

4 March 2013

RECOMMENDATION

Buy

Valuation **\$1.50**

Price Target **\$1.15**

12 month volume 63.9m
12 month share low \$0.38
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 \$0.68
Mkt cap¹ \$202m
Ordinary shares on issue¹ 297.3m
Options (various) 68.5m

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
Geoff Laing Executive Director

MAJOR SHAREHOLDERS

Kalgoorlie Auto Services Pty Ltd 17.8%
Taurus Funds Management 13.9%
Lundin Mining 7.3%
CAP S.A. 5.5%
Exploration Capital Partners 5.0%

As at 15 February 2013

12 MONTH PERFORMANCE



Source: IRESS

Paul Adams

Head of Research

+61 8 9263 5200

padams@djcarichael.com.au

Hot Chili Ltd (HCH)

Productora Site Visit report and valuation update

We attended the recent site visit to HCH's Productora and Frontera Projects, and toured the port facilities owned by HCH's project partner at Productora, CAP. We have constructed a DCF based valuation for Productora using the metrics from the recent Scoping Study as a base. We derive an un-risked, after tax NPV_{10%} of \$383.2m, or \$1.19 per share for the Productora Project based our assumptions. We have risked the Project at 70% to derive a price target of \$1.15 in a sum-of-parts valuation that includes cash, exploration upside and corporate costs. We maintain our Buy recommendation on HCH and see a number of important catalysts this year which should drive share price appreciation.

Key Points

- The Productora resource estimate recently doubled to 165.2Mt at 0.6% Copper and 0.1 g/t gold from 85.1Mt, with no loss of grade. This compares to our November estimate of 160Mt after we lifted our expectations from 140Mt on the discovery of a high grade zone on the former CCHEN ground to the south of the Central Lease. These two high grade zones, now at 53Mt at 1% copper equivalent (0.8% Copper and 0.2 g/t gold), boost project economics significantly in our model.
- Productora provides the backbone of our valuation but we were also able to view HCH's new growth project, Frontera, located 70 km south of Productora on the Pan American Highway. Frontera is a copper-gold porphyry project with copper mineralisation at surface, easily accessible from the sealed Pan American Highway, with a 220KVA power-line transecting the property. HCH's partner at Productora, CAP owns the surrounding permits, setting up a very similar scenario to Productora. HCH has an option to acquire 100% interest in the 270Ha property that was previously drilled by Noranda. We believe there is considerable scope for a significant tonnage of mineralisation given the style of the deposit which could feed a treatment plant at Productora, as part of the central hub strategy that HCH has for the area.
- We assume a 15 year mine life feeding approximately 11Mtpa to produce an average of around 60,000 tonnes of copper in concentrate, plus gold credits. Our operating cost assumptions vary between \$1.20 and \$1.35/lb and we have used a capex assumption of \$600m.
- We assign \$100m, or \$0.31 per share, to the value of exploration from Frontera, Banderas and Los Mantos. Further value additions could still come from Productora above the 230Mt assumed for this valuation
- We believe there are a number of price catalysts over the course of 2013. We expect to see the first results from Frontera in late March. If results prove encouraging, we would expect to see a higher focus on this growth project. We also expect to see a second resource update in Q3 2013 and completion of the PFS.
- In addition, we see HCH having significant corporate appeal, with Lundin Mining now owning 7.3% of the register. Exploration activity on the next big growth project will only add to this appeal and build further value as Productora gets progressively de-risked through the feasibility studies.

Productora Site Visit

We attended a recent site visit to HCH's flagship Productora Project in Chile. Specifically, an overview on the progress on-the-ground at Productora; a visit to the existing port infrastructure at Huasco, located 60 km west of the town of Vallenar, in turn located 15km north of Productora; a visit to HCH's next growth project, Frontera, currently undergoing a drilling program to verify previous drilling intersections.

Progress at Productora

Productora has grown enormously since our last visit. Board and management have been able to achieve rapid progression on an expansive work program without compromising the quality of the output. This is evident in almost every visible aspect of the project whilst on the site visit.

Future work will include a geo-metallurgical drilling program of approximately 2,500m to clearly define the metallurgical characteristics of the transitional ore. A new domain model will then be incorporated into a resource upgrade in Q3. Approximately 9 million tonnes of transitional material will be present in the Central Pit portion of the resource, however sulphide species exist at surface. We envisage a certain amount of blending in the first couple of years of an operation to optimise recovery.

There is potential to stockpile oxide material (approximately 11 million tonnes in the Central Pit area) for processing at a later date, so whilst mining costs will be incurred up front to move the material, revenue will be generated.



Figure 1. Drill coverage, Central area of Productora, looking north

Source: DJC

Where will the resource upside come from?

1. Drilling on the eastern flank of the current resource envelope is likely to add resource tonnes from up-dip continuity of mineralisation intersected at depth on the eastern most holes. We believe most of the increase in tonnage in the forthcoming resource update, will be derived from these zones.

2. A narrower but higher grade zone to the south is yet to be added to the resource. HCH believe the southern extensions of the deposit are located in an up-thrusted block relative to the rest of the deposit i.e. the deposit to the north has undergone progressive dip-slip movement on NW striking fault sets. HCH therefore believe that the whole vertical sequence in this southern extension is still preserved. This will be a target for deeper drilling at some stage in the future.
3. HCH will undertake a resource drill out of the western magnetite zone and the magnetite lenses on the western flank of the copper mineralisation. The effect of this will be to transform in-pit waste into revenue generating material. The terms of an agreement are to be worked on between HCH and CMP, their partner and Chile's largest magnetite producer, over the course of 2013.
4. The new resource will also have the molybdenum included, so far not taken into account in the Scoping Study. We believe this could add a credit of around 10c per lb copper production.

We take the view that the Q3CY13 resource upgrade could be around 210 Mt to 230Mt at 0.6% Cu and 0.1g/t Au (plus Mo credits). A final resource upgrade could occur early to mid-2014 which would be used as part of the 'decision to mine', however we believe the Q3 update will be the resource upon which much for the PFS and BFS work will be based.

Frontera Site Visit

We visited HCH's next major growth project at Frontera, approximately 70km south of Productora, directly down the Pan American Highway. HCH has emerged with the central, 2km long portion of the project, previously drilled by Noranda in the 1990's, who discovered a copper-gold porphyry system from surface. A small open pit and several small adits are present on the property.

Being a porphyry system, it's a different style to Productora. Mineralised porphyry systems tend to be characterised by lower grade but high tonnage mineralisation. A 7,000m first pass RD drilling aims to confirm the previous results and we would expect to see a results release sometime in late March.

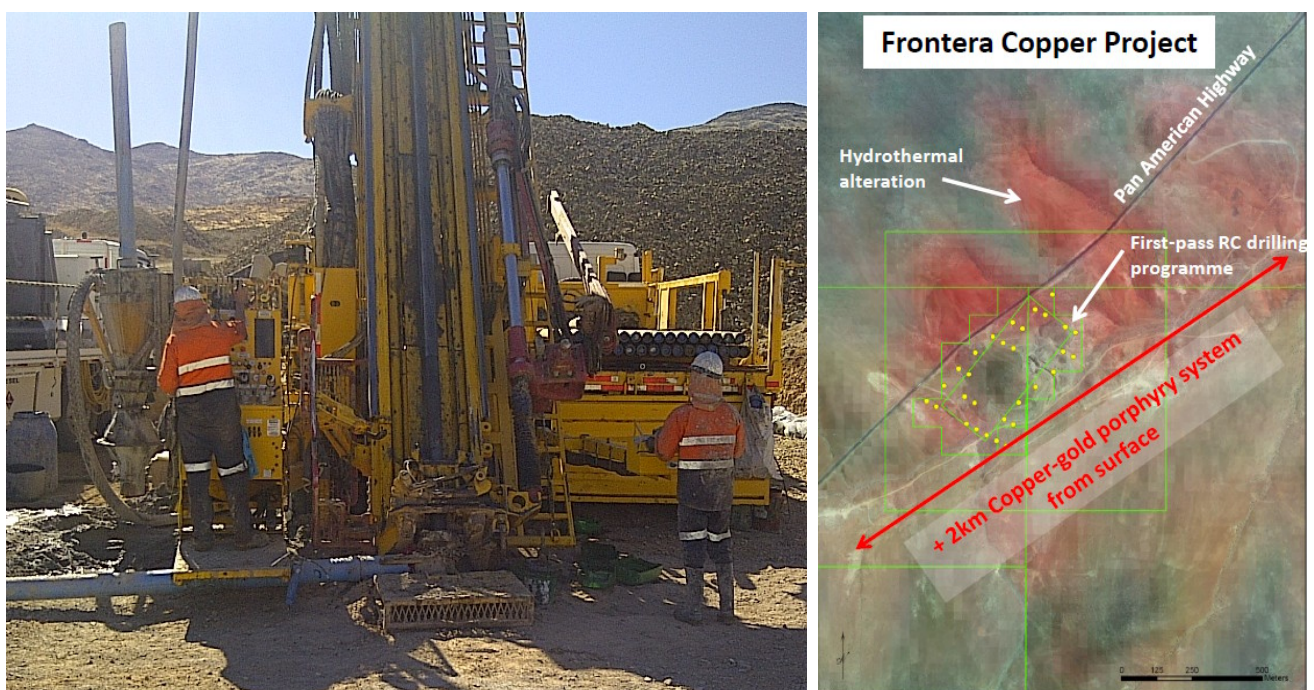


Figure 2. RC Drilling at Frontera drill hole plan

Source: DJC / HCH

Surrounding permits are held by CMP, HCH's partner in Productora. This is a further example of the potential synergies between the two companies. We believe it could be possible for ore to be transported, either by road or slurry pipeline into the Productora treatment plant, should Frontera prove large enough to justify a development.

Capital costs for a project in this location would be comparatively low, given Productora would shoulder the capex burden of a stand-alone project. Capital would be required to divert the Pan American Highway to the west, away from any prospective open pit but this has been done three times before in Chile, most recently, about 18 months ago.

Infrastructure and Port Visit

We visited the port facilities at Huasco on a previous occasion and have already reported on the advantages afforded to HCH by virtue of its location in the coastal cordillera and its proximity to existing infrastructure. We continue to believe that this is crucial to the development of the project and backs up our early comments with respect to the value of the partnership with CMP (CAP).

Valuation

We used the Scoping study metrics as the base case for a DCF valuation for the Productora Project.

- **LOM:** We have a 15 year life of mine assumption, with throughput varying between 6Mt and 11Mtpa, for a total throughput around 150Mt. This represents an approximate resource to reserve conversion of 65% on a resource base of 230Mt. Production starts 2HFY17.
- **CAPEX:** We have assumed capex of \$600m, the mid-point in the HCH Scoping Study range of between \$500m and \$700m. We believe there is scope to reduce capex costs to the lower end of the range but keep the mid-point to cater for cost creep between now and 2016. We have included an additional \$60m (10% of the start-up capital) as sustaining capex at this stage.
- **OPEX:** Varies between \$1.20 for first few years of the project when mining the higher grade, near-surface, low strip ratio ore, to a long term average of \$1.35 – again the mid-point used in the Scoping Study numbers.
- **Metal Recovery:** We have used long term recoveries of 93% and 80% for copper and gold respectively. We have not included molybdenum at this stage. We have long term metal production of around 57,000 tonnes of copper in concentrate plus gold credits.
- **Pricing:** We use a long term copper price of US\$7,500/t, equivalent to \$3.40/lb (currently \$3.53/lb) and a USDAUD exchange rate at parity.
- **Capital structure:** We have assumed project debt of around \$470m, the remainder of the capex to come from equity. However we acknowledge that there are a number of opportunities to reduce equity issue through off-take agreements and forward payments. We have assumed a capital structure of 321.6m shares, diluted for November 2013 option conversion for the purpose of this valuation.
- **Exploration Value:** We assign \$100m, or \$0.31 per share, to the value of exploration from Frontera, Banderas and Los Mantos. Further value additions could still come from Productora above the 230Mt assumed for this valuation.

We derive an un-risked, after tax NPV_{10%} of \$383.2m, or \$1.19 per share for the Productora Project based on the above assumptions. We have risked the Project at 70% to derive a price target of \$1.15 in the following sum-of-parts valuation.

VALUATION	A\$m	A\$ps
Productora	\$ 383.2	\$ 1.19
Exploration	\$ 100.0	\$ 0.31
Cash	\$ 30.0	\$ 0.09
Corporate	-\$ 30.0	-\$ 0.09
Total Valuation (un-risked)	\$ 483.2	\$ 1.50
Valuation - Productora risked @ 70%	\$ 368.2	\$ 1.15

Figure 3. SoP Valuation Table

Source: DJC

We therefore maintain our Buy recommendation on HCH.

Where are the enhancements going to come from?

There are several areas where HCH could optimise CAPEX and OPEX estimates.

- **Strip Ratio:** Reductions in the strip ratio can come from several sources. The most obvious being the discovery of additional in-pit tonnes from the extensional drilling to the east. Secondly, the advent of a magnetite sale agreement with CMP that could transform waste on the western flank of the mineralised zones into revenue generating material through the sale of magnetite.

Approximately 20,000m of drilling has been ear-marked for a maiden magnetite resource estimate on the western flank of the copper / gold zones and on a 6km long zone of magnetite identified on the western edge of the Productora landholdings.

- **Operating costs:** OPEX unit costs have not yet taken into account credits from any molybdenum production or magnetite sales. Costs of between US\$1.20 and US\$1.50 / lb of copper include only gold credits so far.
- **Capex Costs:** Given the geographical location and the infrastructure advantages of Productora, we believe there is some scope to improve on the Capex estimate. HCH has made references to items that could be expensed rather than for part of the capital. We envisage that this may include certain mining equipment that could be leased rather than purchased, reducing the upfront capital costs of the project.

Price catalysts in 2013/2014

We believe there are a number of price catalysts over the next 6 to 12 months that will keep the market focused on the growth potential from here whilst the PFS is undertaken. They will include:

- Drilling results from the extensional drilling at Productora
- Drilling results from Frontera, the project acquired in 2H2012
- Benefits from project enhancement studies, on-going
- Magnetite maiden resource statement
- Updated resource estimate for Productora Q3 2013
- Completion of PFS and start of BFS Q3 2013.

Hot Chili Ltd

\$ 0.68

PROFIT AND LOSS ANALYSIS	(\$m)	2013F	2014F	2015F	2016F	2017F
Sales revenue		0.0	0.0	0.0	0.0	220.4
Cost of Sales		0.0	0.0	0.0	0.0	67.5
Exploration Written off		1.0	0.0	0.0	0.0	0.0
Corporate / Other		4.4	6.0	6.0	6.0	17.0
EBITDA		-5.4	-6.0	-6.0	-6.0	135.9
Depreciation & Amortisation		0.0	0.0	0.0	0.0	16.3
EBIT		-5.4	-6.0	-6.0	-6.0	119.6
Interest Expense (benefit)		-0.2	0.0	0.0	39.5	34.6
Abnormals		0.0	0.0	0.0	0.0	0.0
Profit before Tax		-5.2	-6.0	-6.0	-45.5	85.0
Tax expense		0.0	0.0	0.0	0.0	0.0
NPAT		-5.2	-6.0	-6.0	-45.5	85.0
DJC Adjusted NPAT		-5.2	-6.0	-6.0	-45.5	85.0

CASH FLOW STATEMENT	(\$m)	2013F	2014F	2015F	2016F	2017F
Cashflows from Operating Activities						
Net cash from customers		0.0	0.0	0.0	0.0	135.9
Net Interest		0.1	0.3	0.5	-39.5	-34.6
Exploration & Development		-28.8	-25.0	-10.0	-10.0	-10.0
Tax and Other		0.0	0.0	0.0	0.0	0.0
Cashflows from Investing Activities						
Property, plant & equipment		-0.6	-1.0	-200.0	-400.0	-9.0
Payments for prospects		-7.8	-1.0	-1.0	0.0	0.0
Other		0.0	0.0	0.0	0.0	0.0
Cash Flow from Financing Activities						
Equity raised		43.7	60.0	0.0	180.0	0.0
Change in Debt		0.0	0.0	200.0	270.0	-50.0
Dividends paid		0.0	0.0	0.0	0.0	0.0
Other		-3.0	0.0	0.0	0.0	0.0

Net change in cash	3.6	33.3	-10.5	0.5	32.3
Cash at end of period	20.4	53.7	43.2	43.7	76.0

BALANCE SHEET	(\$m)	2013F	2014F	2015F	2016F	2017F
Cash		20.4	53.7	43.2	43.7	76.0
Other		0.7	0.0	0.0	0.0	0.0
Total current assets	21.1	53.7	43.2	43.7	76.0	
Property Plant & Equipment		0.9	1.9	201.9	601.9	610.9
Exploration & development		44.6	69.6	79.6	89.6	99.6
Other		0.0	0.0	0.0	0.0	0.0
Total non-current assets	45.5	71.5	281.5	691.5	710.5	
Total Assets	66.6	125.2	324.7	735.2	786.5	
Payables		1.5	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	1.5	4.0	4.0	4.0	4.0	
Non-current debt		0.0	0.0	200.0	470.0	420.0
Other		0.0	0.0	0.0	0.0	0.0
Total non-current liabilities	0.0	0.0	200.0	470.0	420.0	
Total Liabilities	1.6	4.0	204.0	474.0	424.0	
Shareholders Funds	65.1	121.2	120.7	261.2	362.5	

Key Assumptions		2013F	2014F	2015F	2016F	2017F
Cu Price	(US\$)	7500	7500	7500	7500	7500
Au price	(US\$)	1530	1500	1500	1500	1500
Exchange rate (USDAUD)	(US\$)	1.03	1.00	1.00	1.00	1.00

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		21.6	59.4	59.4	59.4

RATIOS		2013F	2014F	2015F	2016F	2017F
Number of shares	m	297.3	321.6	361.3	541.3	541.3
EPS	cps	-0.02	-0.02	-0.02	-0.08	0.16
PER	x	na	na	na	na	4.3
EPS grow th	%	na	na	na	na	+
CFPS	cps	-0.02	-0.02	-0.55	-0.82	0.17
DPS	cps	0.00	0.00	0.00	0.00	0.00
EV/EBITDA	%	na	na	na	na	1.2
EBIT Margin	%	na	na	na	na	54.3

BOARD	
Non-Exec Chairman	Murray Black
Managing Director	Christian Easterday
Non-Exec Director	Micahel Anderson
Non-Exec Director	Geoff Liang
Non-Exec Director	Alan Trench
Company Secretary	John Sendziuk

VALUATION	A\$m	A\$ps
Productora	\$ 383.2	\$ 1.19
Exploration	\$ 100.0	\$ 0.31
Cash	\$ 30.0	\$ 0.09
Corporate	-\$ 30.0	-\$ 0.09
Total Valuation (un-risked)	\$ 483.2	\$ 1.50
Valuation - Productora risked @ 70%	\$ 368.2	\$ 1.15

Disclosure Disclaimer**RCAN1108**

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

DJ Carmichael Pty Limited, members of the Research Team; including authors of this report, its directors and employees advise that they may hold securities, may have an interest in and/or earn brokerage and other benefits or advantages, either directly or indirectly from client transactions in stocks mentioned in this report. DJ Carmichael Pty Limited has participated in capital raisings for **Hot Chili Limited** and was paid a fee for this service and DJ Carmichael Pty Ltd acted as a Corporate Advisor to **Hot Chili Limited** and was paid a fee for this service. DJ Carmichael Pty Limited holds securities in **Hot Chili Limited**.

DJ Carmichael Pty Ltd is a wholly owned subsidiary of DJ Carmichael Group Pty Ltd ACN 114 921 247.

In accordance with Section 949A of the Corporations Act 2001 D J Carmichael Pty Limited advise this email contains general financial advice only. In preparing this document D J Carmichael Pty Limited did not take into account the investment objectives, financial situation and particular needs ('financial circumstances') of any particular person. Accordingly, before acting on any advice contained in this document, you should assess whether the advice is appropriate in light of your own financial circumstances or contact your D J Carmichael Pty Limited adviser. D J Carmichael Pty Limited, its Directors employees and advisers may earn brokerage or commission from any transactions undertaken on your behalf as a result of acting upon this information. D J Carmichael Pty Limited, its directors and employees advise that they may hold securities, may have an interest in and/or earn brokerage and other benefits or advantages, either directly or indirectly, from client transactions. D J Carmichael Pty Limited believe that the advice herein is accurate however no warranty of accuracy or reliability is given in relation to any advice or information contained in this publication and no responsibility for any loss or damage whatsoever arising in any way for any representation, act or omission, whether express or implied (including responsibility to any persons by reason of negligence), is accepted by DJ Carmichael Pty Limited or any officer, agent or employee of D J Carmichael Pty Limited. This message is intended only for the use of the individual or entity to which it is addressed and may contain information that is privileged, confidential and exempt from disclosure under applicable law. If you are not the intended recipient or employee or agent responsible for delivering the message to the intended recipient, you are hereby notified that any dissemination, distribution or copying of this communication and its attachments is strictly prohibited.

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.

To elect not to receive any further direct marketing communications from us, please reply to this email and type 'opt out' in the subject line. Please allow two weeks for request to be processed.

© 2013 No part of this report may be reproduced or distributed in any manner without permission of DJ Carmichael Pty Limited.