SPEC BUY

Current Price	$0.24
Target Price	$0.60

Ticker:		HCH
Sector:		Materials
Shares on Issue (m):		347.7
Market Cap ($m):		80.0
Net Cash ($m):		10.0
Enterprise Value ($m):		70.0
F.F. Enterprise Value ($m)		691.0
52 wk High/Low:	$0.55	$0.17
12m Av Daily Vol (m):		0.30

Mineral Inventory (100% basis)

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

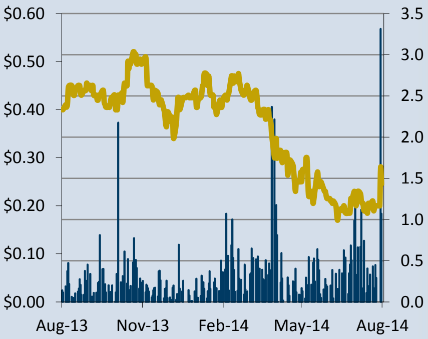
Directors

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	11.9%
Port Finance Ltd (CAP S. A.)	11.8%
Torus SM Holdings	11.7%
Citicorp Nominees	9.2%
Merrill Lynch Nominees	7.8%
Ludlin Mining Corp.	6.4%

Share Price Graph



Friday, 8 August 2014

Hot Chili Resources

Infrastructure deal

Analysts | Matthew Keane | Patrick Chang

Quick Read

Hot Chili (HCH) announced that it has entered into an MOU with its Chilean partner Compañía Minera del Pacífico S.A (CMP) gaining access to key infrastructure in return for 17.5% of the Productora Cu project. In return for stake, HCH will attain easements related to water supply, surface rights over the proposed development area and the remaining 35% interest in mining rights within the Productora structural trend. In addition, CMP will pay an upfront US$1.5m for an option to acquire a further 32.6% of the project for US$80.0m. Key positives for this long awaited agreement include; access to critical infrastructure, the modest upfront stake (where market predictions were higher), and the see through value of US$245m for the project (based on US$80m for 32.6%). Argonaut maintains a SPEC BUY recommendation with a $0.60 target price.

Event & Impact | Positive

Long awaited deal secured: The infrastructure deal with CMP has been executed with the following terms:

- 17.5% project equity in the Productora project in exchange for:
- CMPs easements related to the proposed water pipeline route from the coast
- Certain surface rights over the proposed mining development area
- The remaining 35% interest that CMP holds on certain mining rights near Productora
- An option for CMP to acquire an additional 32.6% for no less than US$80m
- Payment of US$1.5m for this option which allows CMP to move to 50.1%
- The MOU is subject to approvals from CMP's board and HCH shareholders

No additional cost expected for port access: In addition, HCH is undertaking a port access study for negotiations on the Las Losas port facility 40km west of Productora (51% CMP). HCH is likely to invest with CMP on port infrastructure in return for a secured allocation of Cu concentrate exports.

Exploration the oxide feasibility the key: Argonaut considers increased scale vital to Productora's feasibility. Due to the modest Reserve grade (90.5Mt @ 0.48% for 433kt contained Cu), the project suits a high tonnage, bulk movement operation. Of course, a higher grade would likewise improve economics. Monetising the Cu oxide cap will also be beneficial, reducing the effective strip ratio. HCH has ~$20m cash and $15m undrawn debt (Sprott) to fund exploration and a Prefeasibility Study (due H1 2015). HCH has a group budget of $22m for FY15 and Argonaut expects a further US$5m drawn-down on the debt. Post PFS, HCH will likely contribute ~50% of the est. $15-20m BFS funding.

Recommendation

Argonaut maintains a SPEC BUY recommendation and $0.60 price target. Our valuation assumes CMP excising the US$80m option to increase its stake to 50.1%. The effects of additional cash from this transaction, decreased attributable capital (est. US$315m) and decrease project equity have little net impact on our valuation (NAV[12] $0.62).

Significant infrastructure MOU Executed

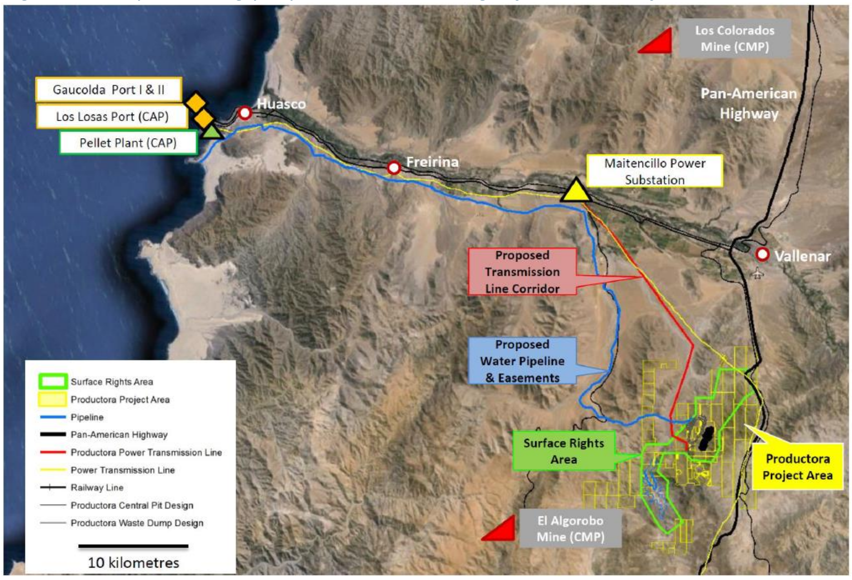
Critical amenities

Infrastructure key to Chilean copper…

Water, power and port access are vital components to Chilean Cu development projects. The MOU with CMP underpins both water and port infrastructure. Power is obtainable from either CMPs power lines which pass within 5km of Productora or from the state grid (within 25-30km @ est. cost of ~15¢/KWh).

…and the CMP MOU should give access to water and port

Figure 1: Map showing proposed and existing infrastructure for Productora



Source: HCH

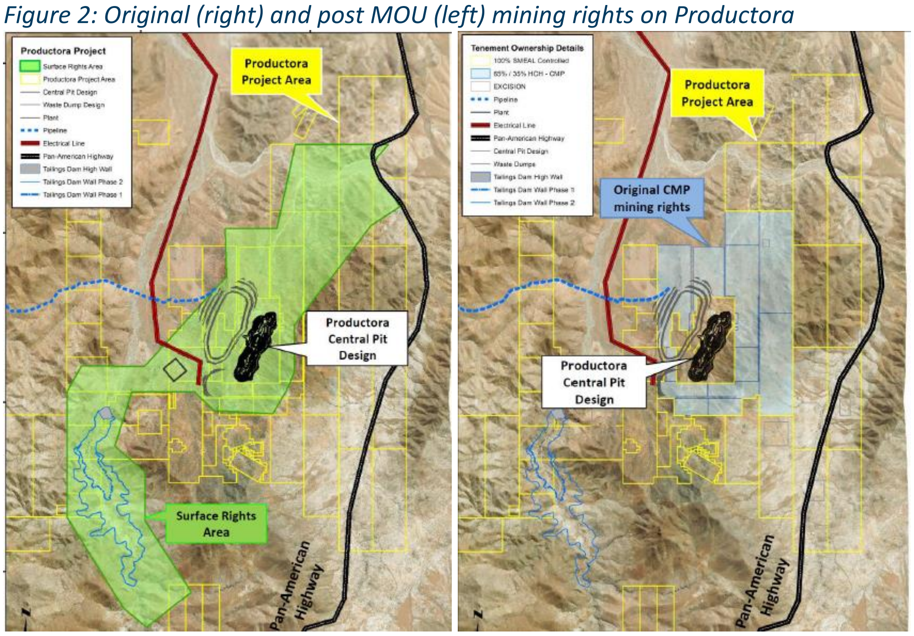
Consolidating Productora

The MOU also consolidates mining rights on Productora…

The MOU finalises consolidation of the greater Productora project area with the remaining 35% that CMP holds on certain mining rights, transferred to joint venture.

…defining a Surface Rights agreement (in green) over the structural trend of Productora mineralisation

Figure 2: Original (right) and post MOU (left) mining rights on Productora



Source: HCH

Defining value on Productora

CMP has rioght to move to 50.1% via a US$80m option…

CMP's option to acquire an additional 32.6% for a minimum US$80m places a see though value of ~US$245m (~A$266m @ FX 0.92). This is 10% higher than Argonaut's DCF valuation of A$241m (applying 50:50 debt to equity funding on US$630m capex). The option can be exercised within 90 days of the completion of the PFS which is expected in H1 2014. CMP will be free carried for the PFS, but will contribute on a pro rata basis for development thereafter. Terms of the excise price are the higher of:

- US$80m or
- The value of shares in Sociedad Minera El Aguila SpA (SMEA SpA HCH's Chilean subsidiary company which holds the Productora project) as determined by an independent technical expert upon completion of the PFS

…purchased for US$1.5m

CMP will pay HCH US$1.5m upfront for the option.

Valuation

Argonaut's target price of $0.60 is largely in line with our NAV[12] valuation of $0.62.

Argonaut has a target price of $0.60 based on a NAV of $0.62

Table 1: Argonaut's HCH valuation summary

Valuation Summary		
Single Mine Valuation	AUD M	AUD / Share
Productora	241.36	0.69
Total	241.4	0.69
Corporate Valuation	AUD M	AUD / share
Corporate Valuation	(105.60)	(0.30)
Frontera	26.00	0.07
Chile Exploration	16.00	0.05
Copper Oxide	7.50	0.02
Cash	20.00	0.06
Debt	10.00	0.03
NAV	215.3	0.62
Target Price		0.60

Source: HCH

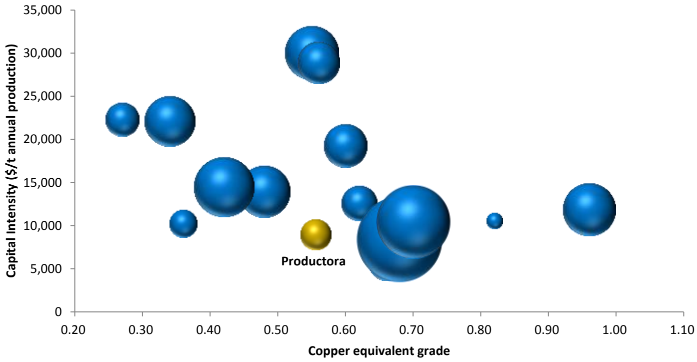
Exploration upside required

Exploration upside is required for Productora…

Argonaut considers exploration upside and/or higher grades are required to support the feasibility of Productora. While the projects Reserve of 214.3Mt @ 0.48% for 1.0Mt contained Cu is not anomalous to operating Chilean and Peruvian porphyry and IOCG deposits on a grade basis, it is comparatively small on a tonnage and contained Cu basis. However Productora does benefit from modest capital intensity.

…however the project benefits from low capital intensity

Figure 3. Chilean copper development projects (bubble size = copper production)



Source: Argonaut / Bloomberg

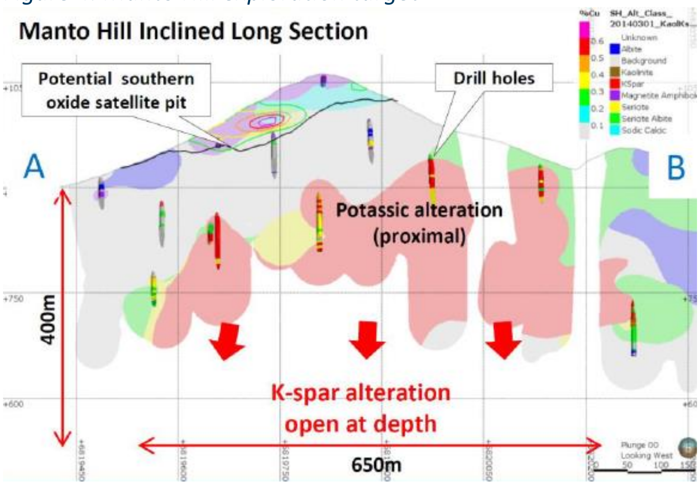
Resource upside potential

Resource upside exists from 15 identified targets…

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 (in-pit and 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 4), which is interpreted to be 600m long and a down-faulted laterally displaced of the 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 both oxide and sulphide ore potential

Figure 4. Manto Hill exploration target



Source: HCH

Copper oxide upside

Copper oxide Resource currently at 15.4Mt @ 0.58% Cu…

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

…with has potential to decrease strip by monetising waste…

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

…and provide an early revenue stream during the pre-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.

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Improtant Disclosure
The Analyst(s) holds shares in HCH.

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