

SPECULATIVE BUY

27 February 2013

ASX Code:	HCH
Share price:	\$0.70
Shares on issue(M):	297.3
Market cap (M):	\$208.1
Cash as at 31/12/12 (M):	\$35.5
EV (M):	\$172.6

Price Target (12 months):	\$1.14
Discount from Price Target:	63%

Directors:

Murray Black	Chairman
Christian Easterday	Managing Director
Michael Anderson	Non-Exec. Director
Allan Trench	Non-Exec. Director
Geoffrey Laing	Director

Substantial Holders:

Kalgoorlie Auto Service	17.8%
Tarurus Funds Management	13.7%
Lundin Mining Corp.	9.1%
Port Finance Limited N.V.	5.4%

Projects:

Productora	Copper
Frontera	Copper
Bandera	Copper
Chile Norte	Copper

HCH Price Graph (12 months)



SITE VISIT – Resource Upgrade & Scoping Study

Hot Chili Limited (“HCH”) hosted a site visit following the announced positive scoping study and major Resource upgrade at the Productora project in Chile which now stands at:

**165.2Mt @ 0.6% Cu, 0.1g/t Au, & 132g/t Mo containing;
920kt Cu, 590koz Au & 22kt Mo**

The Resource extends over 7km of strike with the majority of the Resource located within 250m of surface.

The Resource has a high-grade, near surface component of 53Mt @ 0.8%Cu, 0.2g/t Au that could provide high grade ore in the initial 4 years, enhancing the payback period and overall economics. The mineralisation is from surface with no pre-strip and limited oxide ore development (~12Mt).

Four rigs are currently drilling a 100,000m program of known extensions covering up to 2km of strike length that is expected form part of any new Resource update. A second Resource upgrade is anticipated in the second half of 2013.

A magnetite zone to the West of the Productora Resource is also planned to be drilled to define an additional magnetite Resource with project partner Compañía Minera del Pacifico S.A. (“CMP”), an existing Iron ore producer, as part of the infrastructure sharing arrangements agreed upon in 2012.

The scoping study has highlighted a potential open pit operation producing ~220kt of ~25% Cu concentrate from a conventional floatation process. Indicative cash costs are US\$1.20-US\$1.50/lb, capex \$500-\$700m. The scoping study supports a pre-feasibility study to progress Productora.

Our View

Productora is a high quality project that has had a systematic Resource drill out. The access to infrastructure is a standout feature of the project. The Resource is expected to support a bulk mining open pit project for a ~12 year mine life, producing 60ktpa Cu in concentrate with gold credits. The Eastern margin of the ore body is not closed off and step-out drilling is expected to define the ore body further to the East.

Metallurgical characteristics appear favourable to produce a concentrate product from a coarse grind. Sulphide mineralisation alleviates the process equipment, acid and power requirements for a SX-EW processing plant.

Initial capital indications at \$500m-\$700m translate to \$7,700-\$10,700/annualised ton, which is competitive compared to other global copper projects. Power at 15-20% of opex represents a relatively low proportion. While the expected strip ratio is in the upper half of Cu projects, it is comparable to the El Morro (765Mt @ 0.4% Cu) and Esperanza (1.1Bt @ 0.3%) Chilean projects.

Productora is an attractive project with scale, grade, metallurgy and infrastructure options and trades at modest EV/Resource lb of \$0.07/lb. We were impressed with the project and the team.

Our change in valuation method to a risked DCF valuation, from EV/lb using the concept/scoping study parameters increases our **12 month Price Target to \$1.14**. **Speculative Buy** recommendation maintained.

Quality project professionally and systematically developed

Productora is located in the Chilean coastal ranges at 800-1000m altitude and is easily accessed directly off the Pan-American Highway. The town of Vallenar (pop. ~50k) is 15km to the North of the project area. Rail lines operated by CMP, a 12mtpa magnetite pellet producer and project partner, run immediately to the East and West of the Productora project.

The development of Productora is aligned with Chilean resources major Compañía de Aceros del Pacifico's ("CAP") business strategy of increasing value out of its existing port infrastructure and entering JV agreements to develop their non-iron ore projects. CMP senior management attended the site visit and outlined the strategic fit of Productora with their business plans.

The Resource has been drilled out over a strike length of 7km. The drill program has been efficient, with over 130,000m drilled in the last 18 months.



View from southern end of Productora facing North showing drill pad layout.

Source: PCF

Huasco Port is located ~60km to the West of Productora, which CAP operate (CMP is an operating subsidiary of CAP). Huasco port is a deep water port and currently exports magnetite pellets from a 160,000t berth. Coal and grain are bulk imports at Huasco.

HCH will construct a stand-alone Cu concentrate berth at Huasco to receive the Productora concentrate. The concentrate port berth forms the basis for a regional Cu concentrate production hub strategy, with Productora providing the initial product.



Huasco Port operated by CMP with cape-size ship receiving magnetite pellets.

Source: PCF

Productora Development Considerations

The latest Resource upgrade has doubled the Resource to 920,000t Cu, 590,000oz Au and 22,000t Mo. We would expect a high conversion of Resource to Reserve given the drilling has targeted mineralisation in the top 250m from surface. The ore body starts at surface, with no pre-strip and a minimal oxide development consisting of ~12Mt oxide ore. The oxide is planned to be mined and stockpiled for potential heap leaching in the future.

Productora is favourably located to rail, road, power, port and the city of Vallenar

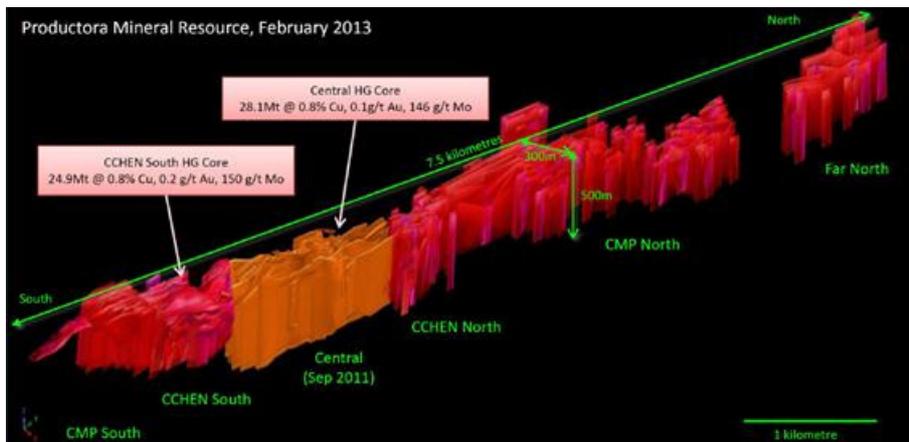
High quality project with a systematic Resource drill-out completed

Port access and CMP as a project partner accelerates approvals and improves economics

High grade central Resource is expected provide strong initial cash flows for the project finance period

Resource is not closed out to the East and South

The recent Resource upgrade identified a high grade central zone 53Mt @ 0.8% Cu, 0.2g.t Au, to give approximately 4 years of high grade ore from surface to support the project finance debt payback period.



Isometric view of Productora Resource wireframe, showing 7.5km strike length and 53Mt high grade core. Source: HCH

The eastern margin of the ore body is not closed off. Step out drilling is required to follow the mineralisation out to its Eastern extent over a strike length of 2km. This appears to sit within the planned pit outlines which we believe could potentially add materially to the Resource.

The Southern extension of Productora, Sierra Zapallo is a down-faulted block, thus representing a higher section in the mineralisation system, characterised by higher gold grades. This 2km zone is expected to add to the Productora Resource base.

The Western side of the Project hosts a magnetite zone control by early thrust faulting. The magnetite Resource drill out is planned for later this year. The Magnetite zone is a discrete structure located to the West of the Cu-Au Resource and sits largely within the western side of the potential central pit. There is potential for the magnetite ore to become a revenue stream rather than waste rock as currently considered in the scoping study.

The host rock is a very competent rhyolite. Management believe this will assist with minimising the waste to ore ratio, which at a proposed 3.5-4.5:1 is currently on the higher side of recent open pit Cu projects and the only parameter where we see any potential weakness in the project. The potential Magnetite, Eastern flank mineralisation and consideration of a lower Cu grade envelope may decrease this proposed range.

A Magnetite zone to the west is located with the potential pit wall

The magnetite zone could provide a revenue stream for HCH



Diamond core from typical central zone showing the mineralised breccia texture Source: PCF

Metallurgy test work to date is favourable

Metallurgical testing to date has been favourable as the Chalcopyrite mineralisation is hosted within a Tourmaline-rich Rhyolite Breccia which disaggregates on crushing and milling to liberate the ore-bearing mineral chalcopyrite at a coarse grind size, with relatively low power consumption for the ore hardness.

The resource development drill out is very impressive. It was clear from the site visit the project has been systematically drilled and this diligence carried through the feasibility stage, which bodes well for project success. We note Ausenco has been contracted to perform the Productora PFS. Ausenco conducted the studies on the PanAust Phu Kham project in Laos, which is similar in size/grade and expected production.

Frontera – Another Productora?

The Frontera project, located 70km South of Productora and adjacent to the Pan American Highway, is a known Cu-porphyry drilled by Noranda in the early 1990's. The ownership over Frontera is similar to Productora, with smaller owners around the project and CMP having the major land position. HCH has bought the tenements from local owners for a total consideration of \$5M, leaving a similar tenement ownership as with Productora. HCH has a 7,000m drill program currently underway at Frontera, with results expected in 6-8 weeks. CMP is also currently drilling its tenements at Frontera. Success at Frontera would deliver a bulk tonnage Porphyry system and add support to the 120kt-150kt production hub strategy in the Chilean coastal ranges.

Risks

In addition to risks related to commodity price, currency exchange rates and project development, consideration also needs to be given to:

Time lines – Productora is a substantial project requiring licenses for the port and sea water intake. The timeline to production is dependent on the granting of these permits which management has stated can be a long lead time item in a project of this nature in Chile.

JV relationships - Project partner CMP owns port access, water intake easements and mining tenure held in JV with HCH. Development to date has been constructive with HCH management succeeding in cultivating a strong relationship with CMP through the development of Productora; however there is a risk to project success should this change in the future.

Valuation

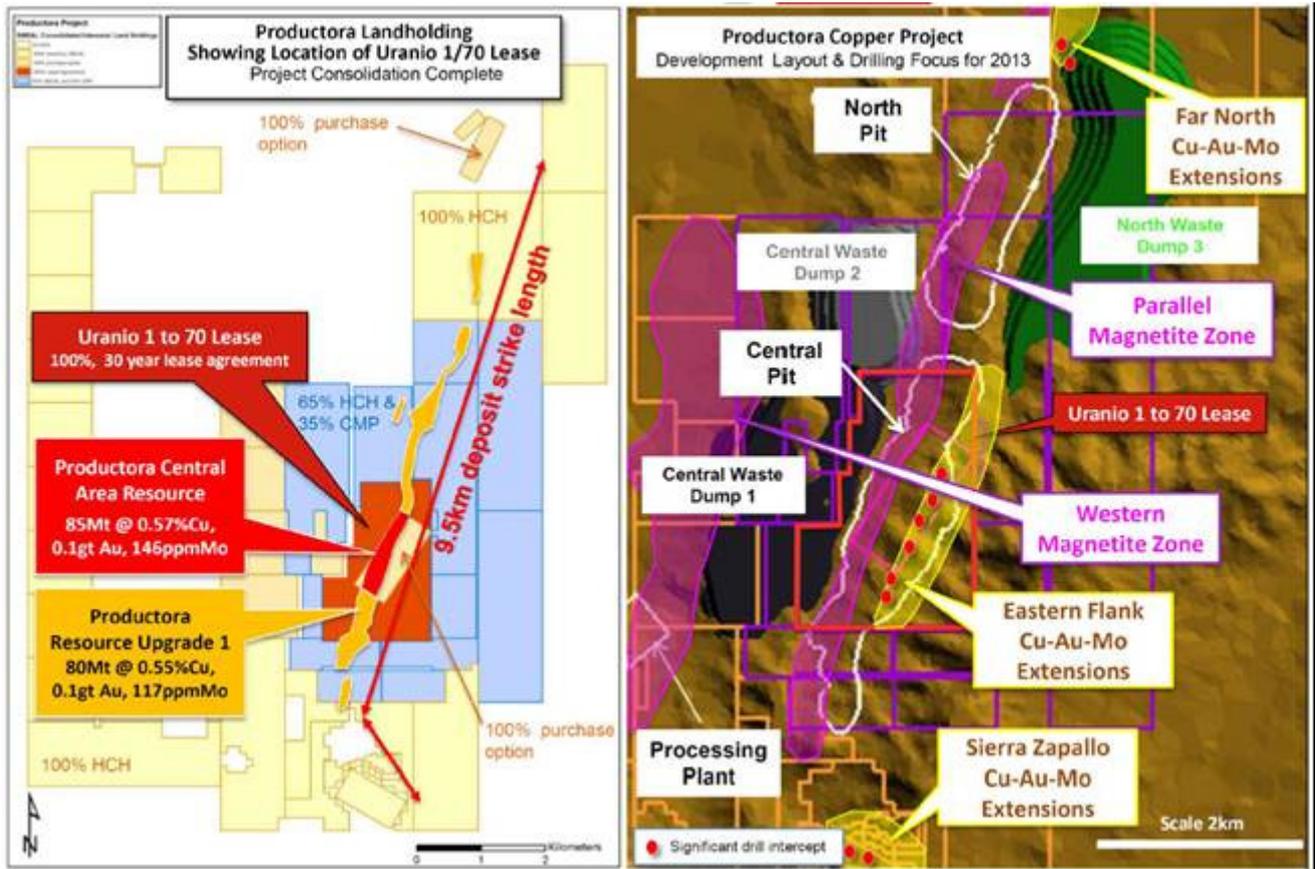
The project economic parameters considered in the conceptual/scoping study appear to largely fall within the typical range seen in recent large scale open pit Cu projects. The potential magnetite resource and Eastern flank of mineralisation and widening the ore body to the East have the potential to lower the proposed strip ratio of the planned pit.

Given the publication of the conceptual/scoping study parameters, we have changed our valuation method for HCH to a risked DCF. Assuming a \$600m capex (nominal \$450m debt), \$1.30/lb LOM opex with 4 years of initial high grade ore at 10.9Mtpa LOM, we have determined an initial risked valuation of \$1.14/sh on diluted share base considering additional new equity to fund the project capex.

Frontera has the potential to be a substantial Cu-Porphyry

Our initial risked DCF valuation of Hot Chili establishes a Price Target of \$1.14/sh

Productora Project Figures



Project maps (left; Maiden Resource 85Mt Red, Upgrade 80Mt Yellow), Right; Central Resource inset. Source: HCH

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