SPEC BUY

Current Price	$0.30
Target Price	$0.76

Ticker:		**HCH**
Sector:		**Materials**
Shares on Issue (m):		**347.7**
Market Cap ($m):		**104.3**
Net Cash ($m):		**4.5**
Enterprise Value ($m):		**99.8**
F.F. Enterprise Value ($m)		**720.8**
52 wk High/Low:	**$0.55**	**$0.23**
12m Av Daily Vol (m):		**0.23**

Mineral Inventory (100% basis)

	Mt	Cu Grade	Cont. Cu
Ore Reserves	90.5	0.5%	433
Mineral Resource	264.8	0.5%	1,216

	$/t
FF.EV/Reserve	1,665
FF.EV/Resource	593

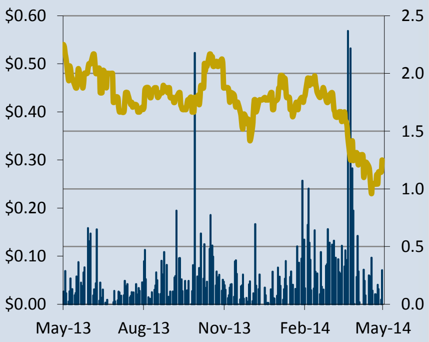
Directors

Murray Black	Non-Executive Chairman
Christian Easterday	Managing Director
Allan Trench	Non-Executive Director
Michael Anderson	Non-Executive Director
Mr de Andraca Adriasola	Non-Executive Director

Substantial Shareholders

J.P. Morgan Nominees	13.4%
Citicorp Nominees	10.3%
Merrill Lynch Nominees	7.8%
Port Finance Ltd (CAP S. A.)	6.1%

Share Price Graph



Friday, 23 May 2014

Hot Chili Ltd

Replenishing the coffers

Analysts | Matthew Keane | Patrick Chang

Quick Read

Hot Chili (HCH) announced that it has executed a US$25m secured debt funding from Sprott Resource Lending Partnership (Sprott). The funding secures HCH's balance sheet for the medium term and enables the Company to continue drilling and complete the PFS for the flagship Productora copper/gold deposit in Chile. This debt also alleviates the risk of a discounted equity raise at a suppressed share price in the near term. HCH recently released a maiden Reserve and updated Resource for Productora of 90.5Mt @ 0.48% copper and 0.11% gold for ~500kt contained copper Eq. Both the tonnage and grade were below Argonaut's expectations of 100Mt @ 0.58% copper. Argonaut has adjusted its model to incorporate a lower feed grade and debt financing to achieve an adjusted valuation of $0.76 (previously $0.99). SPEC BUY recommendation maintained.

Event & Impact | Positive

Debt strengthens balance sheet: Hot Chili (HCH) announced that it has executed US$25m in secured debt funding from Sprot who currently holds an affiliated ~5.8% stake in HCH. This facility enables the Company to re-commence work on the Productora PFS, expected late-2014 / early-2015, and undertake a planned 35-45km drill program to increase Reserves and Resources.

Lending terms: Key terms of the facility include:

- Commercial interest rate (Argonaut est. between 10-12%)
- 1% cash establishment fee, plus 11m options @ $0.40 excise price (5yr maturity)
- 12 month term with an option to extend 12 months with a 2% fee payable in shares
- Funding break-fee of 5.5m shares (5yr maturity @ $0.40) and exclusivity to June 2014

Maiden Reserve: HCH recently completed a maiden Reserve on the Company's flagship Productora project with 90.5Mt @ 0.48% for 433kt contained copper. This is below Argonauts prediction of ~100Mt @ 0.58% for 580kt driven by a lower cut-off grade than was applied to Resource estimations to date. The applied 0.25% copper cut-off reflects a low grade bulk mining operation, typical for operational porphyry style copper deposits in Chile.

Chilean copper: Chile, the world's largest copper producer, commonly hosts large low grade IOCG/porphyry deposits. While HCH currently has modest scale and is below the median copper grade for Chilean development projects (~0.56%), it has favourable capital intensity of ~US$9,000/t vs a peer average of ~US$15,000/t (see over). This debt funding should enable HCH to increase Resources and potentially increase Reserve grade.

Recommendation

Argonaut maintains a SPEC BUY recommendation. Our target price of $0.76 (previously $0.99) has been adjusted to account for a lower head grade and debt servicing.

Near term balance sheet secured

US$25m secured debt facility executed with Sprott…

HCH announced that it has executed US$25m in secured debt funding from Sprott Resource Lending Partnership. Sprott currently holds an affiliated ~5.8% stake in HCH. The funding secures HCH's balance sheet for the medium term and enables the Company to continue drilling and complete the PFS for the flagship Productora copper/gold deposit in Chile.

Funding Terms

…with a 12m extendable term with 1% cash and 11m option establishment fee…

Key terms of the facility include:

- US$25m with a 12 month term secured against the Productora project
- Commercial interest rate (Argonaut est. between 10-12%)
- 1% cash establishment fee, plus 11m options with a $0.40 excise price (5yr maturity)
- Option to extend for 12 months with a 2% fee payable in shares
- Funding exclusivity to Sprott through to 30 June 2014.
- Funding break-fee of 5.5m shares with a 5yr maturity at a $0.40 excise price

Use of funds

…to fund exploration and PFS completion

Proceeds of the debt facility will be used predominantly to progress Productora development. The breakdown of expenditure is estimated at:

- ~US$12m for Resource expansion and Reserve conversion drilling at Productora
- ~US$5m to complete the expanded PFS study which is now expected to include an oxide treatment option
- US$3m on work pertaining to the BFS study (subsequent to a successful PFS)
- US$5m for corporate costs and working capital

Alternatives for debt repayment

Repayment options: equity raising, debt restructure or incorporation in infrastructure deal

With cash at $5.5m at March 31, the market was contemplating the risk of a discounted equity raise at a suppressed share price. With production cash flow not anticipated until FY18, the Company has three potential alternatives to repay the $25m facility. Firstly, with the completion of a positive PFS and potential subsequent share accretion, HCH may opt to raise equity. Secondly, the facility may be restructured into a boarder project finance facility following a positive BFS. This would likely invoke the 12 moth extension option as the BFS is unlikely to be completed within the initial term. Finally, there is potential for either a cash or finance component to the expected infrastructure deal with in-country partner CAP/CMP.

Infrastructure agreement

Infrastructure deal with CAP/CMP expected in H1 2014

An infrastructure agreement with CAP/CMP is expected to incorporate project equity in return for access to the Huasco Port facilities as well as surface rights and easement agreements on Productora, a water pipeline and access corridor. Importantly, it is Argonaut's understanding, that this debt facility has the flexibility to release security for an asset level transaction. This is intuitive, given Sprott's interest at Topco and the importance for a successful agreement for the viability of Productora. Argonaut believes that this transaction should be completed in the current half.

Maiden Ore Reserve and Updated Mineral Resource

Maiden Ore Reserve

Maiden Reserve containing 433kt copper…

..below Argonaut's estimated grade and tonnage

HCH recently completed a maiden Ore Reserve (OR) on the Company's flagship Productora project with 90.5Mt @ 0.48% for 433kt contained copper. This is below Argonaut's prediction of ~100Mt @ 0.58% for 580kt, driven by a lower cut-off grade than was applied to Resource estimations to date. The applied 0.25% copper cut-off reflects a low grade bulk mining operation, typical for porphyry style copper deposits in Chile. 10.2Mt of transitional (partly oxidised) ore was incorporated in the OR, however this material was not used for pit optimisation and a conservative 50% recovery was applied. Notably, this OR was delivered ahead of a Prefeasibility Study (PFS), where most projects deliver an OR prior to completing a Bankable Feasibility Study (BFS).

Table 1: Productora Ore Reserve

Category	Ore	Cu Grade	Au Grade	Mo Grade	CuEq	Cu	Au	Mo	Cu Eq
	Mt	%	g/t	%	%	kt	koz	kt	kt
Probable	90.5	0.48%	0.11	0.017%	0.55%	433	308	15.5	502

Source: HCH

Revised Mineral Resource

Resource upgrade adds 12% for contained copper at a lower grade

A revision to the Productora Mineral Resource (MR) included 214.3Mt @ 0.48% for 1.0Mt copper, 675koz gold and 29kt molybdenum. This revision contains ~12% more contained copper than the previous estimate, primarily driven by a lower cut-off grade of 0.25% (previous OR used 0.30%). Some of the recently discovered Habanero zone (within the proposed central pit area) was incorporated into the MR. Importantly, a large proportion of ore was upgraded into the Inferred category which now comprises 78% of the MR.

Table 2: Productora Ore Reserve

Category	Ore	Cu Grade	Au Grade	Mo Grade	CuEq	Cu	Au	Mo	Cu Eq
	Mt	%	g/t	%	%	kt	koz	kt	kt
Indicated	158.6	0.50%	0.11	0.015%	0.57%	799	540	24.0	902
Inferred	55.6	0.41%	0.08	0.010%	0.46%	299	133	5.0	253
Total	**214.3**	**0.48%**	**0.10**	**0.014%**	**0.54%**	**1,029**	**675**	**29.0**	**1,155**
Previous	165.2	0.59%	0.10	0.013%	0.65%	920	570	22.0	1,079

Source: HCH

HCH's mineral inventory, incorporating the recently released maiden Resource for the Frontera project, is 264.8Mt @ 0.46% for 1.2Mt contained copper.

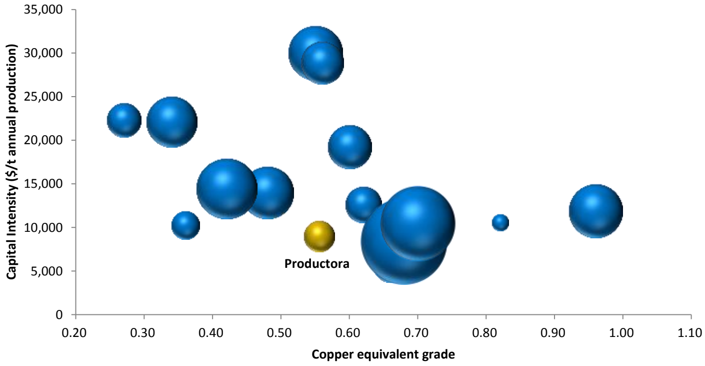
Productora requires further scale

Productora is favourable on capital intensity, but requires scale

While Productora currently has modest scale and is below the median copper grade for Chilean development projects (~0.56%), it has favourable capital intensity of ~US$9,000/t vs a peer average of ~US$15,000/t (Figure 1). Argonaut believes that the projects' viability is highly dependent on a higher inventory to support the proposed bulk mining operation. Of course, a higher grade would also improve economics.

Productora tonnage modest compared to Chilean peers…

Figure1. Chilean copper development projects (bubble size represents copper production)



Source: Argonaut / Bloomberg

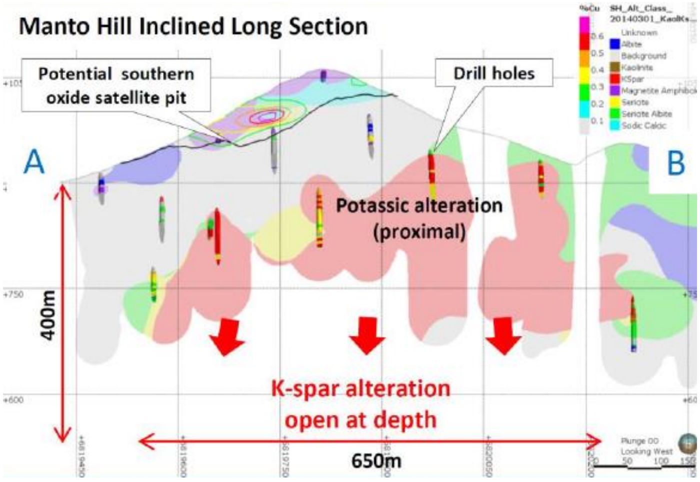
Resource upside potential

…however, Resource upscale is considerable from near-pit and regional exploration…

Further Resource upside exists both within the central pit and regionally. The recently devised alteration model has led to the discovery of the Habanero and Rocoto zones (both open) and the generation of 15 additional priority targets. These targets are based on potassic (k-feldspar) alteration zones. Of particular interest is the Manto Hill target (Figure 2), which is interpreted to be 600m long and a down-faulted and laterally displaced southern segment of Productora. Manto Hill is overlain by the Southern Oxide Zone. Therefore an economic outcome for oxide processing/sales will aid the economics of any underlying sulphide mineralisation of this prospect.

…with Manto Hill offering potential for both oxide and sulphide copper

Figure 2. Manto Hill exploration target



Source: HCH

Copper oxide upside

HCH now assessing oxide ore…

HCH also announced that it has embarked on a study to test the viability of treating copper oxide ore. The current oxide resource stands at 25.6Mt @ 0.52% copper with 15.4Mt @ 0.58% copper within the current pit shell.

Potential to reduce strip ratio

…which has potential to add revenue and reduce strip ratio

The potential to process oxide ore within the current pit shell provides the opportunity to monetise material that would otherwise have been side-cast as overburden. Argonaut believes that this has the potential to reduce the strip ratio to as low as 3:1 from the current ~4:1. This increases our valuation by as much as 20%.

Additional early revenue stream

Oxide may generate revenue stream in early strip phase

Processing surface oxide also has the potential to provide an early revenue stream during the pre-strip phase. Three potential options for oxide ore include; selling unprocessed ore to one of three processing facilities in close proximity to Productora, tolling a pregnant copper liquor from a dump/heap leach operation or constructing a solvent extraction electro winning (SXEW) plant on site to produce a copper cathode. Argonaut believes that tolling pregnant liquor may be preferred as this offers a low capex and lower technical risk with higher payability and lower transport costs than selling unprocessed ore.

Argonaut applies $7.5m to oxide potential, still applying a tolling model

If proven viable, oxide ore is likely to be added to the OR and included in the PFS. Our model does not incorporate an oxide treatment facility, however we have added ~$7.5m (2¢/sh) which is our estimated value for selling unprocessed ore to a neighbouring oxide treatment facility. HCH currently has a Letter of Intent (LOI) with Empresa Nacional de Minería for toll treatment.

Valuation

Valuation decreased to $0.80 based on lower grade and debt servicing…

Argonauts target price of $0.76 (previously $0.99) has been adjusted to account for a lower head grade, which has been reduced in-line with the Maiden Reserve grade, and with the incorporation of the Sprott debt facility. Table 3 outlines Argonaut's revised assumptions.

Table 3. Argonaut's revised and previous assumptions vs HCH Scoping Study

Metric	Scoping Study	Argonaut Assumptions	Revised Assumptions
Processing Rate (Mtpa)	11	11	11
Copper Grade	0.60%	0.58%	0.48%
Strip Ratio	4:1	3.5:1	3.5:1
Metallurgical Recovery (Cu)	>90%	89%	89%
Metallurgical Recovery (Au)	80%	80%	70%
Metallurgical Recovery (Mo)	75%	75%	50%
Concentrate Production (ktpa)	220	235	207
Concentrate Grade	>25%	25%	25%
Contained Cu Production (ktpa)	>55	58	52
Development Capex (US$m)	500 to 700	621	640
C1 Cash Costs (US$/lb)	1.20 to 1.50	1.54	1.62

Source: Argonaut

…with Productora still the key value driver

Table 4. Valuation summary

Valuation Summary		
Single Mine Valuation	AUD M	AUD / Share
Productora	293.30	0.84
Total	293.3	0.84
Corporate Valuation	AUD M	AUD / share
Corporate Valuation	(131.65)	(0.38)
Frontera	26.00	0.07
Chile Exploration	16.00	0.05
Copper Oxide	7.50	0.02
Cash	29.50	0.08
Debt	25.00	0.07
NAV	265.7	0.76
Target Price		0.76

Source: Argonaut

RESEARCH:

Ian Christie | Director, Industrial Research
+61 8 9224 6872 ichristie@argonaut.com

Patrick Chang | Analyst, Metals & Mining Research
+61 8 9224 6835 pchang@argonaut.com

Emily Reilly | Analyst, Industrial Research
+61 8 9224 6809 ereilly@argonaut.com

Matthew Keane | Analyst, Metals & Mining Research
+61 8 9224 6869 mkeane@argonaut.com

INSTITUTIONAL SALES - PERTH:

Chris Wippl | Executive Director, Head of Sales & Research
+61 8 9224 6875 cwippl@argonaut.com

John Santul | Consultant, Sales & Research
+61 8 9224 6859 jsantul@argonaut.com

Troy Irvin | Director, Institutional Research Sales
+61 8 9224 6871 tirvin@argonaut.com

Bryan Johnson | Director, Institutional Research Sales
+61 8 9224 6834 bjohnson@argonaut.com

Damian Rooney | Senior Institutional Dealer
+61 8 9224 6862 drooney@argonaut.com

Ben Willoughby | Institutional Dealer
+61 8 9224 6876 bwilloughby@argonaut.com

Alex Wallis | Institutional Dealer
+61 8 9224 6805 awallis@argonaut.com

INSTITUTIONAL SALES – HONG KONG:

Travis Smithson | Managing Director - Asia
+852 9832 0852 tsmithson@argonaut.com

Glen Gordon | Institutional Research Sales
+852 3557 4874 ggordon@argonaut.com

CORPORATE AND PRIVATE CLIENT SALES:

Glen Colgan | Executive Director, Desk Manager
+61 8 9224 6874 gcolgan@argonaut.com

Kevin Johnson | Executive Director, Corporate Stockbroking
+61 8 9224 6880 kjohnson@argonaut.com

James McGlew | Executive Director, Corporate Stockbroking
+61 8 9224 6866 jmcglew@argonaut.com

Simon Lyons | Director, Private Clients
+61 8 9224 6881 slyons@argonaut.com

Geoff Barnesby-Johnson | Senior Dealer, Corporate Stockbroking
+61 8 9224 6854 bj@argonaut.com

Rob Healy | Dealer, Private Clients
+61 8 9224 6873

Ben Rattigan | Dealer, Private Clients
+61 8 9224 6824 brattigan@argonaut.com

Luke Levis | Dealer, Private Clients
+61 8 9224 6852 llevis@argonaut.com

Cameron Prunster |Dealer, Private Clients
+61 8 9224 6853 cprunster@argonaut.com

James Massey |Dealer, Private Clients
+61 8 9224 6849 jmassey@argonaut.com

Mark Sandford |Dealer, Private Clients
+61 8 9224 6868 msandford@argonaut.com

Important Disclosure
The analyst(s) own shares in HCH

Information Disclosure
Each research analyst of this material certifies that the views expressed in this research material accurately reflect the analyst's personal views about the subject securities and listed corporations. None of the listed corporations reviewed or any third party has provided or agreed to provide any compensation or other benefits in connection with this material to any of the analyst(s).

General Disclosure and Disclaimer
This research has been prepared by Argonaut Securities Pty Limited (ABN 72 108 330 650) ("ASPL") or by Argonaut Securities (Asia) Limited ("ASAL") for the use of the clients of ASPL, ASAL and other related bodies corporate (the "Argonaut Group") and must not be copied, either in whole or in part, or distributed to any other person. If you are not the intended recipient you must not use or disclose the information in this report in any way. ASPL is a holder of an Australian Financial Services License No. 274099 and is a Market Participant of the Australian Stock Exchange Limited. ASAL has a licence (AXO 052) to Deal and Advise in Securities and Advise on Corporate Finance in Hong Kong with its activities regulated by the Securities and Futures Ordinance ("SFO") administered by the Securities and Futures Commission ("SFC") of Hong Kong.

Nothing in this report should be construed as personal financial product advice for the purposes of Section 766B of the Corporations Act 2001 (Cth). This report does not consider any of your objectives, financial situation or needs. The report may contain general financial product advice and you should therefore consider the appropriateness of the advice having regard to your situation. We recommend you obtain financial, legal and taxation advice before making any financial investment decision.

This research is based on information obtained from sources believed to be reliable and ASPL and ASAL have made every effort to ensure the information in this report is accurate, but we do not make any representation or warranty that it is accurate, reliable, complete or up to date. The Argonaut Group accepts no obligation to correct or update the information or the opinions in it. Opinions expressed are subject to change without notice and accurately reflect the analyst(s)' personal views at the time of writing. No member of the Argonaut Group or its respective employees, agents or consultants accepts any liability whatsoever for any direct, indirect, consequential or other loss arising from any use of this research and/or further communication in relation to this research.

Nothing in this research shall be construed as a solicitation to buy or sell any financial product, or to engage in or refrain from engaging in any transaction. The Argonaut Group and/or its associates, including ASPL, ASAL, officers or employees may have interests in the financial products or a relationship with the issuer of the financial products referred to in this report by acting in various roles including as investment banker, underwriter or dealer, holder of principal positions, broker, director or adviser. Further, they may buy or sell those securities as principal or agent, and as such may effect transactions which are not consistent with the recommendations (if any) in this research. The Argonaut Group and/or its associates, including ASPL and ASAL, may receive fees, brokerage or commissions for acting in those capacities and the reader should assume that this is the case.

There are risks involved in securities trading. The price of securities can and does fluctuate, and an individual security may even become valueless. International investors are reminded of the additional risks inherent in international investments, such as currency fluctuations and international stock market or economic conditions, which may adversely affect the value of the investment.

The analyst(s) principally responsible for the preparation of this research may receive compensation based on ASPL's and / or ASAL's overall revenues.

Hong Kong Distribution Disclosure
This material is being distributed in Hong Kong by Argonaut Securities (Asia) Limited which is licensed (AXO 052) and regulated by the Hong Kong Securities and Futures Commission. Further information on any of the securities mentioned in this material may be obtained on request, and for this purpose, persons in the Hong Kong office should be contacted at Argonaut Securities (Asia) Limited of Unit 701, 7/F, Henley Building, 5 Queen's Road Central, Hong Kong, telephone (852) 3557 48000.