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Kingsrose Mining Ltd (KRM)

Reshaped loans assist development thrust

Recommendation

Buy (unchanged)

Price

\$0.275

Target (12 months)

\$0.45 (unchanged)

Expected Return

Capital growth	64%
Dividend yield	0%
Total expected return	64%

Company Data & Ratios

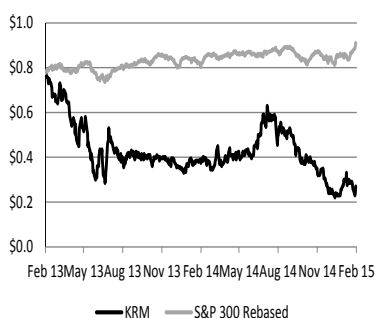
Enterprise value	\$101m
Market cap	\$99m
Issued capital	358.6m
Free float	55%
Avg. daily val. (52wk)	\$0.14m
12 month price range	\$0.22 - \$0.67
GICS sector	Materials

Disclosure: Bell Potter Securities acted as Lead Manager and Bookrunner for the \$8m placement in February 2014 and received fees for that service.

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	0.26	0.38	0.38
Absolute (%)	5.9	-28.9	-28.9
Rel market (%)	-0.8	-34.3	-39.9

Absolute Price



SOURCE: IRESS

Gold production down in Dec-14 quarter but grade is rising

Gold production at KRM's Talang Santo mine in Southern Sumatra, Indonesia, was down 17% on the previous quarter at 5,465 ounces. Gold output was lower from lower ore grades in part associated with some ore zones that were more oxidised than expected, requiring more ground support and resulting in slower production rates. Gold head grades improved over the quarter. The average mined grade in December was 9.5g/t compared to the quarter's average of 8.3g/t.

Gold head grades are expected to improve in the March 2015 quarter. However, KRM has revised its FY15 guidance to gold production of 30 to 35,000 ounces (previously 40,000 ounces) reflecting the lower gold production in 1HFY15. Preparations for sinking the internal vertical shaft to the 5 Level are underway in order to provide earlier access to the high grade zones identified previously by drilling.

Debt restructuring supports accelerated mine development

KRM has reached agreement with the company's financiers to restructure the repayment profile of its loans. The restructuring extends the terms of loan repayments (which were previously going to commence in January 2015 with the final payment in October 2015) and involves 20 instalments commencing in July 2015 with final payment now due in February 2017. The loan extension means KRM can continue to focus on ramping up mine production and can progress more rapidly with sinking the internal shaft to 5 Level.

Investment thesis – Buy, TP \$0.45/sh (unchanged)

The early periods of gold production from the Talang Santo mine have been below expectations. However, given the nature of the orebodies and early stage of development of the mine in the more oxidised upper parts of the deposit, we expect production to improve as the mine gets deeper and into more competent, fresher rock. Ore grades are also expected to increase, especially when mining reaches the high grade zones on the 5 and 6 Levels. We have made some earnings and valuation revisions that incorporate revised FX forecasts. We retain our Buy recommendation.

Earnings Forecast

Year end June	2014a	2015e	2016e	2017e
Sales (A\$m)	4	44	55	83
EBITDA (A\$m)	(32)	14	20	39
NPAT (reported) (A\$m)	(5)	4	8	19
NPAT (adjusted) (A\$m)	(21)	4	8	19
EPS (adjusted) (eps)	(6)	1	2	5
EPS growth (%)	na	na	83%	126%
PER (x)	na	23.0	12.6	5.6
FCF Yield (%)	na	na	8%	25%
EV/EBITDA (x)	na	7.6	5.1	2.6
Dividend (eps)	-	-	-	1
Yield (%)	0%	0%	0%	4%
Franking (%)	0%	0%	0%	0%
ROE (%)	-29%	6%	10%	20%

SOURCE: BELL POTTER SECURITIES ESTIMATES

December 14 production summary

Table 1 - KRM December 2014 production summary

	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Dec-14	Variance	Variance
	Actual	Actual	Actual	Actual	Actual	BP est.	% qoq	% BP est.
Gold and Silver Production								
Ore Mined (t)	0	5,336	3,272	16,123	20,242	28,875	26%	-30%
Average Grade - Gold (g/t)	0.0	13.2	9.2	8.9	8.3	9.2	-7%	-10%
- Silver (g/t)	0	46	36	34	25	30	-26%	-16%
Ore Treated (t)	7,588	4,386	0	23,278	23,747	28,875	2%	-18%
Average Grade - Gold (g/t)	3.6	8.5	0.0	9.1	7.4	9.2	-19%	-20%
- Silver (g/t)	24	41	0	31	24	30	-22%	-20%
Recoveries - Gold (%)	96%	97%	na	97%	97%	93%	0%	4%
- Silver (%)	91%	92%	na	92%	92%	90%	0%	2%
Gold Produced (ozs)	836	1,170	na	6,590	5,465	7,943	-17%	-31%
Silver Production (ozs)	5,346	5,346	na	21,137	16,870	24,982	-20%	-32%
Gold production (oz AuEq)	923	1,253	na	6,881	5,713	8,311	-17%	-31%
Costs (A\$/oz AuEq by-product basis)								
C1 cash costs	na	na	na	660	780	629	18%	24%
All In Sustaining costs	na	na	na	997	1,208	943	21%	28%
Gold Sales and Realised Prices								
Gold Sales (ozs)	na	na	na	4,469	5,884	7,943	32%	-26%
Average realised gold price (A\$/oz)	na	na	na	1,415	1,346	1,371	-5%	-2%
Balance Sheet								
Cash and bullion (\$A m)	1.4	7.7	6.7	9.0	8.4	4.4	-6%	92%
Debt (\$A m)	(11.8)	(11.5)	(11.1)	(11.1)	(11.1)	(11.1)	0%	0%
Net cash/(debt) (\$A m)	(10.4)	(3.8)	(4.4)	(2.1)	(2.7)	(6.7)	27%	-59%

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

The main features of the December 2014 production report were as follows:

- Gold production was 5,465 ounces (5,713 ounces of gold equivalent) from the company's Talang Santo underground mine in Indonesia, 17% lower than in the previous quarter. This production was achieved at an average C1 cash cost of A\$780 and an all in sustaining cost (AISC) of A\$1,208/oz, an increase of 18% and 21% respectively on the previous quarter. Higher unit costs were largely because of a 7% lower average gold head grade and higher mining costs from the need for more ground support for the more extensive zones of oxidised ore on 2 Level. Gold head grades were progressively increasing during the quarter and this trend is expected to continue.
- The company achieved 32% higher gold sales of 5,884 ounces in the latest quarter at an average realised gold price of A\$1,346/oz, down 5% on the previous quarter.
- Mine development at Talang Santo was focused on enabling commencement of stoping in the main ore zones on Levels 2 and 3. The vertical development for the internal shaft to Level 4 was completed at the end of the quarter. Trial stoping in Zone A of the Splay Zone was completed after the mining of 7,142t averaging 8.5g/t gold and 37g/t silver. However, this mining was adversely affected by stope failures and then lower mining recoveries related to the placement of rib pillars to mitigate those failures. Evaluation of alternative mining methods in the narrower sections of Zone B of the Splay Zone above 3 Level is continuing, targeting short, higher grade shoots identified in the development.
- The company remains adequately funded for its activities, with cash of \$6.1m and bullion of \$2.3m for total cash and equivalents of \$8.4m at the end of the quarter. Debt is estimated to have remained at around \$11.1m with a further loan restructuring agreed with the company's lenders after the end of the quarter.

Further restructuring of loans to assist mine development

Mine development is to be assisted by a further restructuring of the company's loans. Repayments are now deferred, enabling cash to be used to expedite mine development that includes the internal vertical shaft to 5 Level. Under the previous loan repayment schedule, repayments were to start in January 2015 with the final payment made in October 2015. The revised loan restructuring involves repayment of the loan in 20 instalments commencing in July 2015 with final payment due in February 2017.

Higher head grades to drive lower unit costs

KRM reported that mined gold head grades improved over the course of the December 2014 quarter and averaged 9.5g/t for December compared with the overall average for the quarter of 8.3g/t. The company expects the improvement in mined head grades to continue in the March 2015 quarter. KRM is also targeting a higher and more stable production profile for the Talang Santo mine, aiming to achieve consistent production of at least 350t per day with commensurately lower all in sustaining costs (AISCs). The improvement in gold head grades is expected to lead to lower unit cash costs and AISCs, with KRM forecasting that once steady state production levels are reached, the AISCs should be in the range of US\$670 to US\$720/oz (approximately A\$840 to A\$900/oz). KRM has issued revised gold production guidance for FY15 of 30 to 35koz (previous guidance was for 40koz in FY15).

Earnings and valuation changes

Reduced earnings forecasts for FY15 to FY17

We have lowered our production forecast and slightly increased our mining cost forecasts for KRM in FY15 and beyond, reflecting the slower ramp-up of underground production at the Talang Santo mine. Our revised earnings estimates also incorporate revised \$US/\$A forecasts, which has contributed overall to reduced earnings forecasts for FY15 to FY17 (Table 2).

Table 2 - KRM earnings and valuation changes

	Previous			New			Change		
	2015e	2016e	2017e	2015e	2016e	2017e	2015e	2016e	2017e
Share capital									
Prices & currency									
Spot - Gold (US\$/oz)	1,208	1,175	1,245	1,208	1,175	1,245	0%	0%	0%
- Silver (US\$/oz)	17	17	15	17	16	15	0%	-2%	0%
- US\$/A\$	0.88	0.85	0.85	0.85	0.80	0.80	-3%	-6%	-6%
Production & costs (By-product basis)									
Gold equivalent (koz)	34	40	58	32	40	58	-6%	-1%	0%
C1 cost (\$US/oz)	607	529	459	629	561	487	4%	6%	6%
All-in sustaining costs (\$US/oz)	919	802	690	994	891	773	8%	11%	12%
Earnings & valuations									
EBITDA (A\$m)	16	23	45	14	20	39	-16%	-12%	-13%
EBIT (A\$m)	11	18	41	9	15	34	-23%	-17%	-16%
NPAT (adjusted) (A\$m)	6	10	22	4	8	19	-25%	-20%	-17%
EPS (adjusted) (cps)	2	3	6	1	2	5	-25%	-19%	-16%
PER (x)	13.1	7.7	3.5	23.0	12.6	5.6	75%	63%	59%
EPS growth (%)	na	69%	119%	na	83%	126%	na	14%	7%
DPS (cps)			1	-	-	1	na	na	0%
Yield	na	na	5%	-	-	4%	na	na	-1%
NPV (\$/sh)	0.42	0.45	0.49	0.43	0.45	0.48	2%	0%	-3%
Price Target (\$/sh)	0.45			0.45			0%		

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Current valuation increased by 2% to \$0.43/sh

Our risked valuation of KRM is based on the following parameters:

- A sum-of-the-parts valuation based on the net present value of discounted cash flow estimates for the Way Linggo Gold Project incorporating production from the Talang Santo mine, exploration and corporate costs using a discount rate of 10%.
- Key modelled assumptions are as follows:
 1. Talang Santo mine life of 7 years based on approximately 60% conversion of resources to reserves.
 2. C1 cash costs for Talang Santo mine of A\$629/oz in FY15; A\$561/oz in FY16 and A\$487/oz in FY17.
 3. Sustaining capital expenditure of around \$1.3m per annum and mine development expenditure at Talang Santo of around \$6m pa over the next three years.
 4. Annual exploration expenditure of around \$3.5m.
 5. Estimated valuation of \$48m for the remaining resource at the Way Linggo mine.
 6. Estimated valuation for exploration elsewhere in the Way Linggo Gold Project of \$56m.
 7. Repayment of the loan under the recently revised terms that sees it fully repaid by February 2017.

Table 3 - DCF-based valuation summary

DCF sum-of-parts valuation	Now		+12 months		+24 months	
	A\$m	\$/sh	A\$m	\$/sh	A\$m	\$/sh
Talang Santo mine	69	0.19	77	0.21	77	0.22
Way Linggo mine	48	0.13	48	0.13	48	0.13
Exploration	56	0.16	56	0.16	56	0.16
Corporate	(17)	(0.05)	(15)	(0.04)	(12)	(0.03)
Total enterprise value	156	0.43	166	0.46	169	0.47
Net cash & bullion/(debt)	(3)	(0.01)	(6)	(0.02)	2	0.00
Equity value	153	0.43	160	0.45	171	0.48

SOURCE: BELL POTTER SECURITIES ESTIMATES

Kingsrose Mining Ltd (KRM)

Company description

KRM is a specialist high grade, narrow vein gold miner and producer with a track record of successful low cost mine development and production in the Way Linggo Gold Project in South Sumatra, Indonesia. The company has been operating in Indonesia since 2008 but members of its Board and senior management have very extensive operating experience in mines in Indonesia and with similar styles of deposit and mines to those at the Way Linggo Gold Project. KRM's key asset is currently the high grade Talang Santo underground gold-silver mine where production was commenced in mid-2014 and is still being ramped up while the mine is successfully explored for multiple high grade mining areas. The Way Linggo mine ceased operations in 2013 but still contains a significant remnant gold-silver resource that is the subject of ongoing studies into its recovery. KRM's Way Linggo Project is held under a fourth generation Contract of Work covering an area of 105km² that is highly prospective for additional high sulphidation epithermal gold deposits and contains multiple prospects and target areas, which are the subject of ongoing exploration.

Investment thesis – Buy, TP \$0.45/sh (unchanged)

The early periods of gold production from the Talang Santo mine have been below expectations. However, given the nature of the orebodies and early stage of development of the mine in the more oxidised upper parts of the deposit, we expect production to improve as the mine gets deeper and into more competent, fresher rock. Ore grades are also expected to increase, especially when mining reaches the high grade zones on the 5 and 6 Levels. We have made some earnings and valuation revisions that incorporate revised FX forecasts. We retain our Buy recommendation.

Risks

The key risks include the following:

- 1. Sovereign risk:** Indonesia, where KRM has its mining operations, is regarded as being a country with much higher sovereign risk than Australia because of various factors. KRM seeks to mitigate the sovereign risk by ensuring it is fully compliant with all legal and statutory operational requirements and by engaging appropriately with and supporting the local communities in which it operates.
- 2. Regulatory and government approvals risk:** Changes to the regulatory regime of the mining industry (which includes taxation and environmental aspects) in the various jurisdictions that KRM operates can impact the returns generated and therefore the valuation of the company's assets. KRM's operations in Indonesia are largely governed by the Contract of Work under which KRM holds its interest in the Way Linggo Gold Project, which largely defines the terms and conditions, including taxation rates, under which KRM operates.
- 3. Commodity price and exchange rate risk:** The relatively liquid nature of gold makes it subject to wide fluctuations in price, particularly during more difficult economic times or major world events. Associated with gold price volatility are different gold price and foreign exchange rate outcomes to our forecasts;
- 4. Operational risk:** By their nature, high sulphidation epithermal gold deposits such as occur in the Way Linggo Gold Project and are represented by the Talang Santo mine can contain considerable geological and grade variability and metallurgical complexity,

which can present operational challenges leading to different outcomes to those we are forecasting;

5. **Lack of exploration success:** The exploration areas where KRM is currently directing its exploration focus to locate additional deposits of gold mineralisation are regarded as highly prospective because of the presence of economic gold mineralisation and the multiple targets for similar mineralisation that has been identified in them. There may be general geological complexity in these areas from the wide range of rock types that are often considerably altered and extensively metamorphosed and the tectonically disrupted nature of them. Areas containing gold mineralization may contain greater than expected geological complexities that may be difficult to resolve without extensive drilling programs and these issues may inhibit the definition of adequate resources and reserves;
6. **Funding risk:** By its nature, the mining and exploration activities of KRM are capital intensive and the company needs to ensure that it has adequate funding to carry out its activities and to maintain its interests. KRM also needs to ensure that it is able to fund its share of capital expenditure commitments when required including when the cost to do so may be higher than expected from unexpected operational complications; and
7. **Inappropriate acquisition risk:** The acquisition of other assets can be inappropriate because it can divert management effort from the current focus and may yield inadequate returns.

Other significant risks include regulatory, environmental and commercial ones, which are typical for natural resource projects. These aspects are usually well understood and readily managed by KRM and the competent and well experienced operational personnel it employs.

Table 4 - Financial summary

PROFIT AND LOSS							FINANCIAL RATIOS						
Year ending 30 Jun	Unit	2013a	2014a	2015e	2016e	2017e	Year ending 30 Jun	Unit	2013a	2014a	2015e	2016e	2017e
Revenue	\$m	25.3	4.0	43.7	54.8	82.6	VALUATION						
Expense	\$m	(21.6)	(35.8)	(29.7)	(34.0)	(42.5)	Normalised NPAT	\$m	1.5	(4.8)	4.5	8.2	18.6
Exploration	\$m	0.0	0.0	(0.5)	(0.6)	(1.0)	Basic EPS	c/sh	0.9	(6.4)	1.3	2.3	5.2
EBITDA	\$m	3.7	(31.9)	13.5	20.1	39.2	Basic EPS growth	%	-85%	na	na	83%	126%
Depreciation & amortisation	\$m	(4.8)	(1.9)	(4.7)	(5.0)	(5.0)	Fully diluted EPS	c/sh	0.9	(6.1)	1.2	2.2	5.0
EBIT	\$m	(1.1)	(33.7)	8.8	15.1	34.2	Full diluted EPS growth	%	-85%	na	na	83%	126%
Net interest expense/income	\$m	(0.4)	(1.0)	(0.9)	(0.7)	0.3	PER	x	29.4x	na	23.0x	12.6x	5.6x
PBT	\$m	(1.5)	(34.7)	7.9	14.5	34.4	DPS	c/sh	-	-	-	-	1
Tax expense	\$m	1.7	10.5	(2.6)	(4.8)	(12.6)	Franking	%	0%	0%	0%	0%	0%
Minority interests	\$m	(1.3)	(3.6)	0.8	1.4	3.3	Yield	%	0%	0%	0%	0%	4%
Reported NPAT	\$m	1.5	(20.6)	4.5	8.2	18.6	FCF/share	c/sh	na	na	na	2	7
Net Adjustments	\$m	0.0	15.8	0.0	0.0	0.0	P/CFPS	x	na	na	na	12.6x	4.0x
Normalised NPAT	\$m	1.5	(4.8)	4.5	8.2	18.6	EV/EBITDA	x	27.7x	na	7.6x	5.1x	2.6x
CASH FLOW							PROFITABILITY						
Year ending 30 Jun	Unit	2013a	2014a	2015e	2016e	2017e	EBITDA margin	%	15%	na	31%	37%	47%
OPERATING CASHFLOW							EBIT margin	%	-4%	na	20%	28%	41%
Receipts	\$m	16.6	3.8	39.6	54.5	80.5	Return on assets	%	2%	na	5%	8%	16%
Payments	\$m	(21.5)	(13.5)	(29.6)	(33.8)	(41.9)	Return on equity	%	2%	-29%	6%	10%	20%
Tax	\$m	(7.8)	3.0	(0.6)	0.1	(4.8)	LIQUIDITY & LEVERAGE						
Net interest	\$m	(0.0)	(0.9)	(0.9)	(0.7)	0.3	Net debt / (cash)	\$m	10.6	4.5	6.2	(1.6)	(26.5)
Other	\$m	0.3	1.7	0.0	0.0	0.0	ND / E	%	15%	6%	8%	-2%	-25%
Operating cash flow	\$m	(12.4)	(6.0)	8.5	20.1	34.1	ND / (ND + E)	%	13%	6%	8%	-2%	-34%
INVESTING CASHFLOW							EBITDA / Interest	x	9.1	-33.1	15.1	30.1	na
Capex	\$m	(1.4)	(0.4)	(1.2)	(1.3)	(1.3)	ASSUMPTIONS - Production & costs						
Investments	\$m	0.0	0.0	0.0	0.0	0.0	Year ending 30 Jun	Unit	2013a	2014a	2015e	2016e	2017e
Intangible assets	\$m	0.0	0.0	0.0	0.0	0.0	Gold production						
Exploration & evaluation	\$m	(3.1)	(1.8)	(3.0)	(3.5)	(4.0)	Talang Santo Au Eq	koz	0	2	32	40	58
Mine development	\$m	(9.8)	(7.4)	(6.0)	(7.5)	(4.0)	Way Linggo Au Eq	koz	11				
Other	\$m	(0.0)	(0.1)	0.0	0.0	0.0	Total Au Eq	koz	11	2	32	40	58
Investing cash flow	\$m	(14.3)	(9.7)	(10.2)	(12.3)	(9.3)	C1 cash costs (net of Ag credits)						
Free cash flow	\$m	(26.7)	(15.7)	(1.7)	7.8	24.8	Talang Santo	A\$/oz			629	561	487
FINANCING CASHFLOW							Way Linggo	A\$/oz	1,155				
Share issues/(buy-backs)	\$m	0.0	23.3	0.0	0.0	0.0	Group C1 cash costs	A\$/oz	1,155	na	629	561	487
Debt proceeds/(repayments)	\$m	9.8	0.0	0.0	(6.6)	(4.5)	Group all in sustaining costs	A\$/oz	na	na	994	891	773
Dividends	\$m	(12.6)	0.0	0.0	0.0	0.0	ASSUMPTIONS - Prices (nominal)						
Other	\$m	0.6	(1.9)	0.0	0.0	0.0	Year ending 30 Jun	Unit	2013a	2014a	2015e	2016e	LT-real
Financing cash flow	\$m	(2.2)	21.4	-	(6.6)	(4.5)	Gold						
Change in cash	\$m	(28.8)	5.7	(1.7)	1.2	20.3	At spot	US\$/oz	1,605	1,295	1,208	1,175	1,100
BALANCE SHEET							Realised	A\$/oz	1,559	1,408	1,421	1,469	1,294
Year ending 30 Jun	Unit	2013a	2014a	2015e	2016e	2017e	Silver						
ASSETS							At spot	US\$/oz	29	20	17	16	14
Cash & deposits	\$m	1.3	6.7	5.0	6.2	26.5	Realised	A\$/oz	28	22	20	20	16
Accounts receivable	\$m	5.5	5.4	9.4	9.7	11.8	Currency						
Inventory	\$m	3.6	3.1	3.1	3.1	3.1	\$/US/\$A	US\$/A\$	1.03	0.92	0.85	0.80	0.85
Property, plant & equipment	\$m	9.8	8.1	8.2	8.2	8.3	Valuation						
Exploration & evaluation assets	\$m	20.5	21.6	24.1	27.0	30.0	Issued capital						
Mine development assets	\$m	39.1	26.2	28.8	33.0	33.0	Shares on issue					358.6	
Investments and other assets	\$m	8.2	15.3	15.3	15.1	15.5	Options					16.3	
Total assets	\$m	88.0	86.5	93.9	102.4	128.3	Total diluted shares on issue						
LIABILITIES												374.9	
Accounts payable	\$m	3.9	2.8	2.8	3.0	3.6	Now		+12 months		+24 months		
Borrowings	\$m	11.9	11.1	11.1	4.5	-	DCF sum-of-parts valuation	A\$m	\$/sh	A\$m	\$/sh	A\$m	\$/sh
Other	\$m	2.5	1.8	4.2	9.1	20.7	Talang Santo mine	69	0.19	77	0.21	77	0.22
Total liabilities	\$m	18.4	15.8	18.1	16.7	24.3	Way Linggo mine	48	0.13	48	0.13	48	0.13
SHAREHOLDER'S EQUITY							Exploration	56	0.16	56	0.16	56	0.16
Share capital	\$m	62.8	84.9	84.9	84.9	84.9	Corporate	(17)	(0.05)	(15)	(0.04)	(12)	(0.03)
Reserves	\$m	2.1	3.4	3.4	3.4	3.4	Total enterprise value	156	0.43	166	0.46	169	0.47
Retained earnings	\$m	1.8	(18.6)	(14.1)	(5.9)	9.1	Net cash/(debt)	(3)	(0.01)	(6)	(0.02)	2	0.00
Total equity	\$m	69.6	70.7	76.0	85.6	103.9	Equity value	153	0.43	160	0.45	171	0.48
Weighted average shares	m	290.8	325.3	358.6	358.6	358.6							

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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