

7 August 2014

RECOMMENDATION

Speculative Buy

Implied Valuation \$0.64

12 month volume	63.9m
12 month share low	\$0.17
12 month share high	\$0.54

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

IRESS & DJC Research

ISSUED CAPITAL

ASX	HCH
Share price	\$0.25
Mkt cap ¹	\$86.9m
Ordinary shares on issue ¹	348m
Options (various)	43.8m

Diluted for new shares Source: IRESS

DIRECTORS

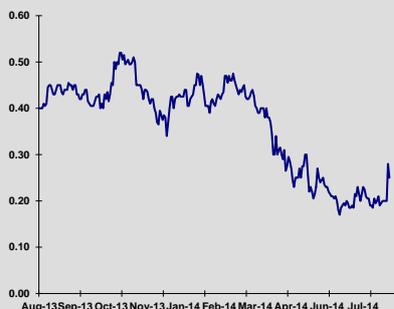
Murray Black	Chairman
Christian Easterday	Managing Director
Dr Alan Trench	Non-Exec Director
Michael Anderson	Non-Exec Director
Roberto de Andraca	Non-Exec Director

MAJOR SHAREHOLDERS

K.A.S. Pty Ltd	19.3%
CAP. SA (Port Finance)	11.8%
Taurus Funds Mgt	11.7%
Lundin Mining	6.3%
Explorionn Capital Partners	5.4%

As at 15 February 2013

12 MONTH PERFORMANCE



Source: IRESS

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Hot Chili Ltd (HCH)

Coming to Terms

HCH has announced the long awaited and much anticipated terms to its Infrastructure agreement with partner CMP over the Productora copper project in Chile. We had estimated that HCH would exchange between 15% and 25% in project equity for access to CMP's infrastructure, which has the potential to reduce the capex of project development and also expedite the development timeline. We were pleased to see the number at the lower end of our expectations, at 17.5%. More importantly, in our view, it demonstrates the commitment that CMP now has to work collaboratively with HCH and to develop the project upon successful PFS and DFS outcomes. CMP also has an option to acquire a further 32.6% interest, which would take them to 50.1% and effective operations control. This would marry CMP's ability in building and operating large open pit mines together with HCH's skill in discovery and development.

Key Points

- Terms of the IA revealed:** After what seemed like a long wait, HCH have delivered the terms of the recently signed Joint Infrastructure Agreement with CMP, HCH's partner in the Productora copper project in Chile. The finalisation of terms provides clarity on the relative interests of each party and for HCH will provide access to infrastructure that will potentially reduce capex and expedite the development timeframe. More importantly, in our view, it shows the commitment that CMP have in working together with HCH to bring an operation to reality. CMP will take an initial 17.5% project equity stake in exchange for surface access rights, access to an infrastructure corridor to the port and the relinquishment of CMP's 35% holding in certain tenements within the Productora project area. This will be the first time that all the holdings will be consolidated under one ownership group.
- Additional Purchase Option to take ownership to 50.1%:** Within the terms of the binding MOU, CMP also has an option to purchase an additional 32.6% interest at an exercise price of a minimum of US\$80m. If CMP exercise this option, it will take their interest to 50.1% and effective operational control. Under the terms of the agreement, CMP will have 90 days after their receipt of the completed PFS and an independent expert report (IER) as to the preferred valuation of a 50.1% interest in the project. The Additional Purchase Option exercise price will be the greater of either the IER valuation or US\$80m.
- Marriage of skills:** Under this scenario we see CMP taking operational control of the project utilising their internal skill base to build large open pits and plants, utilising their own existing infrastructure. In our view, it also paves the way for access to project development capital. HCH would have a significant interest in a large copper project deriving cash flow from 2018 and a significant cash position. HCH would use its skills in exploration and development to further their other projects – Frontera, Banderas and Los Mantos - to a point where ore could be fed into a mill based at Productora.
- Implied valuation of \$0.64 per share:** The terms of the IA imply a minimum project valuation of A\$262m, or A\$130.7m for HCH's 49.9% interest should CMP exercise their option. Under this scenario, HCH would have cash of A\$85.6m and a debt at the end of 1H2015 of \$10m. We determine an implied valuation of \$0.64 per share under this scenario and therefore retain our Speculative Buy recommendation

HCH / CMP Infrastructure Agreement term details

Yesterday, HCH released the much anticipated terms of the MOU with its Joint Venture partner CMP on the Productora Copper Project in Chile. Under the MOU, CMP are to take a 17.5% interest in the Productora Project in exchange for land access rights, easement corridor rights and the relinquishment of a 35% interest in certain tenements held within the Productora project area.

We had assumed that CMP would take a stake of between 15% and 25% of the project, so we were very pleased to see the stake at the lower end of our expectation range.

This will pave the way for a development scenario which will utilize the existing infrastructure, reducing CAPEX costs and potentially reducing development timeframes.

The signed binding MOU initially allows for:

- CMP to emerge with a 17.5% stake in the Productora Project.
- CMP will relinquish its 35% ownership status on several tenements within the Productora Project area.
- CMP will provide certain surface rights and access to an infrastructure easement corridor leading to the coast near Huasco related to a proposed water pipeline route.
- CMP will be free-carried to completion of the Productora PFS.

Post-PFS, CMP will be responsible for funding its share of the exploration / development expenditure in accordance with its ownership in the shares of SMEA SpA, the vehicle that holds the Productora project.

The relinquishment of the 35% ownership in certain tenements brings to an end a 6 year strategy to consolidate the ownership of the project under own roof.

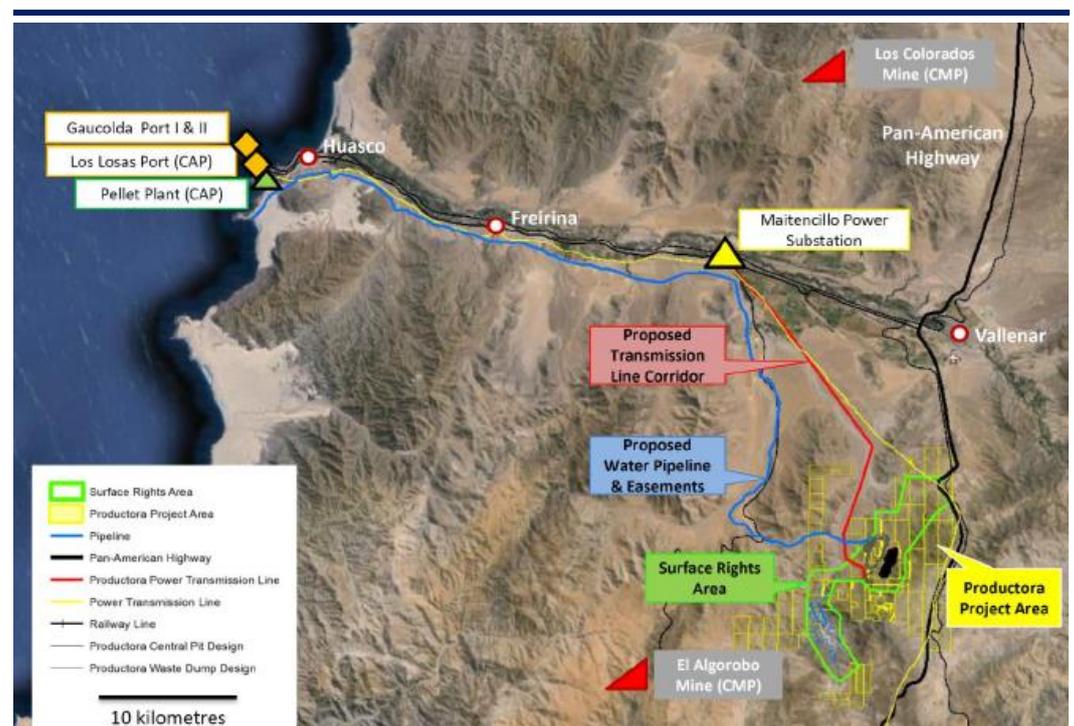


Figure 1. Infrastructure covered by the agreement

Source: HCH

Additional Purchase Option

Within the structure of the binding MOU and in consideration of its execution, CMP has been granted an Additional Purchase Option to acquire a further 32.6% interest for a minimum of US\$80m. If exercised, this would take CMP to a 50.1% interest in Productora.

CMP will pay HCH \$1.5m for the grant of the Additional Purchase Option.

The Additional Purchase Option must be exercised at CMP's election within 90 days of:

- Receipt on a completed PFS.
- A valuation report (IER) of the Productora Project conducted by a jointly appointed independent expert in accordance with the VALMIN Code, stating the independent experts preferred valuation of a 50.1% economic interest in the project, having regard to 'premium of control'.

The MOU is still subject to ratification by the board of CMP (expected within the current quarter). The transactions contemplated in the MOU are also subject to shareholder approval at HCH forthcoming AGM and an IER.

At 50.1% CMP would assume operatorship

In our view, should CMP exercise their option for the additional 32.6%, they are likely to take over operatorship once a decision to mine has taken place and have a major role in the BFS before then.

CMP have the internal capacity and demonstrated expertise in building and operating large open cut mines in the region. Under this scenario, we can see HCH concentrating their efforts on developing the other assets in their copper portfolio to a point where, for incremental capex, projects can be delivered into the production hub based around Productora.

HCH would therefore have a significant holding in a major copper project providing cashflow which would be used for the development of the other assets. These could be either offered for trade sale into CMP or another third party, or kept to derive further cashflow. Under this scenario, HCH effectively could potentially become the copper exploration and development arm of CMP under a new exploration joint venture.

A third scenario could see HCH's remaining 49.9% interest being bought outright, with still the ability to develop the other assets into production sources for the regional strategy.

Either way, we see each scenario as providing material upside for HCH.

The next 12 months

Over the course of the next 12 months HCH intend to:

- Increase mine life to 12-15 years through further exploration at and around Productora
- Complete a PFS on the project
- Update minerals reserves and resources
- Initiate the DFS
- Present the completed PFS to CMP who will jointly procure an IER on project value
- Start to undertake discussions around project financing
- Exploration at growth targets Banderas, Frontera and Los Mantos

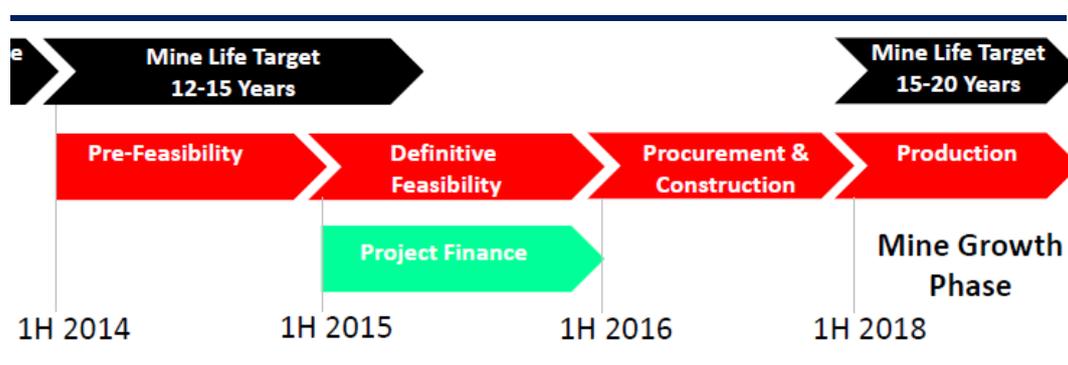


Figure 2. Proposed event time Line for Productora

Source: HCH

MOU provide see-through project value of A\$262m

The Additional Purchase Option provides see through project value. Under the terms of the MOU, CMP can acquire a 32.6% stake in the project for a minimum of US\$80m. This would value the project at US\$244.8m, or A\$262m at USDAUD0.935.

Should CMP exercise this option, HCH would have a 49.9% interest valued at A\$130.6m, or \$0.38 per share on 347.7 shares on issue.

This figure will be the minimum figure. The final figure is to be determined after the technical expert's report on the preferred valuation of a 50.1% interest, whichever is the higher.

If CMP exercise the option a sum-of-parts valuation for HCH would look like this:

	\$(m)	\$ per share
Productora Project (49.9%)	130.6	0.38
Cash	85.6	0.25
Other projects	30.0	0.09
Debt	-10.0	-0.03
Corporate	-15.0	-0.04
Total	221.2	0.64

Figure 3. Sum-of-parts implied valuation of HCH

Source: DJC estimates

Disclosure Disclaimer

RCAN1208

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

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The Author of this report made contact with the **Hot Chili Limited** for assistance with verification of facts, admittance to business sites, access to industry/company information. No inducements have been offered or accepted by the company.

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.

Stocks included in this report have their expected performance measured relative to the ASX All Ordinaries index. DJ Carmichael Pty Limited's recommendation is made on the basis of absolute performance. Recommendations are adjusted accordingly as and when the index changes.

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