential for future production upgrades. AVO suggests development could commence mid 2010 with first production in H1 FY12. The schedule shows output of 57koz in FY12, 44koz in FY13 and 17koz in FY14 with average costs of A\$518/oz and capex of ~\$42m.

■ Action: Buy maintained – growth catalysts in the pipeline, may need funds

We maintain our Buy call with potential production upgrades possible from the Chalice development and ongoing exploration blue sky. We also have a view that AVO will be able to close the DIO deal resulting in additional production from the Frog Legs mine. However, a successful close will require ~\$24m of cash, which with the \$42m for the Chalice development may require some additional funding.

■ Valuation: \$1.65/share (DCF, 6% discount rate)

Our NPV has been upped by 1%, but our target price remains unchanged.

Highlights (A\$m)	06/08	06/09	06/10E	06/11E	06/12E
Revenues	0	146	233	223	195
EBIT (UBS)	(7)	(15)	61	52	34
Net Income (UBS)	(1)	(16)	41	38	27
EPS (UBS, A\$)	(0.01)	(0.07)	0.15	0.14	0.10
Net DPS (UBS, A\$)	0.00	0.00	0.00	0.00	0.00

Profitability & Valuation	5-yr hist av.	06/09	06/10E	06/11E	06/12E
EBIT margin %	-	-10.0	26.2	23.5	17.5
ROIC (EBIT) %	-	(7.4)	34.1	33.7	27.0
EV/EBITDA (core) x	-	16.0	4.2	4.0	4.2
PE (UBS) x	-	NM	11.1	12.2	17.0
Net dividend yield %	-	0.0	0.0	0.0	0.0

Source: Company accounts, Thomson Reuters, UBS estimates. (UBS) valuations are stated before goodwill, exceptionals and other special items. Valuations: based on an average share price that year, (E): based on a share price of A\$1.68 on 28 Jan 2010 23:38 EST

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Global Equity Research

Australia

Mining

12-month rating **Buy**
Unchanged

12m price target A\$2.10/US\$1.90
Unchanged

Price A\$1.68/US\$1.52

RIC: AVO.AX BBG: AVO AU

29 January 2010

Trading data (local/US\$)

52-wk range	A\$2.20-1.44/US\$2.05-0.98
Market cap.	A\$0.46bn/US\$0.41bn
Shares o/s	272m (ORD)
Free float	100%
Avg. daily volume ('000)	1,501
Avg. daily value (A\$m)	2.9

Balance sheet data 06/10E

Shareholders' equity	A\$0.20bn
P/BV (UBS)	2.3x
Net Cash (debt)	A\$0.03bn

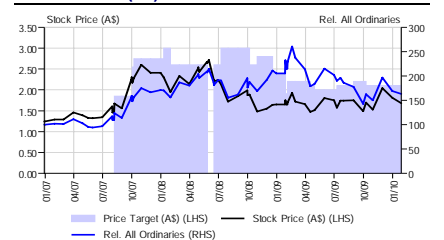
Forecast returns

Forecast price appreciation	+25.0%
Forecast dividend yield	0.0%
Forecast stock return	+25.0%
Market return assumption	9.3%
Forecast excess return	+15.7%

EPS (UBS, A\$)

	06/10E		Cons.	06/09 Actual
	From	To		
H1E	0.07	0.08	-	(0.07)
H2E	0.07	0.07	-	(0.01)
06/10E	0.15	0.15	0.15	
06/11E	0.14	0.14	0.15	

Performance (A\$)



Source: UBS

www.ubs.com/investmentresearch

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Summary of changes

Reconciling the December quarterly production report has resulted in only very minor changes to both our production and financials (Table 1).

Table 1: Summary of changes

June Y/E	2010			2011			2012			
	A\$m	New	Old	Var %	New	Old	Var %	New	Old	Var %
Revenue		235	229	3%	229	229	0%	204	213	-4%
EBITDA		110	107	2%	99	99	0%	79	83	-5%
EBIT		61	59	3%	52	52	0%	34	36	-5%
PBT		59	57	4%	54	53	0%	39	40	-4%
Net Profit		41	40	4%	38	37	0%	27	28	-4%
EPS A\$		15	15	4%	14	14	0%	10	10	-4%
DPS A¢		0.0	0.0	NM	0.0	0	NM	0	0	NM
Physicals										
Ore Mined	kt	1057	1127	-6%	1080	1127	-4%	1080	1127.2	-4%
Grade	g/t	5.8	5.7	2%	5.4	5.4	0%	5.3	5.3	0%
Ore processed	kt	1215	1214	0%	1200	1200	0%	1080	1127.2	-4%
Grade	g/t	5.2	5.1	1%	5.0	5.0	0%	5.3	5.3	0%
Gold produced	koz	197	194	1%	188	189	0%	179	187	-4%
Costs										
Cash costs (including royalties)	A\$/oz	-576	-564	2%	-608	-609	0%	-599	-600	0%
NPV										
Base - 10 year life		1.65	1.63	1%						
Price Target										
NPV Multiple		1.3	1.3							
Price Target		2.10	2.10	0%						

Source: UBSe

Avoca Resources Ltd (AVO.AX)

Analyst/s: Jo Battershill; Glyn Lawcock
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29-Jan-10

MARKET INFORMATION	
Rating:	Buy
Price (as of 28-Jan-10):	1.68
Price Target (12 months):	2.10
Issued Capital:	272.3
Market Capitalisation:	457.4
Avg. daily turnover (US\$m)	2.7
Year end:	June
Website:	http://www.avocaresources.com.au
Major Shareholders:	Pala 22.5%, CBA 5.01%

INVESTMENT SUMMARY				
(A\$m)	2009	2010E	2011E	2012E
Net profit [reported] (\$m)	(16.3)	41.3	37.5	27.0
Net profit [adjusted] (\$m)	(16.3)	41.3	37.5	27.0
EPS [reported] (\$)	(0.1)	0.2	0.1	0.1
EPS [adjusted, diluted] (\$)	(0.1)	0.2	0.1	0.1
EPS Growth (%)	(1132.3)	NM	(9.2)	(28.1)
PER [adjusted] (x)	<0.0	11.1	12.2	17.0
Dividend (\$)	0.0	0.0	0.0	0.0
Payout ratio (%)	0%	0%	0%	0%
Dividend Yield (%)	0%	0%	0%	0%
FCF Yield (%)	(0.9)	14.0	16.2	13.4
Franking (%)	0.0	0.0	0.0	0.0
Shares [period-average, diluted] (m)	233.5	272.3	272.3	272.3

VALUATION	
Valuation per share [NAV @ 6%] (\$)	1.65
Share Price Target [12 months] (\$)	2.10
Price/NAV [6% disc rate] (x)	1.02

Operating Assets [DH09]	A\$m	¢
Higginsville	403	148
Exploration	35	13
Dioro Exploration stake	35	13

Gross Assets 473 174

Net Cash	(4)	-1
Corporate costs	(20)	-8

Net Asset Value @ 10% discount rate 449 165

ENTERPRISE VALUE				
(A\$m)	2009	2010E	2011E	2012E
Enterprise Value	515	454	392	331
EV/EBITDA (x)	18.6	4.1	3.9	4.2
EV/Operating Free Cash Flow (x)	297.6	7.0	5.3	5.7

EPS SENSITIVITIES				
Commodity	Base Change	2010E	2011E	2012E
		EPS Change		
Gold price	10%	16.0%	36.0%	45.0%
Currency	5c	-9.0%	-19.0%	-25.0%

CASH FLOW				
(A\$m)	2009	2010E	2011E	2012E
Operating income [EBIT, UBS]	(15)	61	52	34
Depreciation & Amortisation	42	49	47	45
Net change in working capital	29	0	0	0
Other (operating)	0	0	0	0
Pre-tax op cash flow	57	110	99	79
Interest (paid) / received	(5)	(2)	1	4
Tax paid	7	(18)	(16)	(12)
Other	(7)	0	(0)	0
Operating cash flow	52	91	85	72
Capital expenditure	(55)	(27)	(10)	(11)
Free cash flow	(4)	64	74	61
Net (acquisitions) / disposals	0	0	0	0
Dividends paid (Common)	0	0	0	0
Shares issued/(repurchased)	29	0	0	0

Source: Company accounts, UBS estimates. UBS valuations are stated before goodwill, exceptionals and other special items. Note: For some companies, the data represents an extract of the full company accounts.

Source: UBS

COMPANY DESCRIPTION						
Avoca Resources Limited (AVO) controls 2,700sqkm between the world-class Norseman and St Ives Goldfields in Western Australia. AVO is producing gold from the Trident deposit at the 100%-owned Higginsville project 150km south of Kalgoorlie. Production for CY10 is estimated at +190koz at cash costs of ~A\$475/oz excluding royalties. AVO believes a mine life of at least 10 years is achievable at Higginsville given the highly prospective area and positive exploration results. Future production is expected to be sourced from other deposits in the region including the Chalice and Two Boys projects.						

OPERATIONAL ASSUMPTIONS						
Commodity Prices	1H10E	2H10E	2009	2010E	2011E	2012E
Gold price (US\$/oz)	1,031	1,038	864	1,034	1,044	917
A\$:US\$	0.87	0.88	0.73	0.88	0.88	0.84
Production (koz)						
Higginsville	102	95	130	197	188	179
Cash costs including state royalty						
Higginsville (A\$/oz)	468	474	642	470	502	505
Higginsville (US\$/oz)	407	417	469	412	442	425
Cash costs including private royalty						
Higginsville (A\$/oz)	573	579	701	576	608	599
Higginsville (US\$/oz)	499	509	512	504	535	503

DIVISIONAL BREAKDOWN [EBIT]						
(A\$m)	1H10E	2H10E	2009	2010E	2011E	2012E
Higginsville	37	33	23	70	62	43

PROFIT & LOSS						
(A\$m)	1H10E	2H10E	2009	2010E	2011E	2012E
Sales Revenue	120	113	146	233	223	195
Operating Cash Profit	62	57	54	119	109	88
Depn & Amortisation	(25)	(24)	(42)	(49)	(47)	(45)
Operating Profit	37	33	12	70	62	43
Exploration	(0)	(3)	(3)	(3)	(5)	(5)
SGA	(4)	(2)	(23)	(6)	(4)	(4)
EBIT	32	29	(15)	61	52	34
Net interest	(1)	(1)	(9)	(2)	1	4
Profit before tax	31	28	(23)	59	54	39
Tax expense	(9)	(8)	7	(18)	(16)	(12)
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]	22	20	(16)	41	38	27
Abnormal Gain/(Loss) after Tax	0	0	0	0	0	0
Net Profit [adjusted]	22	20	(16)	41	38	27
EBITDA margin (%)			19.0	47.3	44.6	40.4
Net Interest Cover [EBIT] (x)			1.7	(32.9)	43.7	8.0
Tax Rate (%)			NM	30.0	30.0	30.0
EBIT/Total Assets (%)			(5.1)	18.4	14.1	8.6
NPAT/Equity (%)			(10.3)	20.8	15.9	10.3

BALANCE SHEET [Selected Items]				
(A\$m)	2009	2010E	2011E	2012E
Net Working capital	(27)	(27)	(27)	(27)
Fixed Assets	177	154	117	83
Net Other	36	43	50	57
Capital Employed	186	171	141	113
Net Cash / (Debt)	(29)	28	95	150
Total Equity [incl. minorities]	157	199	236	263
Minorities	0	0	0	0
Net Debt / Equity (%)	18.4	(14.1)	(40.4)	(56.9)
Book Value per Share(\$)	0.61	0.73	0.87	0.97

■ Avoca Resources Limited

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UBS 12-Month Rating	Rating Category	Coverage ¹	IB Services ²
Buy	Buy	48%	40%
Neutral	Hold/Neutral	40%	35%
Sell	Sell	13%	26%
UBS Short-Term Rating	Rating Category	Coverage ³	IB Services ⁴
Buy	Buy	less than 1%	17%
Sell	Sell	less than 1%	67%

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 December 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).

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

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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 ^{4, 5, 13}	AVO.AX	Buy	N/A	A\$1.68	28 Jan 2010

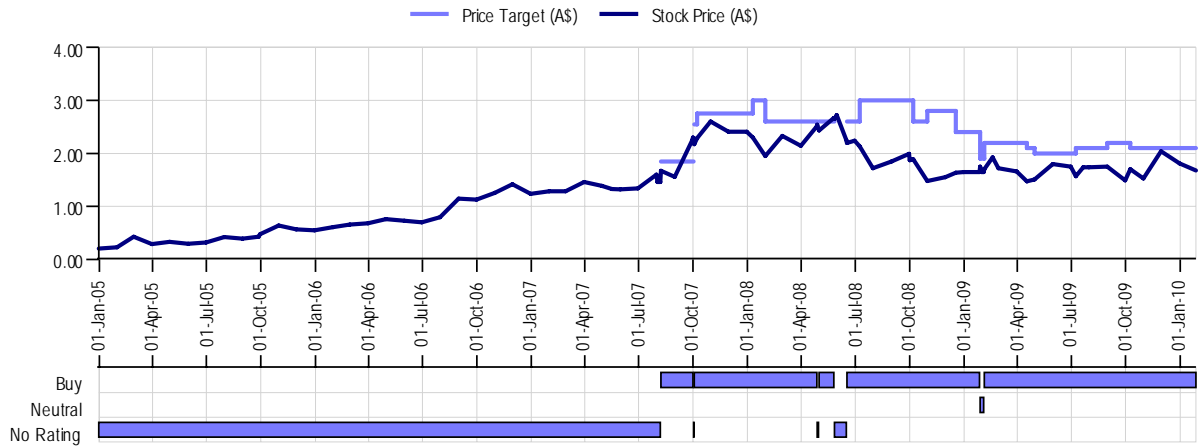
Source: UBS. All prices as of local market close.

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Avoca Resources Limited (A\$)



Source: UBS; as of 28 Jan 2010

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