

Thursday, 8 September 2016

Stephanie Yong
ASX Compliance Pty Ltd
ABN 26 087 780 489
20 Bridge Street
Sydney NSW 2000

RE: FINANCIAL CONDITION QUERY

We refer to your letter dated 5 September 2016 regarding a query in relation to our half-year financial report for the half-year ended 30 June 2016 ("Financial Report") and the accompanying Auditor's Review Report.

Using the numbering in your letter, we respond as follows:

1. The Company can confirm that in the Directors' opinion the Financial Report:
 - a. complies with the relevant Accounting Standards; and
 - b. gives a true and fair view of the financial performance and financial position of the Company.
2. The Company has already made considerable progress in achieving the initiatives described in Notes 1(a) and 16. For example, the Company has recently announced a number of measures including:
 - a. On 22nd August 2016 the Container Sale and Contract Extension under which it had entered into a transaction with Flinders Logistics for the sale and leaseback of its 450 shipping containers releasing \$2.5m in liquidity and future cost savings,
 - b. On 25th August 2016 the Debt Restructure and Amended Offtake Agreement under which the Company has been able to:
 - i. Defer the price participation charges in the existing agreement until 2018; and
 - ii. Reduce the precious metals royalty by 65% over the existing arrangement.

The impact of these two changes is material in that in addition to the reduction in offtake charges, \$5.4m of expenditure during the critical cashflow period has been deferred.

 - c. On 25th August 2016
 - i. the Kanmantoo Copper Mine Ore Reserve Statement confirmed the 17% positive grade reconciliation will be included in a revised Mineral Resource Estimate and Ore Reserve Estimate.
 - ii. the Inferred Resource Infill Drilling Results will be included in a revised Mineral Resource Estimate and Ore Reserve Estimate.

HILLGROVE RESOURCES LIMITED

Neither the positive grade reconciliation nor the infill drill results are included in our current cashflow projections and will not be included until the current comprehensive assessment is completed.

The revised Resource and Reserve Estimates will be released in the December quarter and disclosed to the market at this time.

- d. In addition, the Company is taking steps to source additional debt financing.

Given the significant progress to date and in particular the capital raising initiatives announced, the Company has every confidence that the various initiatives identified will be completed by 31 December 2016 and therefore should result in an unqualified audit report/review for future financial periods.

3. We provide the following update on progress in relation to the following matters:

- *Achieve the continuing financial support of the Company's largest mining contractors (representing approximately 70% of the total trade creditors balance), and in respect of which outstanding balances are outside normal payment terms, through reaching agreement which will have a positive effect on the Group's cash flow.*

Weekly meetings are held with the largest creditors at which short term payment plans are agreed. Moreover, the Company is in the process of finalising payment negotiations with several of its largest contractors and will advise the market once agreement has been finalised.

- *Negotiating additional debt and equity funding of \$15 million with a view to realising at least \$5 million by mid October 2016, \$5 million by the end of November 2016 and the balance of \$5 million by the end of February 2017.*

As previously announced on 5 September 2016, the Company has signed a conditional term sheet with one of the Company's major shareholders to fully underwrite a rights issue of convertible notes to raise approximately \$5 million. The Company is working towards releasing a prospectus for the rights issue within the next few weeks. In addition, as mentioned above the Company is taking steps to source additional debt financing to follow on from the rights issue raising.

- *At the date of signing this report, the Group has a large number of trade creditors (excluding the largest mining contractors) with balances outstanding which are outside normal payment terms. The continued support of these trade creditors in managing the Group's cash balance throughout 2016 is required.*

The Company continues to liaise with its trade creditors and maintain their ongoing support. This is a continual and ongoing process, with clear communication to the trade creditors outside the main mining contractors. In view of recent events including the exiting of previous financiers Macquarie Bank and Freepoint / Ventures LLC, and the recently announced signing of the term sheet for an underwritten rights issue, trade creditors are continuing to provide their support.

4. Yes, we confirm that the Company does consider its level of operations are sufficient to warrant continued quotation.

HILLGROVE RESOURCES LIMITED

Presently the Company is mining at the rate of more than 20 million tonnes per annum and producing up to 20,000 tonnes of copper per annum. The Company presently employs approx. 245 site based employees and contractors at Kanmantoo and head office. Annual export earnings are in a range of \$120 to \$180 million per annum. With over sixty million dollars invested in the cutback of Giant Pit the Company will complete the final stripping in the next six months and then generate significant free cashflows at very low stripping ratios.

5. Yes, we confirm that the Company does consider that its financial condition is sufficient to warrant continued quotation.

As previously announced, the Company identified that it would experience a period of constrained cash flow due to a change in its LOM plan which deferred copper production and reduced revenue during the Giant Pit cutback which is expected to continue until March 2017, and announced certain initiatives to address that issue. As mentioned above, the Company has successfully completed a number of those initiatives and has made very significant progress on the other initiatives.

Based on its current plans and progress with initiatives currently underway the Company expects that cash flow will return to appropriate and less constrained levels during the fourth quarter this year.

The Company reiterates that the constrained cash flow is a temporary issue because of the deferral of copper production during the Giant Pit cutback and that the Kanmantoo Mine still has a significant positive NPV in line with the carrying value for that asset which at 30 June 2016 was \$61.4 million.

6. Not applicable.
7. We confirm that the Company is in compliance with ASX Listing Rules and, in particular, Listing Rule 3.1 and 12.2.

Yours Sincerely

(sent electronically without signature)

Paul Kiley
CFO and Company Secretary



5 September 2016

Paul Kiley
CFO
Hillgrove Resources Limited
5 – 7 King William Road
Unley SA 5061

By email

Dear Mr Kiley

Hillgrove Resources Limited (the “Entity”) – Financial Condition Query

ASX Limited (“ASX”) refers to the following:

1. The Entity’s half-year financial report for the half-year ended 30 June 2016, lodged with ASX Limited (“ASX”) on 1 September 2016 (the “Financial Report”).
2. The Independent Auditor’s Review Report on pages 34 to 35 of the Financial Report (“Auditor’s Review Report”) which includes the following Disclaimer of Opinion (the “Disclaimer”):

Basis for Disclaimer of Review Conclusion

We draw attention to Note 1(a) ‘Going Concern’ in the financial report which indicates that as at June 2016 the consolidated entity’s current liabilities exceeded its current assets by \$23.7 million. It further highlights revisions to the Life of Mine plan, which result in a forecast cash flow shortfall, particularly in the last quarter of the 2016 financial year. Both Notes 1(a) and 16 also outline a number of initiatives the directors have undertaken and intend to undertake to ensure the consolidated entity is able to continue as a going concern. These initiatives include the restructure of the balance sheet, sourcing additional equity and debt funding, restructuring repayment terms with the two most significant creditors and obtaining the continued forbearance of other creditors as well as reducing cash outflows through a significant cost reduction program. At the date of this report, we have not been able to obtain sufficient appropriate evidence to support the achievement of the initiatives described in Notes 1(a) and 16.

Further, the statement of financial position as at 30 June 2016 includes the recognition of property, plant and equipment, deferred tax assets and capitalised exploration and evaluation expenditure which are expected to be realised in future years. The ability to recover the carrying values of these assets is dependent on successfully implementing the initiatives outlined in Note 1(a) ‘Going Concern’, and the consolidated entity continuing as a going concern.

These conditions, along with other matters as set forth in Note 1(a), indicate the existence of material uncertainties which cast significant doubt about the ability of the consolidated entity to continue as a going concern and whether it will realise its assets and discharge its liabilities in the normal course of business.

Given the above circumstances, in our opinion, the uncertainties are so material and pervasive that we are unable to express a conclusion on the half-year financial report taken as a whole.



Relevant Listing Rules and Guidance

- Listing Rule 12.1 – *The level of an entity's operations must, in ASX's opinion, be sufficient to warrant the continued quotation of the entity's securities and its continued listing.*
- Listing Rule 12.2 – *An entity's financial condition (including operating results) must, in ASX's opinion, be adequate to warrant the continued quotation of its securities and its continued listing.*
- Listing Rule 19.11A – *If a listing rule requires an entity to give ASX accounts, the following rules apply:*
...
(b) The accounts must be prepared to Australian accounting standards. If the entity is a foreign entity the accounts may be prepared to other standards agreed by ASX.

Questions for Response

In light of the Auditor's Review Report, the information contained in the Financial Report, and the application of the listing rules stated above, please respond to each of the following questions:

1. Is the Entity able to confirm that in the Directors' opinion the Financial Report:
 - (a) complies with the relevant Accounting Standards; and
 - (b) gives a true and fair view of the financial performance and financial position of the Entity?
2. Given the Disclaimer relates to the Auditor's inability to obtain sufficient audit evidence to support the achievement of the initiatives described in Notes 1(a) and 16, which include the restructure of the balance sheet, sourcing additional equity and debt funding, restructuring repayment terms with the two most significant creditors, obtaining the continued forbearance of other creditors, and reducing cash outflows through a significant cost reduction program, what steps does the Entity intend to take to obtain an unqualified audit/review report for future financial periods?
3. The Entity has stated in Note 1(a) of the Financial Report that "*..in order for the consolidated entity to continue as a going concern, the consolidated entity must achieve the following:*"
 - *Achieve the continuing financial support of the Company's largest mining contractors (representing approximately 70% of the total trade creditors balance), and in respect of which outstanding balances are outside normal payment terms, through reaching agreement which will have a positive effect on the Group's cash flow.*
 - *Negotiating additional debt and equity funding of \$15 million with a view to realising at least \$5 million by mid-October 2016, \$5 million by the end of November 2016 and the balance of \$5 million by the end of February 2017.*



- *At the date of signing this report, the Group has a large number of trade creditors (excluding the largest mining contractors) with balances outstanding which are outside normal payment terms. The continued support of these trade creditors in managing the Group's cash balance throughout 2016 is required."*

Please provide an update on these items.

4. Does the Entity consider that its level of operations is sufficient to warrant continued quotation of its securities on ASX in accordance with the requirements of listing rule 12.1? In answering this question, please explain the basis for this conclusion.
5. Does the Entity consider that the financial condition of the Entity is sufficient to warrant continued listing on ASX in accordance with the requirements of listing rule 12.2? In answering this question, please explain the basis for this conclusion.
6. If the answer to questions 4 or 5 is "No", please explain what steps the Entity has taken, or proposes to take, to warrant continued listing on ASX in accordance with the requirements of listing rules 12.1 and 12.2.
7. Please confirm that the Entity is in compliance with the listing rules and, in particular, listing rules 3.1 and 12.2.

Please note the ASX reserves its right under listing rule 18.7A to release this letter and the Entity's response to the market. Accordingly, the Entity's response should address each question separately and be in a format suitable for release to the market.

Unless the information is required immediately under listing rule 3.1, a response is requested as soon as possible and, in any event by **9:30am AEST, Thursday 8 September 2016**.

Any response should be sent to me by return email. It should not be sent to the ASX Market Announcements Office.

If you have any queries regarding any of the above, please let me know.

Yours sincerely

(sent electronically without signature)

Stephanie Yong
Senior Adviser, Listings Compliance (Sydney)