AUSTRALIA

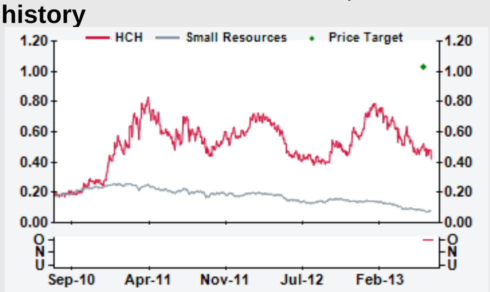
HCH AU — **Outperform**

Price (at 05:31, 10 Jul 2013 GMT)		A$0.42
Valuation - DCF (WACC 12.0%)	A$	1.12
12-month target	A$	1.03
12-month TSR	%	+145.2
Volatility Index		High
GICS sector		Materials
Market cap	A$m	125
30-day avg turnover	A$m	0.1
Number shares on issue	m	297.5

Investment fundamentals

Year end 30 Jun		2012A	2013E	2014E	2015E
Revenue	m	0.0	0.0	0.0	0.0
EBIT	m	-2.9	-10.6	-12.1	-14.1
Reported profit	m	-2.1	-10.5	-12.1	-32.8
Adjusted profit	m	-2.1	-10.5	-12.1	-32.8
Gross cashflow	m	-1.6	-4.1	-4.1	-24.8
CFPS	¢	-0.9	-1.4	-1.2	-4.9
CFPS growth	%	58.8	-57.7	16.4	-308.2
EPS adj	¢	-1.1	-3.5	-3.5	-6.5
EPS adj growth	%	85.5	-203.2	-2.5	-83.5
Total DPS	¢	0.0	0.0	0.0	0.0
Total div yield	%	0.0	0.0	0.0	0.0
ROA	%	-14.5	-21.5	-18.5	-6.0
ROE	%	-10.9	-21.7	-18.8	-30.5
EV/EBITDA	x	-16.6	-8.4	-8.3	-13.1
Net debt/equity	%	-51.7	-48.9	-29.6	34.1
P/BV	x	2.9	2.1	2.3	1.5

HCH AU vs Small Resources, & rec history



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, July 2013

(all figures in AUD unless noted)

11 July 2013
Macquarie Securities (Australia) Limited

Hot Chili

The market blows cold…

Event

- In a test of the Australian market's appetite for small cap resources, Hot Chili (HCH AU) has announced the arrangement of an A$11.7m capital raising.

Impact

- **Private placement with existing strategic shareholders**. Primary demand for the placement came from 5.5% shareholder and project partner CAP (CAP CL, Not Rated) and 5% holder, Sprott-affiliated Exploration Capital Partners.
- **$11.7m at A$0.45 per share in two tranches.** The first tranche of 4m shares is unconditional and will raise A$1.8m (settlement 22 July). Tranche two of 22.13m shares to raise A$9.9m is subject to both shareholder approval and CAP's internal approval process (EGM in August).
- **Why? Strengthening local ties and concerns about the macro?** In an indication of how the world has changed, HCH raised A$35.5m at A$0.75 a share at the end of 2012. The Company had A$25m in cash at the end of the March Quarter, which we believe would have seen them through some key milestones including a major resource upgrade, infrastructure agreements and the completion of a PFS by year end. In our mind, this begs the question: why raise now? Our read-through is that the timing was potentially driven by a desire to strengthen local ties ahead of infrastructure access negotiations and, in all likelihood, an expectation that the copper price will continue to fall.
- **Strategics and alternative financing to play an increasing role in project finance.** The apparent unwillingness of the broader Australian market to continue to support what we believe is one of the more robust emerging resource projects on offer highlights to us the growing importance of strategic partners and non-ECM project funding.

Earnings and target price revision

- No change. The dilution from this placement has no significant impact on our DFC NPV[12] of A$278m for Productora although it does make us question how the project will be funded. However, at this early juncture the potential options are hard to quantify and we choose to leave our target price unchanged. We point our modelled project IRR of +20% as illustration of its potential.

Price catalyst

- 12-month price target: A$1.03 based on a DCF methodology.
- Catalyst: resource upgrades, infrastructure, PFS by end CY13.

Action and recommendation

- Outperform. In a world of falling commodity prices a preference for lower risk 'producing' assets is natural. Despite this, we still believe that emerging projects that can demonstrate strong fundamentals will get up. Albeit that they are likely to have to give away more to secure financing. In our view, HCH's Productora project is one of these and will ultimately justify the investment.

Valuation, recommendation, risks

Valuation and recommendation

Outperform; target price of A$1.03

Our valuation of HCH is based on a preliminary DCF NPV[12] of A$278m for Productora. We ascribe a notional US$50m to HCH's other projects and after hedging, corporate costs and tax, we value HCH at A$0.95/sh at A$ spot of US$0.96 and A$1.12/sh at a long-term A$ exchange rate of US$0.86. We average these to obtain our price target of A$1.03/sh, representing a 12-month TSR of 145.2%.

Our model assumes a 10Mtpa operation with a 12-year mine life commencing in 2017, producing on average ~57kt copper and ~24koz Au per annum for the life of mine. We assume an initial $630m in capex with an additional $70m in Year 2 for a dedicated port facility. We assume a mixture of debt and equity funding for the Project in an approximate 70:30 ratio. Our model uses forward gold and copper price curves.

Fig 1 Modelling assumptions

Metric	Assumption	Comment
Resource	165.2Mt at 0.6% Cu, 0.1g/t Au	We do not carry any additional resources in our model. We do expect the resource to grow over time.
Resource to reserve conversion	70%	Successful results from extensional drilling are required to ensure high resource-reserve conversion and favourable strip ratios.
Mine life	12 years	Based on depletion of the assumed reserve.
Throughput	10Mtpa	
Recovery	92% Cu 80% Au	
Production & payability	~57,000t Cu 90% payable LoM ~24,800oz Au 75% payable LoM	We model higher-grade Cu production for yeas 2-5 producing 77ktpa of contained copper.
By-product credits	Gold only	Upside lies in moly and iron credits.
Operating cost	$1.25 – $2.18/lb payable	Although Chilean power cost are expected to reduce post 2018 we do not factor in any improvement in the model.
Capex	US$630m in Yrs -1 and 0 US70m in Yr 3 for dedicated port	
Timing	Construction - Mar Q 2015 Prestrip – Mar Q 2016 Production – Mar Q 2017	We assume a 12-month ramp-up to nameplate.
Funding/dilution	$240m new equity at ~75c $675m debt @ 10% interest	
Long-term FX	AUDUSD 0.82 / CLPUSD 550	

Source: HCH, Macquarie Research, June 2013

Strong near-term catalysts in resource growth and infrastructure agreement

In our view the main catalysts for HCH's share price are linked to de-risking the Project and demonstrating upside.

⇒ **Maiden iron ore resource** due to be released late CY2013; we expect this to be the first tangible indication of the potential upside contained within the magnetite mineralisation at Productora. If the resource can be combined with the announcement of a mine-gate sale agreement, then the potential for uplift should be magnified.

⇒ **Infrastructure access agreement and iron ore mine-gate sales.** An infrastructure agreement is in our view critical to the development of Productora and, if an agreement can be reached on terms the market views as favourable, this should provide a major share price catalyst. A mine-gate sales agreement is not essential to the Project but could provide meaningful upside to the economics and therefore should be a catalyst.

⇒ **Rationalisation of the CMP ground** to increase current HCH 65% holding should provide some incremental momentum to the share price.

⇒ **Cu/Au and Mo resource upgrades** expected late CY2013 and early CY2104; again this should provide incremental share price momentum as the resource base grows. Metallurgical test work demonstrating the potential to monetise the molybdenum resource should provide additional upside. There is also the potential for exponential growth as a result of additional discovery.

⇒ **PFS and decision to commence DFS,** due in late CY2013 and likely to coincide with a resource upgrade and potentially the iron ore resource. This will be a significant milestone for HCH and should provide a strong catalyst. Assuming the infrastructure agreement, resource upgrade and some clarity on the potential for by-product credits have also been delivered, the PFS should provide the market with a comprehensive understanding of the potential of Productora.

Risks – low and manageable

Early-stage project – Productora is an early-stage project and has not yet been subject to detailed study. The successful completion of the scoping study suggests there are no 'red flags' but significant further work is required. We also see a good deal of upside, as we believe that there is potential for improvement in the project economics if by-product credits can be achieved.

Exploration success – HCH still requires some exploration success to achieve a +20-year mine life, which we view as necessary for project inducement. We believe the risk here is low and expect additional tonnes and grade to be added both within the existing resource and in extensions to the north and south. As with the potential molybdenum and iron credits, we also believe that there is upside in the resource. Rationalisation of the CMP JV ground will reduce the burden of finding additional tonnes.

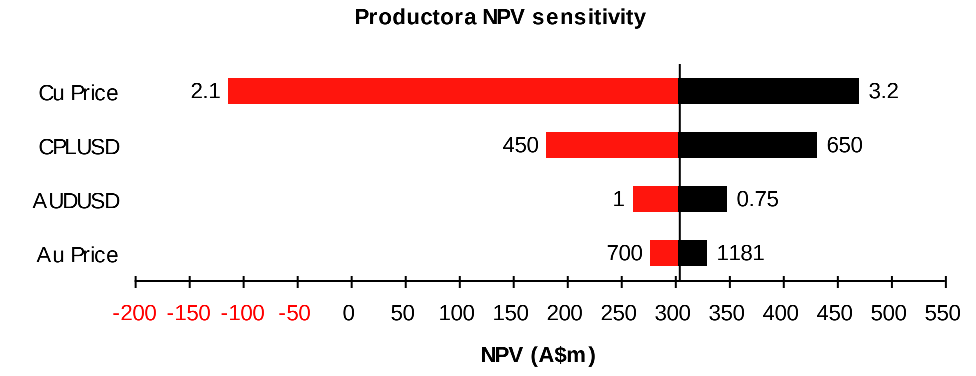
Infrastructure and land holding agreements – Infrastructure agreements on rational terms are critical. There appear to be a number of synergies HCH can offer CMP, which should make such agreements attractive but CMP are very much in the driving seat regarding terms. Whilst there are options for HCH to develop the Project on its own, the increase in capex would, in our view, likely be prohibitive.

Permitting – Productora is exposed to the same permitting risks as other Chilean resource projects. This is a well trodden path in Chile and we see this as more of a risk to timing rather than risk to the ultimate approval of the Project.

Funding – The capex requirement for Productora will be significant; HCH currently estimates between US$500m – US$700m. HCH has a demonstrated ability to raise funds with $92m raised since IPO in 2010 and the Company has been well supported by its shareholders. We believe that the Project is robust and should ultimately attract the necessary funding however; we also believe forecast macro headwinds over the next 12-18 month could impede progress.

Commodity price and FX exposure – HCH is exposed to movements in the copper and gold price and also potentially in movements in the iron and molybdenum price. The Company is also exposed to movements in the Chilean Peso, US dollar and Australian dollar.

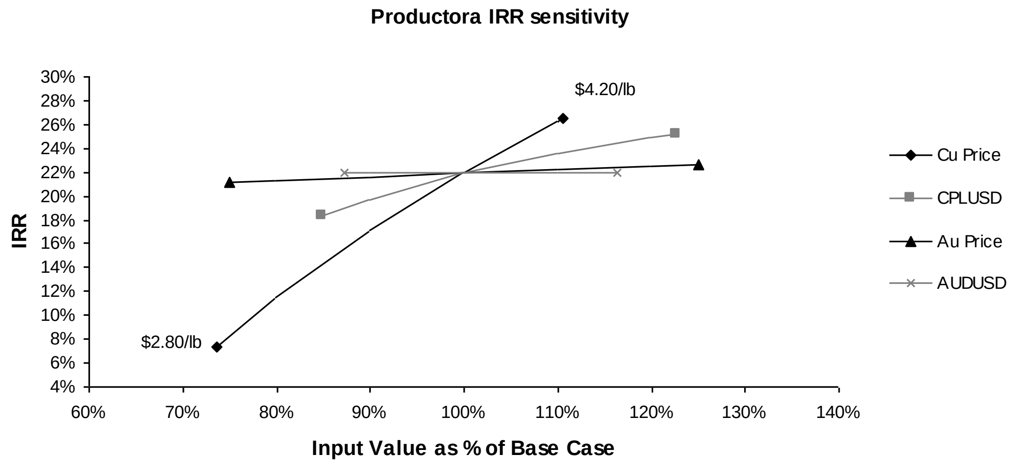
Fig 2 NPV sensitivity to commodity and FX change



Source: Macquarie Research, June 2013

Sensitivity analysis of our Productora model suggests the project is most sensitive to changes in the copper price and Chilean Peso/USD exchange rate. Our modelled IRR ranges between 7% and 28%; again this is driven primarily by the copper price. Our base case, which uses Macquarie long-term commodity and FX forecasts, has an IRR of 21%, which suggests a robust project.

Fig 3 IRR sensitivity to commodity and FX change



Source: Macquarie Research, June 2013

Hot Chili Limited

ASX: HCH	**Price: (A$ps)**	0.42	**Year end:**	Dec	**Rating:**	Outperform
	Mkt cap: (A$m)	133	**Diluted shares (m)**	316.3	**Target:**	A$1.03

ASSUMPTIONS		FY12	FY13e	FY14e	FY15e	FY16e	FY17e
Exchange Rate	A$/US$	1.03	1.02	0.90	0.88	0.86	0.84
Spot Copper Price	**US$/lb**	**3.70**	**3.48**	**3.08**	**2.98**	**3.21**	**3.50**

RATIO ANALYSIS		FY12	FY13e	FY14e	FY15e	FY16e	FY17e
Diluted share capital	m	199.7	316.3	347.7	547.7	637.3	726.8
EPS (diluted and pre sig. items)	A¢	-1.1	-3.5	-3.5	-6.5	-8.8	-5.2
P/E	**x**	**-33.8x**	**-11.1x**	**-10.9x**	**-5.9x**	**-4.4x**	**-7.4x**
CFPS	A¢	(1.2)	(1.0)	(1.2)	(4.5)	(7.0)	(3.1)
P/CF	x	-32.9x	-37.2x	-32.8x	-8.5x	-5.5x	-12.5x
DPS	A¢	0.0	0.0	0.0	0.0	0.0	0.0
Dividend yield	**%**	**0.0%**	**0.0%**	**0.0%**	**0.0%**	**0.0%**	**0.0%**
Franking Level	%	0%	0%	0%	0%	0%	0%
Book value per share	x	0.16	0.20	0.18	0.28	0.34	0.25
P/Book value	x	2.4x	1.9x	2.1x	1.4x	1.1x	1.5x
R.O.E. (pre sig items)	%	-6%	-16%	-19%	-22%	-24%	-21%
R.O.A. (pre sig items)	%	-9%	-16%	-19%	-3%	-2%	4%
Interest Cover	x	3.5x	182.5x	0.0x	-0.8x	-0.5x	0.4x
EBITDA per share	A$ps	-0.01	-0.03	-0.03	-0.03	-0.03	0.05
EV/EBITDA	**x**	**-36.2x**	**-8.5x**	**-8.5x**	**-12.3x**	**-23.6x**	**19.2x**

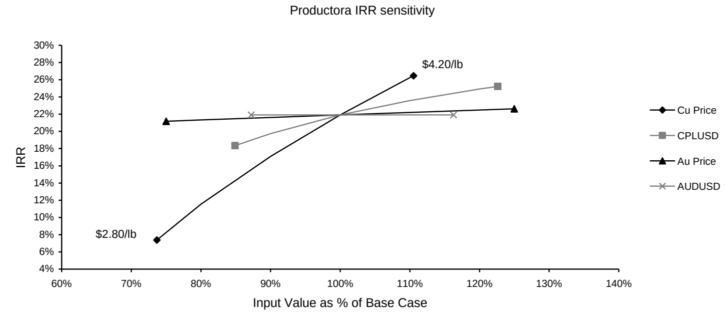
EARNINGS		FY12	FY13e	FY14e	FY15e	FY16e	FY17e
Sales Revenue	A$m	0	0	0	0	0	118
Other Revenue	A$m	0	0	0	0	0	0
Total Revenue	**A$m**	**0**	**0**	**0**	**0**	**0**	**118**
Operating Costs	A$m	0	0	0	0	0	(66)
Operational EBITDA	**A$m**	**0**	**0**	**0**	**0**	**0**	**52**
Exploration Expense/Write-offs	A$m	(0)	(6)	(8)	(8)	(8)	(6)
Corporate & Other Costs	A$m	(2)	(4)	(4)	(6)	(9)	(12)
EBITDA	**A$m**	**(3)**	**(11)**	**(12)**	**(14)**	**(17)**	**35**
D&A	A$m	0	0	0	0	0	(8)
EBIT	**A$m**	**(3)**	**(11)**	**(12)**	**(14)**	**(17)**	**27**
Net Interest	A$m	1	0	0	(19)	(36)	(63)
Profit Before Tax	**A$m**	**(2)**	**(11)**	**(12)**	**(33)**	**(53)**	**(36)**
Tax Expense	A$m	0	0	0	0	0	(2)
Minorities	A$m	0	0	0	0	0	0
Net Profit After Tax	**A$m**	**(2)**	**(11)**	**(12)**	**(33)**	**(53)**	**(38)**
Significant Items (post tax)	A$m	0	0	0	0	0	0
Reported NPAT	**A$m**	**(2)**	**(11)**	**(12)**	**(33)**	**(53)**	**(38)**

CASHFLOW		FY12	FY13e	FY14e	FY15e	FY16e	FY17e
Operational Cash Flow	**A$m**	**-2**	**-3**	**-4**	**-6**	**-9**	**40**
Net Interest	A$m	0	0	0	(19)	(36)	(63)
Tax Paid and Other	**A$m**	(1)	1	0	0	0	0
Net Operating Cashflow	**A$m**	**(2)**	**(3)**	**(4)**	**(25)**	**(45)**	**(22)**
Exploration	A$m	(15)	(24)	(10)	(10)	(10)	(7)
Capital Expenditure	A$m	(0)	0	(10)	(156)	(295)	(231)
Investments	A$m	0	0	0	0	0	0
Sale of PPE and Other	A$m	0	(0)	0	0	0	0
Net Investing Cashflow	**A$m**	**(15)**	**(24)**	**(20)**	**(166)**	**(305)**	**(238)**
Dividends Paid	A$m	0	0	0	0	0	0
Debt	A$m	0	0	0	250	425	(100)
Equity Issuance	A$m	30	44	12	120	120	0
Other	A$m	(1)	(2)	0	0	0	0
Net Financing Cashflow	**A$m**	**29**	**42**	**12**	**370**	**545**	**(100)**
Net change in cash	**A$m**	**12**	**15**	**(13)**	**180**	**195**	**(360)**

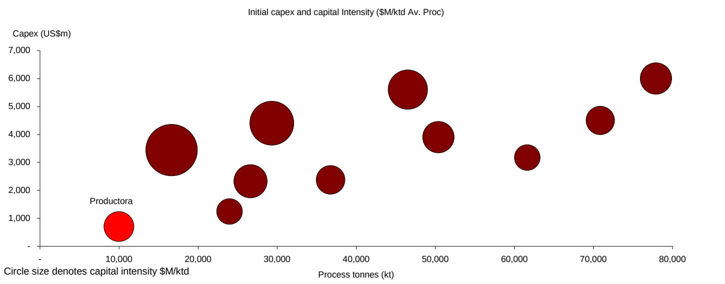
BALANCE SHEET		FY12	FY13e	FY14e	FY15e	FY16e	FY17e
Cash	A$m	17	31	19	198	394	34
PP&E & Mine Development	A$m	0	0	11	166	461	684
Exploration	A$m	16	34	36	38	40	41
Total Assets	**A$m**	**33**	**65**	**65**	**402**	**895**	**759**
Debt	A$m	0	0	0	250	675	575
Total Liabilities	**A$m**	**0**	**1**	**1**	**251**	**676**	**578**
Total Net Assets / Equity	**A$m**	**33**	**64**	**64**	**151**	**218**	**181**
Net Debt / (Cash)	A$m	(17)	(31)	(19)	52	281	541
Gearing (net debt/(nd + equity))	%	(107%)	(96%)	(42%)	25%	56%	75%
Gearing (net debt/equity)	%	(52%)	(49%)	(30%)	34%	129%	300%

ATTRIBUTABLE MINE OUTPUT		FY12	FY13e	FY14e	FY15e	FY16e	CY17e
Copper Production (equity)							
Productora	kt	0.0	0.0	0.0	0.0	0.0	13.3
Copper in Concentrate	**kt**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**13.3**
Payable Copper Production	mlb	0.0	0.0	0.0	0.0	0.0	79.1
Cash Copper Price Realised	US$lb	0.00	0.00	0.00	0.00	0.00	3.59
Net Cash Costs (per payable lb)	**US$/lb**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**1.46**
Notional Cash Margin	US$/lb	0.00	0.00	0.00	0.00	0.00	2.13
Operational EBIT Contribution (pre hedging)							
Productora	US$m	0	0	0	0	0	37

Productora IRR sensitivity



Capital intensity US$m to ktpd



RESERVES AND RESOURCES	Mt	% Cu	g/t Au	g/t Mo	Cu (kt)	Au (koz)	Mo (kt)
Reserves	Mt	% Cu	g/t Au	g/t Mo	Cu (kt)	Au (koz)	Mo (kt)
Proven	0.0	0.0%	0.0	0.0	0	0	0
Probable	0.0	0.0%	0.0	0.0	0	0	0
Total reserves (kt)	**0.0**	**0.0**	**0.0**	**0.0**	**0**	**0**	**0**
Resources	Mt	% Cu	g/t Au	g/t Mo	Cu (kt)	Au (koz)	Mo (kt)
Measured	0.0	0.0%	0.0	0	0	0	0
Indicated	70.6	0.6%	0.1	140	420	260	10
Inferred	94.6	0.5%	0.1	126	500	310	12
Total resources (kt)	**165.2**	**0.6%**	**0.1**	**132**	**921**	**569**	**22**

EQUITY DCF VALUATION				
Projects	**US$m**	**US$ps**	**A$ps**	**A$ps** @ spot
Productora	268	0.83	1.02	0.91
Projects and exploration	50	0.16	0.19	0.17
Hedging	0	0.00	0.00	0.00
Corporate	-55	-0.17	-0.21	-0.19
Net Cash / (Debt)	31	0.10	0.12	0.11
Net Equity Value (@ 12% WACC)	**294**	**0.92**	**1.12**	**1.00**

Source: Company data, Macquarie Research, June 2013

Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand
Outperform – return >3% in excess of benchmark return
Neutral – return within 3% of benchmark return
Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield

Macquarie – Asia/Europe
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie First South - South Africa
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie - Canada
Outperform – return >5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return >5% below benchmark return

Macquarie - USA
Outperform (Buy) – return >5% in excess of Russell 3000 index return
Neutral (Hold) – return within 5% of Russell 3000 index return
Underperform (Sell)– return >5% below Russell 3000 index return

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low–medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.
* Applicable to Asia/Australian/NZ/Canada stocks only

Recommendations – 12 months
Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:
Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / efpowa*
ROA = adjusted ebit / average total assets
ROA Banks/Insurance = adjusted net profit /average total assets
ROE = adjusted net profit / average shareholders funds
Gross cashflow = adjusted net profit + depreciation
*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 30 June 2013

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	49.80%	57.68%	48.05%	41.13%	61.75%	47.10%	(for US coverage by MCUSA, 8.12% of stocks followed are investment banking clients)
Neutral	39.85%	24.45%	42.86%	54.70%	34.42%	30.89%	(for US coverage by MCUSA, 6.60% of stocks followed are investment banking clients)
Underperform	10.35%	17.87%	9.09%	4.17%	3.83%	22.01%	(for US coverage by MCUSA, 0.00% of stocks followed are investment banking clients)

Company Specific Disclosures:
Important disclosure information regarding the subject companies covered in this report is available at www.macquarie.com/disclosures.

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