

## SPEC BUY

Current Price \$0.019  
Valuation \$0.07

Ticker:	HCH		
Sector:	Materials		
Current Shares on Issue (m):	1,738.5		
Market Cap (\$m):	33.0		
Net Cash est (\$m):	3.0		
Enterprise Value (\$m):	30.0		
52 wk High/Low:	\$0.047	\$0.010	
12m Av Daily Vol (m):	5.2		

Directors			
Murray Black	Non-Executive Chairman		
Christian Easterday	Managing Director		
Allan Trench	Non-Executive Director		
Michael Anderson	Non-Executive Director		
Roberto de Andraca Adriasola	Non-Executive Director		
George Nickson	Non-Executive Director		

Major Shareholders			
Taurus Funds Management		15%	
Exploration Capital & Sprott		13%	
Black Edward		7%	
CAP SA		5%	

Reserves (Probable)	Mt	% Cu	Mt
Productora	166.9	0.43	562.9

Resources (Ind and Inf)	Mt	% Cu	Cu cont.	Mt
Productora (higher-grade)	236.6	0.48		1.13
Productora (lower-grade)	218.0	0.16		0.34

Cash Flow (A\$m)			
	FY17	FY18	FY19
Operating CF	-3.0	-2.2	-2.2
Investing CF	-1.4	-1.6	-3.2
Financing CF	6.4	5.1	3.1
Closing Cash	2.4	3.7	1.4

Figures in A\$ unless otherwise stated

Share Price Graph and Trading Volume (msh)



Please refer to important disclosures at end of the report (from page 5)

Wednesday, 15 April 2020

## Hot Chili Ltd (HCH)

### Buying time to add value

Analysts: Matthew Keane | Michael Eidne

#### Quick Read

HCH has negotiated a 12-month extension with private Chilean mining group SCM Carola for payments on the Cortadera acquisition. The two payments of US\$10m and US\$15m will now be due in mid-July 2021 and 2022 respectively. This has alleviated pressure on the Company to raise the required capital to make the first payment, originally due mid-2020. The deferral provides time to continue exploration and add significant value, ahead of any potential strategic investment or partnership with a mid-cap or major mining company. Cortadera is emerging as a world class porphyry deposit which has already attracted the attention of larger miners. In addition, HCH recently accepted a proposal from a government owned operator to sell ore from its Productora deposit. This is an opportunity to generate early cashflow to partly fund Cortadera exploration. Importantly, the partnership could facilitate expedited permitting for Cortadera.

#### Event & Impact: Deferred payments - Positive

**Deferred payments:** HCH and SCM Carola have reached an agreement to defer payments for the Cortadera acquisition by 12 months. HCH will now make the first payment of US\$10m in mid-July 2021 then the final US\$15m payment in mid-2022 to attain 100% of the asset. Consideration for the deferral will be US\$2m, due before 15 July 2020. This relieves pressure to raise the required funds in the near-term amidst a suppressed equity market, impacted by the COVID-19 crisis. We believe it also provides time to accrete value to the project and attract a strategic investor to help fund development.

**Early cashflow from Productora:** HCH recently accepted a proposal from Chilean government agency Empresa Nacional de Minería (ENAMI) for the lease mining and processing of ore from the Productora deposit (80% HCH). Circa 120kt ore will be processed over a 2-year period through ENAMI's Vallenar plant, located ~15km north of Productora. Consideration will be US\$2/t ore processed and a 10% royalty for the value of extracted minerals. While the expected revenue to HCH is modest (est. US\$400-500kpa), we believe the company will earn considerable good will from the state agency, which could expedite permitting approvals for Cortadera.

**Type-II porphyry, what the majors want:** Drilling and geological evaluation to date has indicated that Cortadera is a Type II copper/gold porphyry system. This type of porphyry is characterised by phyllic / potassium rich cores and generally possess higher gold ratios and higher overall contained copper and gold. Of the largest 25 porphyry deposits, Type II contain 60% of the total contained gold. These deposits are also favoured for large scale, low cost bulk underground mining (block caving) due to their scale but also soft core with favourable geomechanics.

#### Recommendation

Argonaut maintains a Speculative Buy recommendation with a revised valuation of \$0.07 (from \$0.08, see over).

## Valuation

**Argonaut values HCH on an EV/Resource basis...**

Argonaut values Cortadera on a fully diluted projected EV/Resource basis. For this assumption, we have converted all of the 80,095 outstanding convertible notes (3.33c conversion price with a face value of \$100) to derive an additional 240.3 million shares. We have also assumed that the Company will require further equity in order to fund the final vendor payments of US\$2m (A\$3.1m) in July 2020, US\$10m (A\$15.6m) in July 2021 and US\$15m (A\$23.4m) in July 2022 (assumption: \$10m raised at 1.5c/sh). Subsequently, we model ~2,646m shares on issue on a fully diluted basis. However, we note that HCH may have opportunities to raise capital via investment(s) from strategic partners.

**...applying \$50/t for estimated CuEq tonnes at Cortadera...**

According to S&P Market Intelligence, the average acquisition cost per in-situ tonne of copper since the start of 2018 was ~US\$215/t and the average EV/Resource for listed copper developers (non-transactional) was A\$183/t on a copper equivalent basis. For Productora, given the lower grade nature of the project and the limited scale, we ascribe an in-situ copper equivalent value of A\$25/t for HCH's 80% joint venture interest. For Cortadera, we have applied a higher multiple of \$50/t, due to its larger scale and higher grade, while still accounting for the early stage nature of the project. We believe these multiples are conservative given the aforementioned average EV/Resource multiples for developers and precedent transactions.

**...and \$25/t for resource CuEq tonnes at Productora...**

**...which we believe this is conservative given present transaction values of US\$215/t...**

To generate an estimate for the contained tonnes and grade for Cortadera, we have split the deposit in a high grade core and a lower grade halo. We estimate ~100Mt at 0.70% Cu and 0.25g/t Au for the core and ~400kt at 0.45% Cu and 0.20g/t Au for the halo, giving a combined inventory of ~3.3Mt contained copper equivalent. Productora has an existing resource of ~1.3Mt contained copper equivalent.

**...and listed developer EV/Resource values averaging A\$183/t**

Argonaut's revised sum of parts valuation is A\$183m or 7c/sh (previously \$157m or 8c/sh). Key changes to our valuation include: a higher grade and tonnage estimate for Cortadera, based on further drill results (previously 460Mt at 0.45% Cu and 0.2g.t Au), a lower estimate for Productora and other exploration assets (from \$68m to \$41m) and higher pro-forma shares on issue (previously 1,967m).

We generate a standalone DCF valuation of ~\$0.08/sh for Productora, using metrics from previous studies at a 12% discount rate. However, as Productora is less likely to be a standalone mine and processing facility, we feel that a more appropriate to value it on an EV/Resource basis.

**Argonaut derives a 7c/sh target price**

*Table 1. Argonaut's sum of parts valuation for Hot Chili Ltd*

NAV Valuation	Base Case	Value Per Share
<b>Sum of Parts</b>	AUD M	AUD / Share
Cortadera	167.2	0.06
Productora	26.3	0.01
Other Exploration Assets	15.0	0.01
Corporate NPV	(28.3)	(0.01)
Cash	3.0	0.00
Debt	-	-
<b>Total</b>	<b>183</b>	<b>0.07</b>

Source: Argonaut

## Type-II porphyry, what the majors want

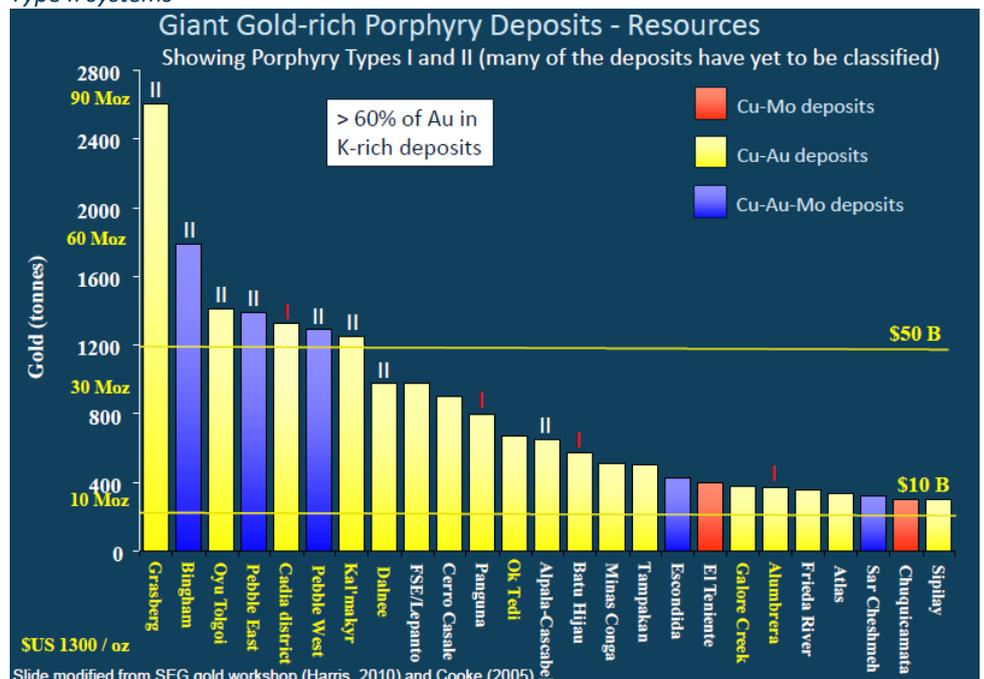
Cortadera looks to be a Type II copper/gold porphyry...

...the favoured type by the majors...

...based on high gold credits and a soft core, which aids block caving

Drilling and geological evaluation to date has indicated that Cortadera is a Type II copper/gold porphyry system. This type of porphyry is characterised by phyllic / potassium rich cores. They generally have higher gold ratios and higher overall contained copper and gold. While potassium rich intrusions constitute a small minority (5-10%) of epithermal and porphyry deposits, they contain 25% of the economic Cu/Au/Ag. Of the 25 largest porphyry deposits, Type II contain 60% of the total contained gold. Better known examples of this style of porphyry deposit include: Grasberg (Freeport-McMoRan), Bingham Canyon (or Kennecott, RIO), Oyu Tolgoi (RIO) and Cadia-Ridgeway (Newcrest). These deposits are also favoured for their amenability to large scale, low cost, bulk underground mining (block caving). The soft phyllic core also provides favourable geomechanics for cave-style mining.

Figure 1. Ranking of gold rich copper/gold porphyry deposits, showing the dominance of Type II systems



Slide modified from SEG gold workshop (Harris, 2010) and Cooke (2005)  
 Source: Harris (2010) and Cooke (2005), via Steve Garwin, HCH consultant

### Cuerpo 3 has the scale for block caving

Cuerpo 3 is the largest intrusion identified to date at Cortadera. Its current dimensions of 750m strike, ~300m width and 1,200m depth should provide the scale for an efficient block cave operation. Importantly, it is mineralised from surface with the high grade core extending from just over 200m below surface. This bodes well for a for a low strip, open pit followed by either a targeted high grade underground mine in the core or large scale block cave operation (or both).

## Cortadera remains open

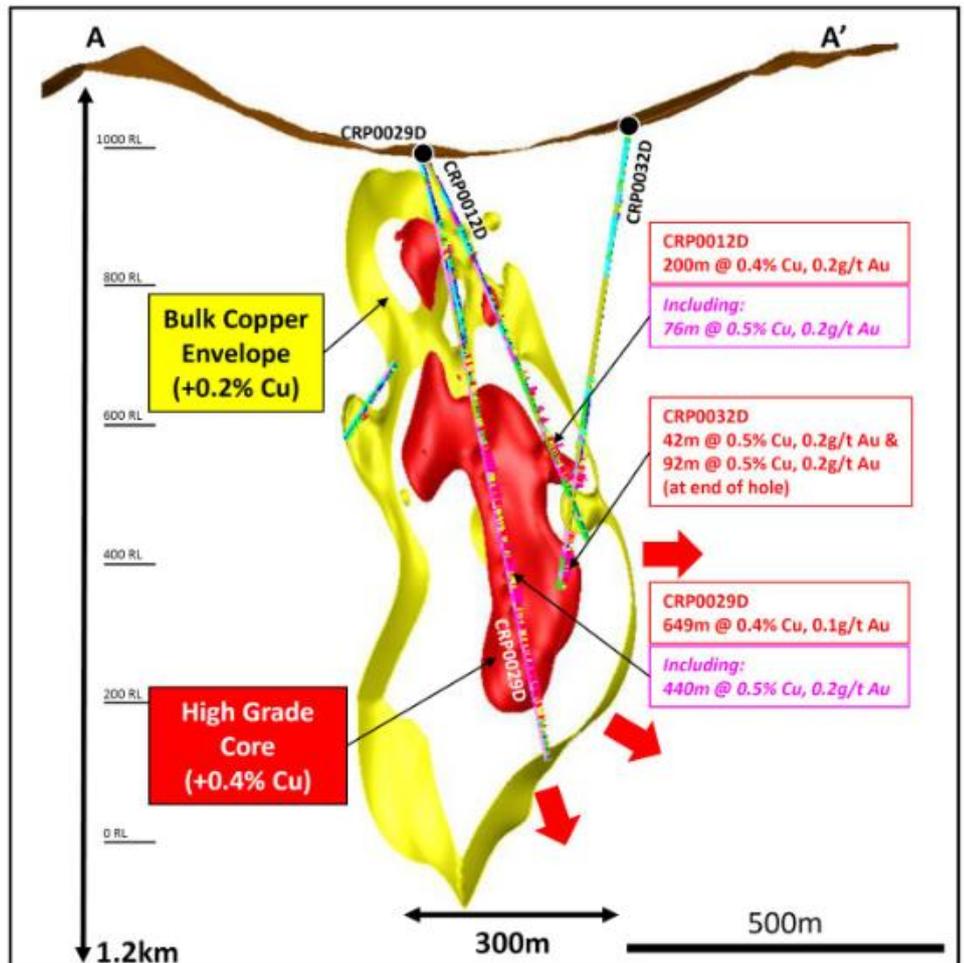
**Cortadera remains open in nearly all directions...**

Cortadera remains open in most directions with assay results still pending from extensional drilling to the north and the south. Assays from the latest drill holes are being held up by the impact of COVID-19 on Peruvian laboratories. The latest reported assays from hole CRP0040D extended the Cuerpo 3 high grade core to over 500m in strike, 200m in width. It extends from 200m to well over 400m vertical depth. CRP0040D returned 542m at 0.5% Cu and 0.2g/t Au from 422m down-hole, including 218m at 0.7% Cu and 0.2g/t Au from 616m. Average drill intercepts for the high grade core range between 0.7-0.9% Cu and 0.2-0.5g/t Au. Drilling has currently been suspended to conserve cash and as a safety precaution during the COVID-19 crisis.

**...and the HG core is still increasing in scale...**

Figure 2. Cross section through the latest drill intercept of the high grade core. Hole CRP0040D

**...grading 0.7-0.9% Cu and 0.2-0.5g/t Au.**



Source: HCH

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