

5 November 2013

RECOMMENDATION

Buy

Valuation **\$1.32**

Price Target **\$0.99**

12 month volume 51.1m
12 month share low \$0.39
12 month share high \$0.81

Market Risk High
Liquidity Risk Med
Infrastructure Risk Low
Country Risk Low

IRESS & DJC Research

ISSUED CAPITAL

ASX HCH
Share price \$0.50
Mkt cap¹ \$173m
Ordinary shares on issue¹ 346m
Options (various) 44.9m

Diluted for new shares Source: IRESS

DIRECTORS

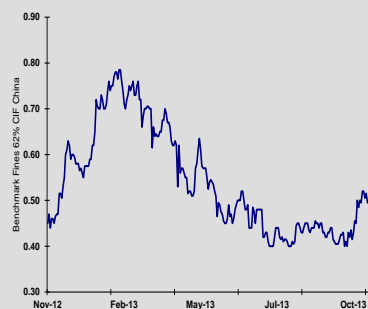
Murray Black Chairman
Christian Easterday Managing Director
Dr Alan Trench Non-Exec Director
Michael Anderson Non-Exec Director
Roberto de Andraca Non-Exec Director

MAJOR SHAREHOLDERS

Kalgoorlie Auto Services Pty Ltd 19.7%
JP Morgan Nominees 13.4%
Citicorp Nominees 10.3%
Merrill Lynch 8.8%
Port Finance 5.3%

As at 15 February 2013

12 MONTH PERFORMANCE



Source: IRESS

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Hot Chili Ltd (HCH)

Milestones Approach

Since HCH announced the discovery of a new high grade zone at its flagship Productora Project in Chile, continued drilling has likely added more tonnes to this zone. The discovery is located within the existing optimised pit shell but in an area previously modelled as waste. The discovery could have material positive benefits on the up-coming resource update (scheduled for 1Q 2014) and project economics. We maintain our Buy recommendation on HCH and move our assumed tonnage increase for the next resource update to 230Mt to 240Mt as indications are that lower cut-off grades are being considered.

Key Points

- **High grade pods keep building:** HCH has been concentrating their resource drilling campaign at Productora on the eastern flank of the existing Central Pit mineralised breccia zone that hosts the bulk of the current 165Mt resource. This flank had been modelled as waste in previous studies largely through lack of drilling and the interpretation that the whole mineralised body was dipping steeply to the west.
- **New discovery at Habanero:** The new discovery at Habanero builds on the previous high grade areas discovered on the eastern flank. Previously reported intersections included 71m at 1.6% copper and 0.4g/t gold from a wider intersection of 181m at 1.0% copper and 0.3g/t gold. A further three holes have recorded intersections at grades in excess of 1% copper. A further 20 holes are planned to expand the drill coverage at Habanero. The possibility of further discoveries in areas adjacent to Habanero, at the Cayenne zone and in the area of the Productora UG mine, will enhance the economics of the northern part of the proposed pit. Mineralisation at Habanero is currently open down dip and is now extended to a strike length of 400m.
- **2013 resource drilling near complete:** Apart from the zones above, HCH is waiting for regulatory approval for a further 100 holes to be drilled into the eastern flank of the proposed pit and this will complete the drilling programme for 2013. The Productora resource update and a maiden JORC reserve will therefore likely come January / February 2014.
- **PFS to be delivered in 1H2014:** The completion of the PFS has been pushed back a few months to include the next resource update, the infrastructure, iron and copper oxide agreement terms and throughput optimisations. We believe HCH will make changes to the Scoping Study metrics in terms of increased production grades in the early years and a reduction in strip ratio. If the economic cut-off grade (COG) is reduced to 0.2% copper, even further reductions in the strip ratio would be expected.
- **Joint Infrastructure agreements close:** HCH and its major JV partner, CMP are now close to finalising a Joint Infrastructure Agreement for Productora allowing mine development to be completed at lower CAPEX costs and in a shorter time frame. We expect to hear some news on these agreements before year end.
- **Buy recommendation maintained:** We maintain our Buy recommendation but have updated commodity prices and other valuation metrics to derive a lower price target of \$0.99 per share (\$1.15) which includes an assumption of a top up capital raise 1H2014.

Drilling targets high grade and bulk tonnage

HCH has delivered drilling updates on its eastern flank infill program and its continued drilling on the Habanero high grade pod, at its flagship Productora copper-gold-molybdenum project in Chile. Both drilling programs have been successful at either adding strike length and/or further discovery of bulk tonnage potential within areas of the optimized pit shell deemed waste in the Scoping Study.

It is also the first time we have seen HCH move on defining an ore reserve. The drilling has been targeted to maximize resource to reserve conversion and to reduce the strip ratio. QA/QC drilling has also been a focus to provide confidence in estimation.

Of the 100,000m 2013 campaign, approximately 100 holes are yet to be completed. Most of these are located on the eastern flank and there are a number still to target the new high grade Habanero zone. This discovery has the potential to alter the pit shell shape in the northern end of the Central Pit but may not be as extensive as we would expect due to the topography in this area, which is working against the dip of the zone. We could, for instance, envisage a small keel in the pit design in this area if the optimizer drives down on this zone. In any event, the pit economics in this area will be significantly improved as a result of the discovery.

The Habanero zone has now been extended to a strike length of approximately 400m with another 20 holes still to be received. Visual indications are positive for continued mineralisation in this area.

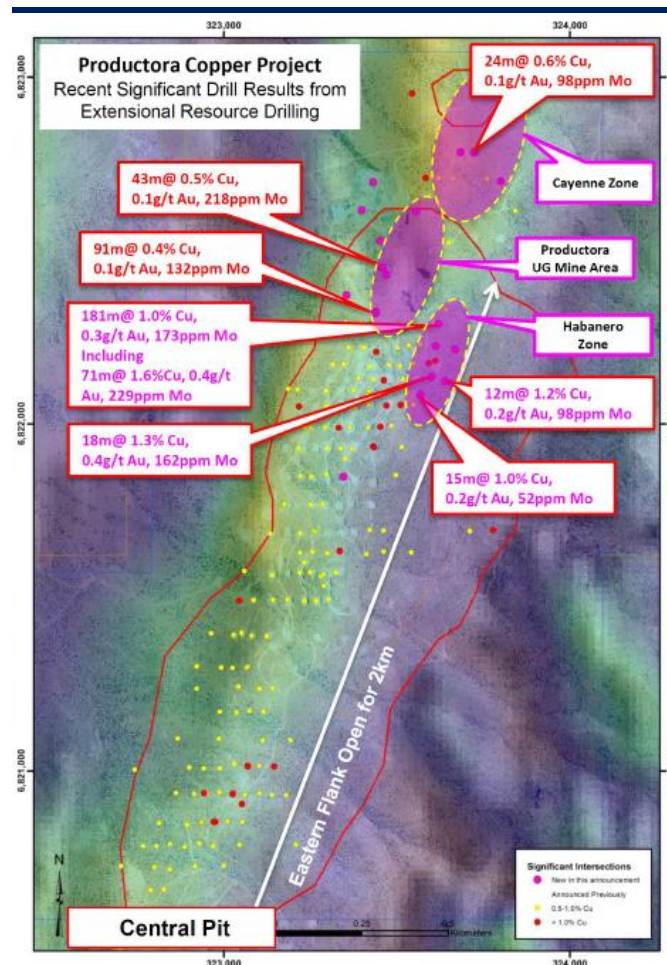


Figure 1. Drill intercepts and zones, north Productora

Source: HCH

Requirement for extra drilling knocks resource update into Q1 2014

The discovery of Habanero and the additional material being found on the eastern flank has caused the next resource update to move from end Q4 2013 to Q1 2014. Further drilling has been undertaken to assess areas adjacent to the current UG Productora mine and the Cayenne Zone at the northern extents of the pit shell.

If HCH are going to try and delineate their maiden Ore Reserve, this is a prudent move, as any mineralisation discovered on the eastern flank will reduce the strip ratio and if drilled to sufficient density, will be incorporated into a reserve estimate.

Given the additional amount of mineralisation being found on the eastern flank, the high grade zone at Habanero, and new lower grade mineralisation at Cayenne and around the Productora UG mine, we have moved our assumed tonnage target for the upcoming resource from 200 – 220Mt to 230-240Mt. In the latest quarterly HCH also made reference to the possibility of dropping the economic cut-off-grade (COG) to 0.2% copper from 0.3%. This would also have the effect of dragging more tonnes into the resource.

In normal circumstances, this would produce a lower overall grade for the deposit, but we believe this will be somewhat mitigated by the discovery and delineations of the high grade zones, so the net effect could be a higher resource tonnage but at similar overall grade to the existing 165Mt resource at 0.6% copper and 0.1g/t gold.

Pre-Feasibility Study 1H 2014

Production of the PFS will occur as soon as practically possible after the release of the updated resource model, but we are not now expecting this until 2Q 2014 as HCH has reduced the spend to items only on the critical path and to incorporate:

1. The resource upgrade
2. The infrastructure, iron and copper oxide agreements, and
3. Throughput optimization studies

We believe the original Scoping Study metrics will be changed significantly in terms of the strip ratio. This is expected to decrease significantly after incorporation of the newly discovered mineralisation on the eastern flank and potentially from the decision to use a lower COG. Higher grade zones near surface could also help reduce opex costs in the early years of the operation.

All metallurgical work undertaken so far indicates a benign recovery route, with recoveries in the range of >90% for copper and >80% for gold at a relatively coarse 180µ grind size.

Infrastructure Agreements on schedule for 2013

Draft and formal agreements on the surface rights and easement access and the port and pipeline access agreements respectively are nearing completion with CMP's major partner in the project, CAP/CMP. We would expect these to be signed by year end. A water extraction regulatory application was submitted in early 2013 and awaits approval.

It is our view that once signed the agreements will significantly de-risk project development. To have an agreement that provides direct access, through an infrastructure corridor, to get mine concentrate onto a ship to international markets and to have a water pipeline providing all processing requirements along the same corridor is extremely valuable and will reduce capex costs significantly.

Frontera resource soon

HCH are due to release their maiden JORC resource on the Frontera Project late 2013. This project lies 70km south of Productora, adjacent to the Pan Pacific Highway. Drilling during 2013 has confirmed Frontera as a major growth project behind Productora as unlike Productora, Frontera is a porphyry related system. CMP, HCH's strategic partner at Productora, are drilling ground adjacent to HCH's project area.

The first round of drilling confirmed classic copper-gold porphyry characteristics in chalcopyrite-bornite mineralisation that plunges steeply NE. Resource modeling has already started and we expect to see the maiden resource sometime in December.

Changes to our valuation metrics and recommendation

We have updated our model to reflect slightly lower commodity pricing and exchange rates, one largely mitigating the effects of the other.

We also reduced our C1 cash costs slightly for the first couple of years as the discovery of near surface, higher grade pods could enhance copper production and lower unit costs. We have also assumed a small top-up capital raise for late 1H 2014 to maintain a comfortable working capital buffer. HCH raised \$11.7m in July as CMP, their strategic partner, increased their stake and placed an executive, Mr Roberto de Andraca, on the HCH board further strengthening the relationship.

The net effect of the changes is to reduce our DCF based 12 month price target to \$0.99 (\$1.15) but this doesn't change our fundamental investment thesis towards HCH. We maintain our Buy recommendation and look towards the following catalysts:

1. Completion of the infrastructure, iron and copper oxide agreements.
2. Frontera maiden JORC resource.
3. Productora updated resource and maiden reserve.
4. PFS study for Productora.

VALUATION	A\$m	A\$ps
Productora	\$ 400.7	\$ 1.09
Exploration	\$ 100.0	\$ 0.27
Cash	\$ 12.8	\$ 0.03
Corporate	-\$ 30.0	-\$ 0.08
Total Valuation (un-risked)	\$ 483.5	\$ 1.32
Valuation - Productora risked @ 70%	\$ 363.3	\$ 0.99

Figure 2. Sum of parts valuation for HCH

Source: DJC

Hot Chili Ltd

\$ 0.50

PROFIT AND LOSS ANALYSIS	(\$m)	2013A	2014F	2015F	2016F	2017F
Sales revenue		0.0	0.0	0.0	0.0	212.9
Cost of Sales		0.0	0.0	0.0	0.0	64.7
Exploration Written off		0.0	0.0	0.0	0.0	0.0
Corporate / Other		4.4	6.0	6.0	6.0	16.6
EBITDA		-4.4	-6.0	-6.0	-6.0	131.6
Depreciation & Amortisation		0.1	0.0	0.0	0.0	16.3
EBIT		-4.5	-6.0	-6.0	-6.0	115.3
Interest Expense (benefit)		-0.2	0.0	0.0	37.7	32.7
Abnormals		0.0	0.0	0.0	0.0	0.0
Profit before Tax		-4.3	-6.0	-6.0	-43.7	82.6
Tax expense		0.0	0.0	0.0	0.0	0.0
NPAT		-4.3	-6.0	-6.0	-43.7	82.6
DJC Adjusted NPAT		-4.3	-6.0	-6.0	-43.7	82.6

CASH FLOW STATEMENT	(\$m)	2013A	2014F	2015F	2016F	2017F
Net cash from customers		0.0	0.0	0.0	0.0	131.6
Net Interest		0.2	0.3	0.5	-37.7	-32.7
Tax and Other		-3.6	-4.0	-5.0	-5.0	-5.0
Cashflows from Operating Activities		-3.4	-3.7	-4.5	-42.7	93.9
Property, plant & equipment		-0.3	-1.0	-200.0	-400.0	-9.0
Exploration & Development		-43.9	-20.0	-10.0	-5.0	-5.0
Payments for prospects		0.0	-1.0	-1.0	0.0	0.0
Other		0.0	0.0	0.0	0.0	0.0
Cashflows from Investing Activities		-44.1	-22.0	-211.0	-405.0	-14.0
Equity raised		44.5	21.7	0.0	180.0	0.0
Change in Debt		0.0	0.0	220.0	260.0	-50.0
Dividends paid		0.0	0.0	0.0	0.0	0.0
Other		-2.3	0.0	0.0	0.0	0.0
Cash Flow from Financing Activities		42.2	21.7	220.0	440.0	-50.0
Net change in cash		-5.3	-4.0	4.5	-7.7	29.9
Effects from Exchange rates		0.4	0	0	0	0
Cash at end of period		11.1	7.1	11.6	4.0	33.9

BALANCE SHEET	(\$m)	2013A	2014F	2015F	2016F	2017F
Cash		11.1	7.1	11.6	4.0	33.9
Other		0.0	0.0	0.0	0.0	0.0
Total current assets		11.2	7.1	11.6	4.0	33.9
Property Plant & Equipment		0.5	1.5	201.5	601.5	610.5
Exploration & development		63.1	83.1	93.1	98.1	103.1
Other		0.0	0.0	0.0	0.0	0.0
Total non-current assets		63.6	84.6	294.6	699.6	713.6
Total Assets		74.7	91.7	306.2	703.5	747.4
Payables		4.0	4.0	4.0	4.0	4.0
Borrowings		0.0	0.0	0.0	0.0	0.0
Other		0.0	0.0	0.0	0.0	0.0
Total current liabilities		4.0	4.0	4.0	4.0	4.0
Non-current debt		0.0	0.0	220.0	480.0	430.0
Other		0.0	0.0	0.0	0.0	0.0
Total non-current liabilities		0.0	0.0	220.0	480.0	430.0
Total Liabilities		4.0	4.0	224.0	484.0	434.0
Shareholders Funds		70.7	87.7	82.2	219.5	313.4

Key Assumptions		2013A	2014F	2015F	2016F	2017F
Cu Price	(US\$)	7300	7300	7300	7300	7300
Au price	(US\$)	1300	1300	1300	1300	1300
Exchange rate (USDAUD)	(US\$)	0.95	0.95	0.95	0.95	0.95

Resources and Reserves	t (m)	% Cu	g/t Au
Current Resources			
Productora	165.2	0.60	0.10
Frontera	-	-	-
Los Mantos	-	-	-
Total	165.2	0.60	0.10

PHYSICALS		2016F	2017F	2018F	2019F	2020F
Tonnes milled	Mt		4.0	11.0	11.0	11.0
Cu Grade	%		0.75%	0.75%	0.75%	0.55%
Au Grade	g/t		0.2	0.2	0.2	0.2
Copper production	000t		25.5	76.7	76.7	76.7
Gold production	Kozs		20.6	56.6	56.6	56.6

RATIOS		2013A	2014F	2015F	2016F	2017F
Number of shares	m	309.9	366.5	406.3	586.3	586.3
EPS	cps	-0.01	-0.02	-0.01	-0.07	0.14
PER	x	na	na	na	na	3.6
EPS growth	%	na	na	na	na	+
CFPS	cps	-0.01	-0.02	-0.49	-0.76	0.15
DPS	cps	0.00	0.00	0.00	0.00	0.00
EV/EBITDA	%	na	na	na	na	0.9
EBIT Margin	%	na	na	na	na	54.1

BOARD	
Non-Exec Chairman	Murray Black
Managing Director	Christian Easterday
Non-Exec Director	Micahel Anderson
Non-Exec Director	Roberto de Andraca
Non-Exec Director	Alan Trench
Company Secretary	John Sendziuk

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Disclosure Disclaimer

RCAN1161

This Research report, accurately expresses the personal view of the Author.

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The recommendation made in this report is valid for four weeks from the stated date of issue. If in the event another report has been constructed and released on **Hot Chili Limited**, the new recommendation supersedes this and therefore the recommendation in this report will become null and void.

Recommendation Definitions

SPECULATIVE BUY – 10% or more outperformance, high risk

BUY – 10% or more outperformance

HOLD – 10% underperformance to 10% over performance

SELL – 10% or more underperformance

Period: During the forthcoming 12 months, at any time during that period and not necessarily just at the end of those 12 months.

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