

# Aquila Resources (AQA)

Unlocking longer term value

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## Recommendation

**Buy**

### Price

**\$8.96**

**Target (12 months)**

**\$11.40**

AQA is an emerging producer of coking coal, iron ore and manganese, the key suite of steel making raw materials. It has the potential to become the 4<sup>th</sup> largest producer of this commodity mix behind Vale, BHP and Anglo. Baosteel has recognised the value of the portfolio with a 15% strategic stake. With such extensive optionality the potential for positive outcomes is large and we upgrade to a Buy rating.

## Expected Return

Capital growth **27%**

Dividend yield **0%**

Total expected return **27%**

## Company Data & Ratios

Enterprise value **\$2,625m**

Market cap **\$2,893m**

Issued capital **322m**

Free float **44.9%**

12 month price range  
**\$6.01-11.38**

GICS sector  
**Materials**

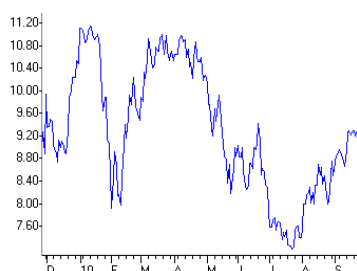
## High quality assets adjacent to the majors

AQA has a highly attractive portfolio of assets in world class provinces; coking coal in the Bowen Basin, iron ore in the Pilbara, and manganese near the Kalahari manganese field. In most cases these assets are adjacent to existing producers of high value scarce products. The highest priority projects could be sufficient to support equity production of up to 18.6Mtpa of iron ore, 5Mtpa of coking coal, and 0.74Mtpa of manganese. Baosteel could assist with funding and off-take, and may invest further at the project level.

## Recognising the value of the portfolio

With only one asset in production, significant earnings are at least 5 years away, and the growth projects are still subject to timing, execution and infrastructure risks. However we believe the risks are more than priced in, and the opportunities and optionality outweigh those risks. In this report we investigate steps AQA might take to unlock value in the stock, any of which might kick-start a re-rating. Our price target is \$11.40 and we have upgraded to Buy (from Accumulate) recognising the potential for positive surprise as asset negotiations and development decisions take place.

## Absolute Price



## Earnings Forecast

Year end June	2010a	2011e	2012e	2013e
NPAT (reported) (A\$m)	-37.6	9.5	4.9	198.4
NPAT (adjusted) (A\$m)	-33.1	9.5	4.9	198.4
EPS (adjusted) (cps)	-11.7	2.8	1.4	58.0
EPS growth (%)	na	1.2	-0.5	39.5
PER (x)	na	320.8	625.5	15.5
P/CFPS (x)	na	41.3	61.8	13.8
EV/EBITDA (x)	na	403.6	161.2	13.2
Dividend (¢ps)	0.0	0.0	0.0	0.0
Yield (%)	0.0	0.0	0.0	0.0
ROE (%)	-9.3	2.2	1.1	30.6

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

# The right commodities in the right places

Aquila has projects in existing world class provinces: coking coal in the Bowen Basin, iron ore in the Pilbara, and manganese near the Kalahari Basin. In most cases deposits are close to those of existing producers and global majors, and in some cases they are right next door.

## Potential for 5mtpa Bowen Basin coal

64% of the world's seaborne coking coal comes from the Bowen Basin (Figure 1). Here, AQA has accumulated tenements close to those of existing producers and global majors. AQA has projects next to BMA's Peak Downs and Goonyella Riverside, producers of the world's premium brands.

### ISAAC PLAINS (AQA/VALE 50/50) – CENTRAL BOWEN BASIN

Isaac Plains is located to the east of Moranbah, right in the centre of the Bowen Basin coal mining district. The mine produces a mix of thermal, PCI, and semi-hard coking coal. This is not a premium mix, but as an opencut, was relatively easy to get into production, and is ramping up to full capacity (AQA 1.4Mtpa).

### EAGLE DOWNS (AQA/VALE 50/50) – DOWN DIP OF PEAK DOWNS

Eagle Downs is located immediately adjacent to and down dip of BMA's Peak Downs. Peak Downs is a large open pit operation producing high quality hard coking coal, one of BMA's premium brands. Eagle Downs would mine the same coal measures, but at costs marginally above those that can be achieved by BMA as Peak Downs also increases in depth.

### BELVEDERE (VALE/AQA/AMCI 51/24.5/24.5) DOWN DIP OF DAWSON

Belvedere is located to the north of Moura in the Southern Bowen Basin immediately adjacent to and down dip of Anglo American Metallurgical Coal's Dawson Mine. Dawson is an open cut mine with potential to produce 12Mtpa of coking, soft coking and thermal coal. AQA/Vale would be mining the same coal measures, although by more expensive underground mining methods.

### WASHPOOL (AQA 100%) – NEAR CURRAGH

Washpool is located to the north west of Blackwater, and is close to Curragh (WES). Curragh produces low ash hard coking coal and PCI coal for export, and high ash thermal coal which is sold to a domestic power station. Washpool would produce a higher ash coking coal with good coking properties.

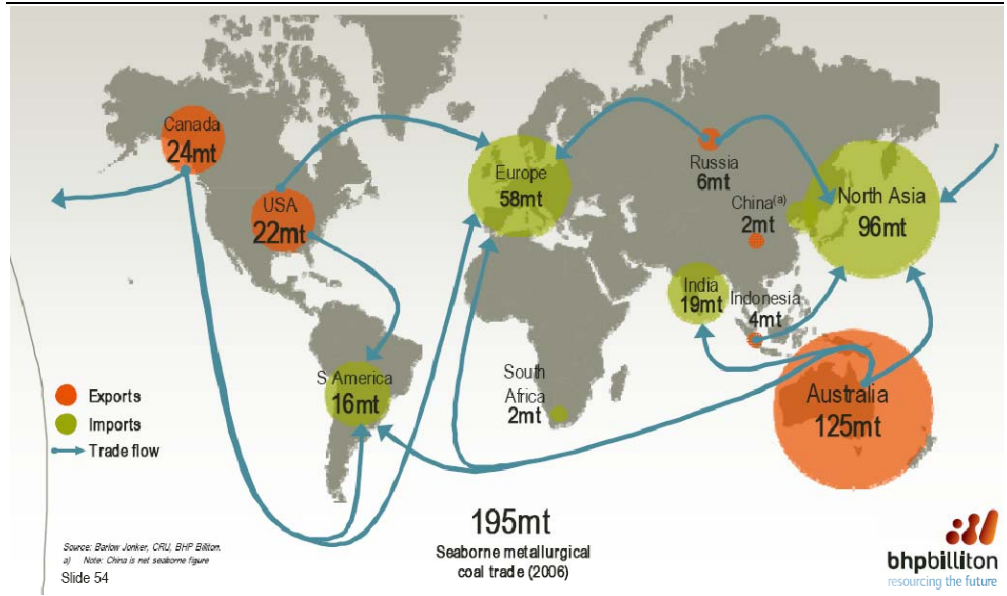
### RED HILL (AQA 100%) – ADJACENT TO GOONYELLA

Red Hill is located to the north of Moranbah and is adjacent to Goonyella Riverside, operated by BMA. This is one of the largest open cut operations in Australia with a capacity of 15Mtpa and produces high quality coking coal, another of BMA's premium brands. Burton open-cut mine owned by Peabody Energy Australia Coal Pty Ltd is also close-by, and produces medium volatile hard and semi-hard coking and thermal coal.

### NUMEROUS OTHER TENEMENTS (AQA 50% OR 100%)

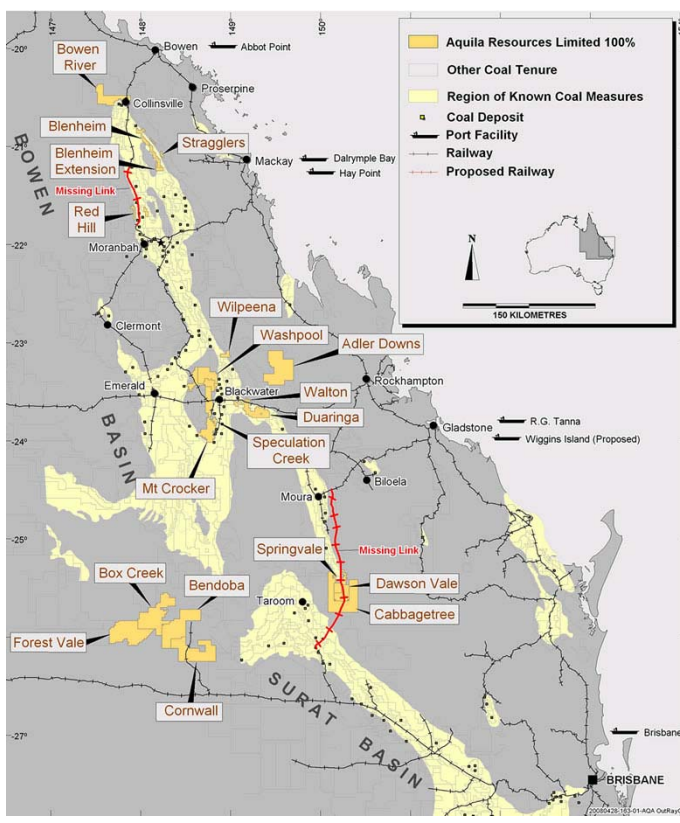
AQA has many more tenements, but with priority being given to the projects above, there has been little exploration. These are shown in Figure 2. It is likely that some tenements considered to be non-core, could be sold to fund higher value projects.

Figure 1 – Bowen Basin – Home of coking coal



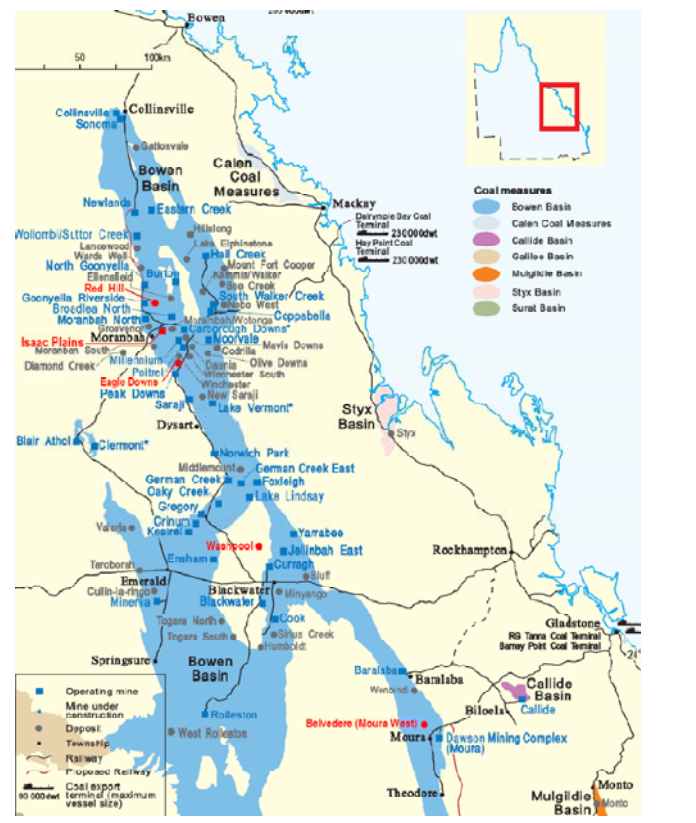
SOURCE: BHP BILLITON 2008

Figure 2 – AQA 100% tenements, in addition to 3 projects with Vale



SOURCE: COMPANY DATA

Figure 3 – AQA projects next to other Bowen Basin mines



SOURCE: COMPANY DATA

## The new force in the Pilbara

### LARGE TENEMENT HOLDING VIA API (AQA 50%, AMCI 50%)

The Pilbara region of Western Australia is one of the premier iron ore provinces globally for both its vast metal endowment and location close to the Asian market. BHP, RIO, and FMG, three of the four largest iron ore producers, export from the Pilbara. AQA has a large tenement landholding in the province through the Australian Premium Iron JV (API), in which AQA has a 50% interest. API holds approximately 9,350km<sup>2</sup>.

API is currently developing Stage 1 (30Mtpa 100%) of the Project, which is based initially on pisolite (channel iron) ore deposits located 30 to 85 km south west of Pannawonica (Robe River, RIO).

The East Pilbara projects are located between Paraburdoo (Hamersley, RIO), Tom Price (RIO) and Newman (BHP) areas. The tenements are believed to be prospective for Marra Mamba and Brockman Iron Formations. The Hardey deposit could support additional production of 10Mtpa of BID (bedded iron).

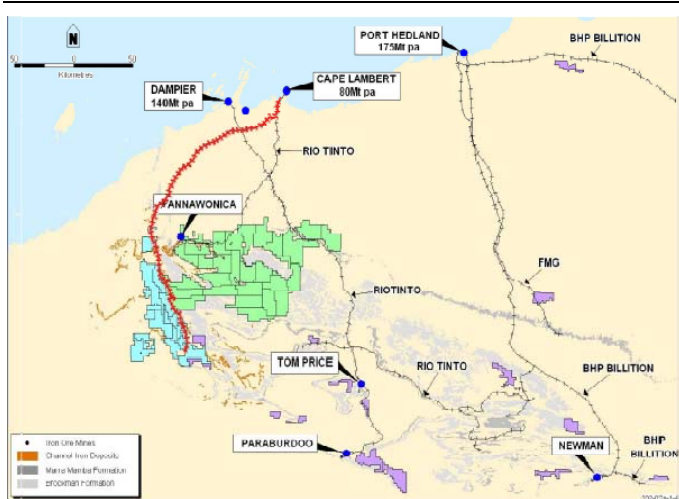
### ANKETELL POINT PORT WILL OPEN UP THE WEST PILBARA

API's WPIOP (West Pilbara Iron Ore Project) is proposing a fourth port for the Pilbara, in addition to Port Hedland (BHP, FMG + independents), Cape Lambert and Dampier (RIO). Whilst the port at Anketell Point has an initial design capacity for up to 30Mtpa to accommodate API's projects, provision has been made to allow for the progressive expansion of the facilities for other users, up to 350Mtpa of export capacity. FMG plans to use the port for up to 200Mtpa for the Solomon project and the Western Hub. China Metallurgical may use it for its 15 Mtpa Cape Lambert Project.

The port was approved by the WA government on March 5 2010, and the next step is for government and environmental approvals to be received in the middle of 2011, followed by two years of construction, with production expected late in 2013.

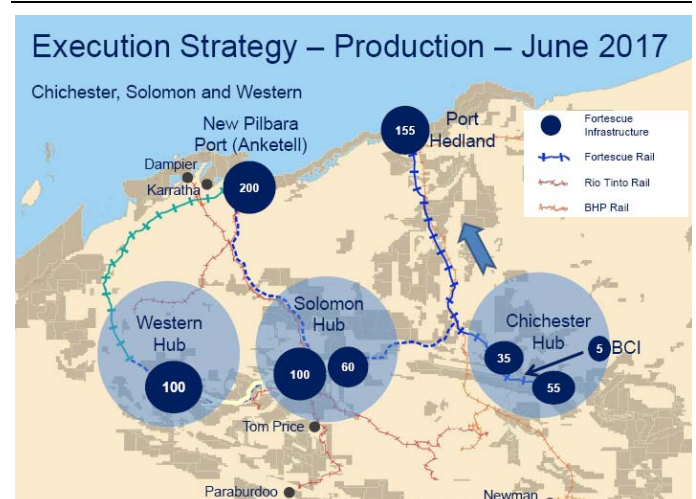
The benefit of this project is that it offers API the opportunity to manage its own infrastructure. Baosteel is likely to support the project as it opens up a major new port to increase supply. Funding is unlikely to be a major issue with the support of the China Development Bank (see Page 7).

Figure 4 – Proposed port and rail for API



SOURCE: COMPANY

Figure 5 – Proposed port and rail for FMG



SOURCE: FMG

### High grade iron ore adjacent adjacent to Kumba

The Meletse deposit close to the town of Thabazimbi, is adjacent to an existing Kumba mine. There is potential for a 2-3Mtpa operation which could be sold to domestic or export customers. As the Kumba mine is nearly exhausted, Meletse could replace this feed to a domestic customer.

### High grade manganese near the Kalahari Basin

Figure 6: Avontuur near Kalahari Basin



Source: COMPANY

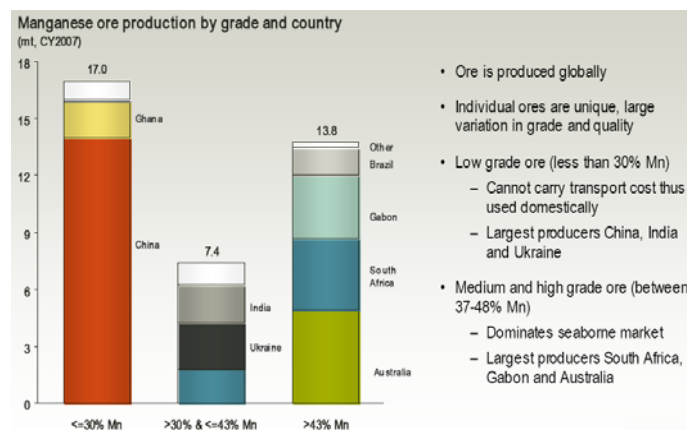
AQA's 74% owned Avontuur Manganese project is just north of the Kalahari Basin in South Africa. The majority of the world's high grade manganese comes from Australia, the Kalahari Basin, Gabon (Eramet) and Brazil (Vale).

The Avontuur resource is 67Mt @ 39.3% Mn which would be considered medium to high grade. There are two separate resources 25km apart, with one only 20km north of Samancor's Wessels mine. The larger of the two is the Gravenhage resource at 64.9Mt @ 39.1% Mn, which is relatively shallow, and suitable for a 1Mtpa operation with a mine life of up to 30 years.

AQA's equity share of a 1Mtpa operation would be 0.74Mtpa, which would make it a top 6 global producer. The size, grade, and commercial potential of this resource are consistent with other producing mines in Australia and South Africa.

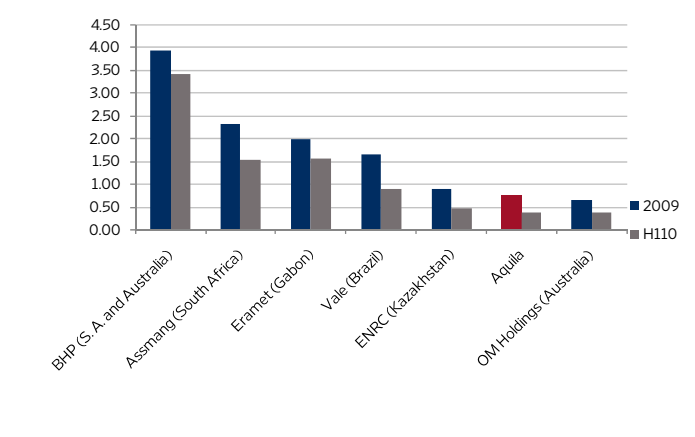
AQA is a member of a manganese producers group negotiating with Transnet for infrastructure upgrades. At this stage there are two options, using the port at Saldanha to the west or at Coega to the east. The current plan is to have access available in 2013, but given the typical delays associated with such work we are cautious about this timeline.

Figure 7 – Source of high grade manganese – Australia and S. Africa



SOURCE: BHP BILLITON 2008

Figure 8 – AQA potentially top 6 producer (Mtpa)

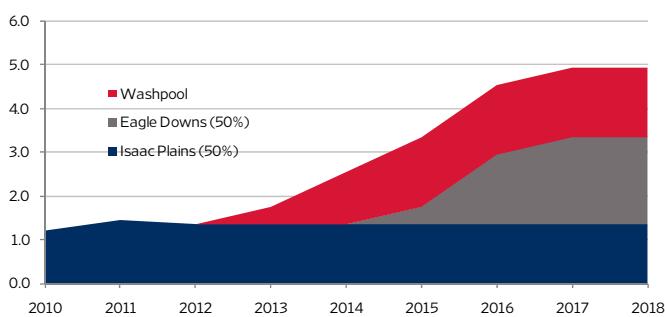


SOURCE: TEX REPORT

# Potential for a major steel make producer

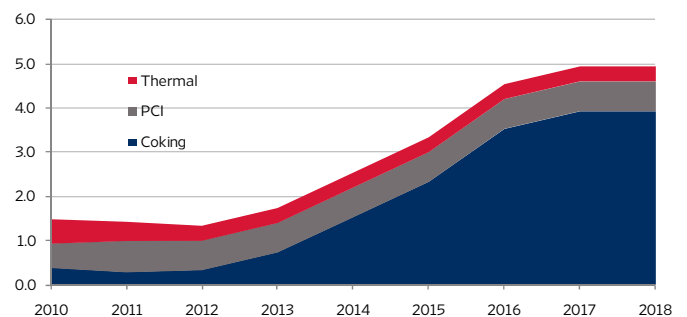
AQA has the potential to have attributable production of 5Mtpa of coal, with the majority coking coal, 18.6Mtpa of iron ore and 0.74Mtpa of manganese. We have calculated that this production level is 41Mt in iron ore equivalents using 2008 prices, number 4 behind Vale, BHP and Anglo. FMG is looking to expand beyond 95Mt of iron ore but does not have any coking coal or manganese. We do acknowledge that Figure 13 is based on 2007 production levels which have now greatly increased, but the exercise shows that AQA could become a sizable producer.

Figure 9 – Attributable coal production (Mt)



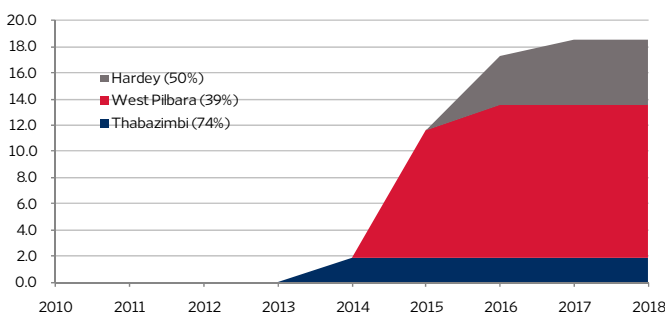
SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Figure 10 – Attributable coal production by type (Mt)



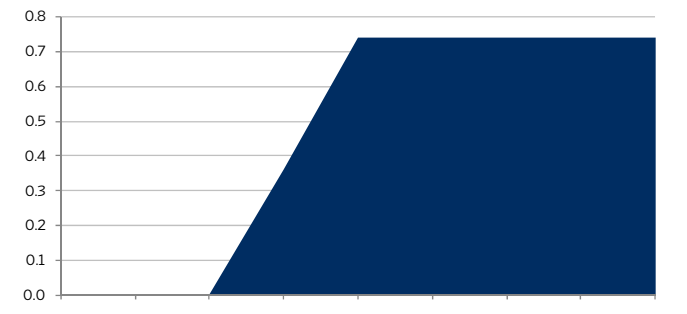
SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Figure 11 – Attributable iron ore production (Mt)



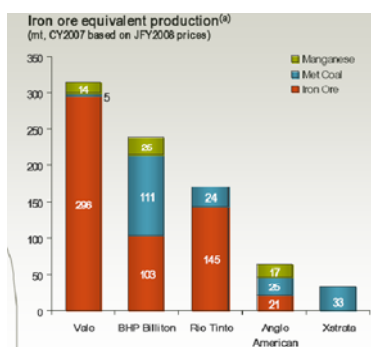
SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Figure 12 – Attributable manganese production (Mt)



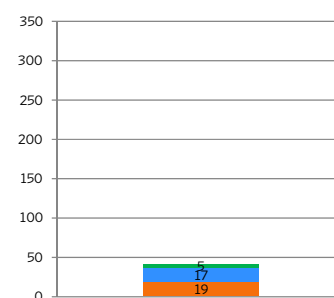
SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Figure 13 – Top steel make producers



SOURCE: BHP BILLITON ANALYSIS 2008 USING 2008 PRICES

Figure 14 – AQA production in iron ore equivalents – total 41Mt



SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES USING SAME ASSUMPTIONS AS FIGURE 13

## Supported by Baosteel and CDB

In August 2009 AQA signed a landmark deal with Baosteel, China's largest steel mill. The agreement was twofold: Baosteel took a placement at \$6.50 to raise \$285.6m and now owns 15% and has a board seat; and the two parties entered into a Memorandum of Strategic Co-operation which laid the foundations for a long term strategic alliance whereby Baosteel would support AQA to secure finance, make direct investments, and secure off-take arrangements.

In line with the alliance agreement, Baosteel has introduced AQA to China Development Bank (CDB), and these two parties now have an MOU to look for funding opportunities.

So far Baosteel has made no further direct investments at the project level, but we believe that's not due to lack of interest. Potential investments could be:

- 1 A share of API's WPIOP.
- 2 A stake in a sell down of any 100% owned coal assets, or the South African assets of Thabazimbi or Avontuur.

The involvement of Baosteel and CDB has greatly reduced the risks associated with an emerging producer, typically finance and off-take.

# Valuation suggests considerable upside

## Worth \$11.44 using DCF Valuation

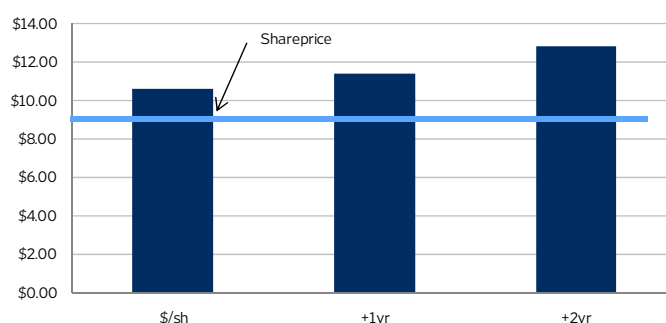
We prefer to use a DCF valuation methodology for the resource companies we cover and this is presented below for AQA. As this does not work so well for longer dated projects we have also presented some other valuation methodologies. Our valuation has fallen marginally since our last report due to higher capex assumptions.

Figure 15 - Valuation

	\$M	\$/sh	+1yr
<b>Iron Ore</b>			
West Pilbara 30Mt CID	-284	-0.83	-0.88
Hardey 10Mtpa BID	498	1.46	1.61
Port sharing	449	1.31	1.44
Infrastructure sale	193	0.57	0.62
WA Iron ore sub total	855	2.50	2.79
Thabazimbi	102	0.30	0.35
<b>Coal</b>			
Isaac Plains	335	0.98	0.91
Eagle Downs	1005	2.94	3.27
Belvedere	306	0.90	0.98
Washpool	91	0.27	0.40
<b>Manganese</b>			
Avontuur	590	1.73	1.95
<b>Other</b>			
Corporate	-134	-0.39	-0.39
Investments	27	0.08	0.08
Options	31	0.09	0.09
Cash	268	0.78	0.57
Other assets	150	0.44	0.44
<b>Total</b>	<b>3626</b>	<b>10.60</b>	<b>11.44</b>

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Figure 16 - Valuation curve



SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

## Worth \$22.83 using EV/t resource

The average EV/t of coal resource multiple is \$2.8/t across all types of coal. Some coking coal transactions have been above \$3/t. If we use an average multiple of \$2.8/t AQA's coal portfolio would be worth \$11.99/share. Belvedere alone would be worth \$1.7bn, and even if we ignore the inferred resources, it would be worth \$689m. Doing a similar exercise for iron ore using an EV/t of resource multiple of \$5/t, that portfolio would be worth \$4.73. Again, using a \$40/t value for manganese, Avontuur would be worth \$6.11. In total this comes to \$22.83/share, much greater than our DCF valuation of \$11.44/share.

## Worth \$29.60 using comparable companies

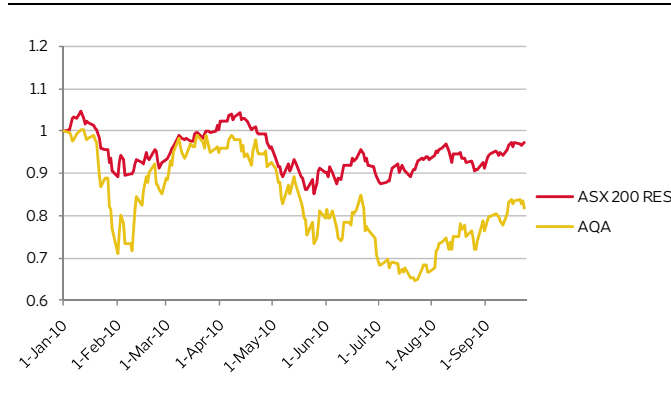
Using a crude measure of comparable companies, the potential production level for AQA in 2017 is roughly equivalent to the coal production of Macarthur Coal (market cap \$3.5bn), the manganese production of OM Holdings (market cap \$815m), and 1/3 of the iron ore production of FMG (market cap x 0.33 = \$5.2bn). This suggests a total market cap of \$9.5bn, 3.4 times AQA's current market cap.

# Unlocking the value

AQA has underperformed the ASX200 at a time where bulk prices are at record highs. It has also underperformed the peers we have identified.

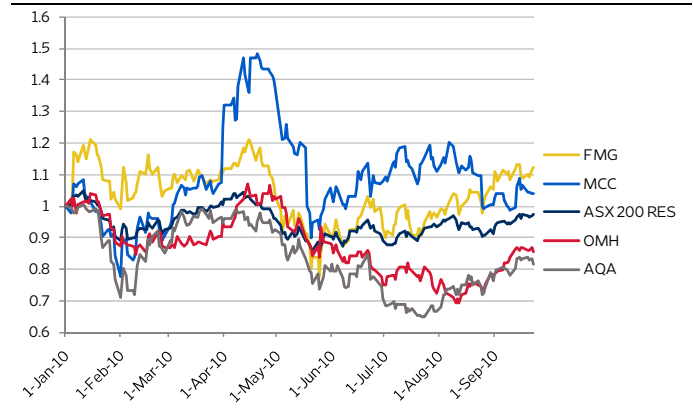
We have shown that the quality of assets is high, and the valuation is well above the current share price so we investigate why this may be, and how potentially this value may be unlocked.

Figure 17 - AQA vs ASX 200 Resources



SOURCE: IRESS

Figure 18 - AQA vs peers



SOURCE: IRESS

## A funding solution for WPIOP

The WPIOP is the most significant for AQA, with potentially the greatest value, and the biggest capex. With a capital estimate of \$5.7bn (100%), the obvious question is how could an emerging producer with minimum cash flow fund such a big project. We expect the majority of funding to be through project financing, so with the support of CDB, we do not see this as an issue. A development decision with a funding solution would be extremely favourable, and if the company sticks to the current time line, that could be some time in 2011.

With Anketell Point such a key component of FMG's growth strategy, we expect it to be working concurrently towards a funding solution.

### CONCEPTUAL FUNDING PLAN

We have developed a conceptual funding plan (Figure 20). The project cash flows are shown at the bottom and we have "filled in" the required cash from different sources at the top, sufficient to keep total cash positive.

Cash was \$281m at 30 June. The next source of cash is likely to come from the sale of the 24.5% stake in Belvedere to Vale. Thereafter we expect AQA to use majority project financing.

Another option is to sell noncore assets, of which there are several. These may include the coal assets in Botswana and South Africa, the Northern Cape Iron Ore project, and other tenements in the Bowen Basin. It may also be possible to sell small stakes in projects to potential offtake partners.

Our conceptual model includes an example of all these options. We have also assumed that AQA raises a further \$900m in equity to keep a gearing ratio below 50%. If AQA was to raise this amount today at \$8/sh, the extra 113m shares would dilute our valuation 9%.

Figure 19: Potential non-core assets



Source: COMPANY

We have assumed that the majority of funding is required in 2013/2014, as we have been conservative in the start-up time of projects. If AQA is successful in sticking to its timeline, the funding requirement may come sooner.

Other options that we have not considered are, a third party funding the port and rail for the WPIOP, or sharing part of the port costs with FMG or MCC.

**Figure 20 – Conceptual funding plan (\$m)**

	2011	2012	2013	2014	2015	2016	2017	2018
<b>Starting Cash</b>	<b>281</b>	<b>205</b>	<b>58</b>	<b>169</b>	<b>98</b>	<b>40</b>	<b>842</b>	<b>1623</b>
<b>Divestments</b>								
Belvedere - sell 24.5% to Vale	306							
Washpool - sell 50% to X		69						
Red Hill - sell 100%		50						
<b>External funding</b>								
Debt		100	900	900				
Equity			450	450				
<b>Projects</b>								
Corporate Costs	-30	-30	-30	-30	-30	-30	-30	-30
Isaac Plains 50%	54	59	56	53	43	32	30	30
Eagle Downs 50%	-10	-10	-10	-265	-231	110	137	137
Washpool 50%	-5	-125	-60	33	35	31	31	31
Thabazimbi 74%	-10	-10	-100	72	49	33	25	25
Avontuur 74%	0	-50	105	116	116	62	62	124
West Pilbara 39%	-100	-200	-1200	-1400	458	430	362	362
Hardey 50%	0	0	0	0	-500	135	163	163
<b>Ending Cash</b>	<b>205</b>	<b>58</b>	<b>169</b>	<b>98</b>	<b>40</b>	<b>842</b>	<b>1623</b>	<b>2465</b>

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

## Further exploration for WPIOP

It is necessary to explain why we have a negative valuation for such a significant project. The 30Mtpa WPIOP includes a major new infrastructure initiative, however the resources discovered to date are small relative to the size and cost of the port and rail, which results in a low return. The upside will come from finding new resources over time, and leveraging off the existing infrastructure. Initial exploration has focused on 2,570km<sup>2</sup> of tenement area, but there remains another 6,840km<sup>2</sup> which is highly prospective for both Channel Iron and Bedded Iron deposits. \$15m has been proposed for exploration activities in 2010/2011.

The 10Mtpa Hardey project which would be the next bolt-on for the WPIOP, generates a much better return as the majority of infrastructure will already be in place. There may be many more Hardeys discovered over time, but today those resources are yet to be discovered, and it is difficult to assign value to resources that don't exist, but as an example, each new Hardey could add another \$1.46 to the share price. We have given the port and rail a residual value, assuming no more resources are economic and the infrastructure still has some value.

## Potential demergers/spin-outs/sell-downs

As we have shown above, the sum of the parts valuation on a comparable company basis is quite significant. An obvious way to unlock value could be to separate the assets. There was a plan in 2008 to demerge the exploration assets into a new listed entity, Aquila Exploration Limited (AEL), with the intention of unlocking some value from the hidden assets, and create AQA mark II, but the timing was not great at the start of the GFC and the plan was scrapped. There were also thoughts of spinning off the Asenjo energy coal project in Botswana in Canada. The negative of breaking up the assets however is that each business must then become self-funding.

There are many options for splitting up the portfolio and we have suggested a few:

1. **Selling Belvedere to Vale.** Vale has already exercised the option to buy the 24.5% of the project that it does not own. The question now is the price. There was a process for determining this in the JV agreement, but now Vale is contesting AQA's use of the process. The disagreement suggests a large difference in value expectations, potentially a good sign for AQA.
2. **Listing the South African assets on the LSE or JSE.** This could include Thabazimbi, Avontuur, the Waterberg coal assets and the Asenjo energy coal project.
3. **Sell stakes in assets linked to offtake arrangements.** This could include Washpool, Thabazimbi, Avontuur.
4. **Trade other assets.** There are many other assets within the portfolio that we don't hear about including the Asenjo coal project in Botswana, the Northern Cape iron ore assets and many other Bowen Basin tenements.

### Cleaning up the joint venture structures

Most of AQA's larger projects are joint ventures. While the benefits of JVs include assistance with funding and other expertise for emerging producers, the JV structures are now complicating the way forward for AQA.

This has been highlighted today by the announcement that Vale has served a writ against AQA, contesting the valuation methodology used to arrive at an agreeable valuation for Belvedere. This adds to the disagreements between the partners with AQA having already sued Vale for delaying the Eagle Downs project by pulling out of the Abbot Point infrastructure solution. It makes sense for one party to own each of these assets but the sticking point will always be price so it's hard to see this being resolved quickly. Vale risks losing Eagle Downs at a discount if it loses the Abbot Point case, so we may yet see a change of control in this asset.

In the iron ore business the WPIOP ownership structure is a complicated web, and we have borrowed an RHI slide (Figure 22) to explain it. It would be preferable to clean up this structure. Longer term it makes sense for AQA and offtake partners including Baosteel and POSCO to own the project.

Figure 21 – JV structures

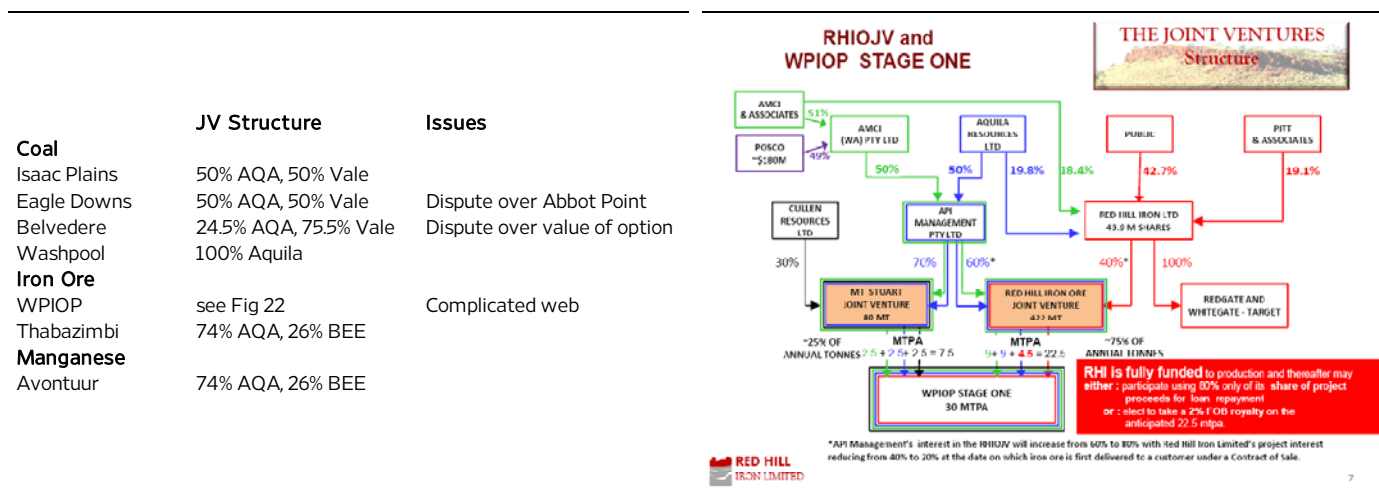
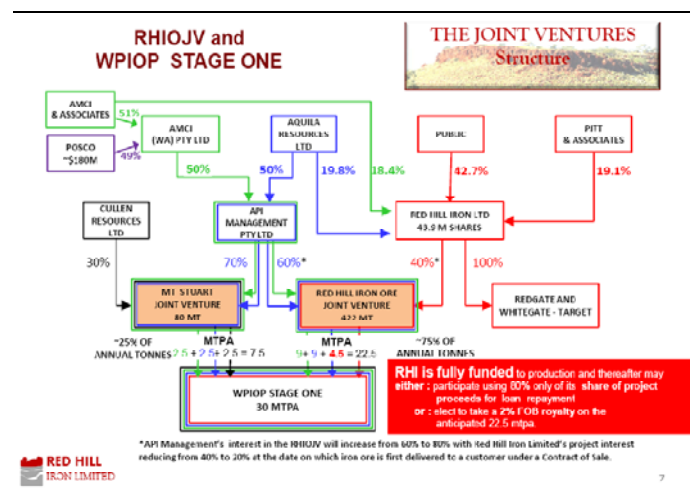


Figure 22 – WPIOP ownership



SOURCE: SOUTHERN CROSS ESTIMATES

SOURCE RHI

## Resolving infrastructure issues

### AUSTRALIAN COAL

An infrastructure solution had been arranged for each coal project, however Vale pulled out of the Northern Missing Link/Abbot Point option for the Eagle Downs project at the 11<sup>th</sup> hour in February 2010. Eagle Downs was the next major production option behind Isaac Plains, and therefore this decision pushed the longer dated production out even further.

The other options investigated since February have been:

- 3 **Abbot Point X110**, but this has since been awarded to BHP Billiton and Hancock Coal.
- 4 **DBCT Dudgeon Point**, currently due for completion in 2016
- 5 **Wiggins Island Stage 2** at Gladstone which could be ready in 2015/16, and use Barney Point for ramp-up tonnages which will be small in 2013 and 2014.
- 6 **Buy spare capacity**, there may be some unused capacity in the system but this could be costly.

At this stage the preference is for option 3 as it offers a nearer term solution.

### SOUTH AFRICAN INFRASTRUCTURE

The Meletse iron ore deposit has the options of exporting through Maputo or Richards Bay or selling domestically. Selling domestically at export parity pricing would be the best option for AQA as it would be cheaper and easier. This is a likely option as the adjacent Kumba mine which sells domestically will be depleted in the next few years.

The Avontuur manganese mine has two export options, but the solution is yet to be determined.

## Fast track projects into production ASAP

One of the issues that AQA faces is the mismatch between market cap and earnings. The market cap is nearly \$3bn, and the company is in the ASX 200, yet attributable production is only 1.4Mtpa of coal, and meaningful earnings are still 4-5 years away. It's easier said than done to fast track projects as they are all subject to lengthy approvals processes and infrastructure solutions, but its worth looking at other alternatives which may include:

1. **Doing an asset/infrastructure swap.** It may be possible to find spare capacity where there is existing infrastructure, and swap this for a share of production. Examples include:
  - a. Macarthur Coal in the Bowen Basin has spare capacity which may help Eagle Downs.
  - b. Avontuur and Thabazimi in South Africa might find some existing spare capacity.
  - c. Swap some of FMG's existing production for some early capacity at Anketell Point.
2. **Buying an asset in production**, although this is unlikely to be value accretive.

# Aquila Resources (AQA)

## Company Description

AQA is an Australian based developer of bulk commodity projects (coal, iron ore, manganese). The Isaac Plains coal mine (AQA share 1.4Mtpa) is currently ramping up, and attributable coal production should grow to 5Mtpa by 2017 through the development of the Eagle Downs and Washpool projects, all in the Bowen Basin, Queensland. AQA's 50/50 partner in Isaac Plains and Eagle Downs is Vale. AQA has a 50% interest in the API JV which is seeking to develop the West Pilbara Iron Ore Project (WPIOP), with initial production of 30Mtpa of CID product through Anketell Point near Cape Lambert. The Avontuur manganese project could produce 1Mtpa. The project pipeline enables a steep production curve to globally significant scale.

## Investment Strategy

The portfolio of iron ore, coking coal and manganese is a powerful combination as the current supply base for these steelmaking raw materials is highly concentrated. This makes AQA's assets attractive to consumers looking for independent off-take agreements or acquisitions.

The large portfolio of tenements creates the flexibility to choose higher priority targets to fast track, and potentially divest lower priority assets as a source of funding.

AQA offers a strong growth profile, independent exposure to steelmaking raw materials, potential internal funding options through divestments, and M&A potential. The growth potential should be supported by strong news flow over the next 12 months. Following recent share price weakness we have upgraded to a Buy..

## Valuation

Our 12 month valuation is \$11.44 which we use for the basis of our price target of \$11.40.

## Risks

The majority of projects are at an early stage therefore we see the development risk as high. Isaac Plains is the only source of production and cash flow currently. Other projects are in the concept to feasibility stage and higher production and related cash flows are several years away. Risks include resource definition, securing off-take agreements, access to infrastructure, and financing.

The agreements with Baosteel have greatly reduced the financing and off-take risks, however other risks specific to each deposit, and access to shared infrastructure remain.

## News flow

- Belvedere sale - imminent
- Eagle Downs BFS - mid 2011
- Avontuur feasibility study results - mid 2011
- Ongoing positive news on bulks pricing
- Sector M&A

# Aquila Resources

as at 27 September 2010

Recommendation

Buy

Price

\$8.96

Target (12 months)

\$11.40

Table 1 - Financial summary

Aquila (AQA)						Share price: \$ 8.96					
As at 27/09/2010						Market Cap: \$ 3,064					
<b>PROFIT AND LOSS</b>						<b>VALUATION DATA</b>					
<b>Y/e June 30</b>	<b>2010a</b>	<b>2011f</b>	<b>2012f</b>	<b>2013f</b>	<b>2014f</b>	<b>Y/e June 30</b>	<b>2010a</b>	<b>2011f</b>	<b>2012f</b>	<b>2013f</b>	<b>2014f</b>
Sales revenue	130	219	212	430	803	Net profit adj (\$m)	-33	9	5	198	491
EBITDA	-52	7	21	347	833	EPS (c)	-12	3	1	58	144
Depreciation	-7	-6	-19	-35	-53	EPS growth (%)	na	124%	-49%	3948%	148%
<b>EBIT</b>	<b>-59</b>	<b>2</b>	<b>2</b>	<b>313</b>	<b>780</b>	P/E ratio (x)	na	321	626	15	6
Net Interest Expense	12	12	5	-29	-79	CFPS (c)	2	22	15	65	157
Pre-tax profit	-50	14	7	283	702	Price/CF (x)	385	41	62	14	6
Tax	17	-4	-2	-85	-211	DPS (c)	0	0	0	0	0
Net Profit	-33	9	5	198	491	Yield (%)	0	0	0	0	0
Adjustments	0	0	0	0	0	Franking (%)	0	0	0	0	0
<b>SCEQ adj profit</b>	<b>-33</b>	<b>9</b>	<b>5</b>	<b>198</b>	<b>491</b>	EV/EBITDA	-54	404	161	13	7
One-off items	-5	0	0	0	0	EBITDA margin (%)	-40	3	10	81	104
<b>Reported net profit</b>	<b>-38</b>	<b>9</b>	<b>5</b>	<b>198</b>	<b>491</b>						
<b>CASHFLOW</b>						12 month valuation per share: 11.44					
<b>Y/e June 30</b>	<b>2010a</b>	<b>2011f</b>	<b>2012f</b>	<b>2013f</b>	<b>2014f</b>	<b>A\$ Target price (12 mth): 11.40</b>					
Receipts from customers	119	236	212	430	803	<b>Total Return (including yield): 27%</b>					
Payments to suppliers	-118	-170	-166	-94	24	<b>PROFITABILITY RATIOS</b>					
Net interest	6	12	5	-29	-79	<b>Y/e June 30</b>	<b>2010a</b>	<b>2011f</b>	<b>2012f</b>	<b>2013f</b>	<b>2014f</b>
Tax paid	0	-4	-2	-85	-211	EBITDA/sales (%)	-40	3	10	81	104
Other	0	0	0	0	0	EBIT/sales (%)	0	1	1	73	97
<b>Operating cashflow</b>	<b>7</b>	<b>74</b>	<b>49</b>	<b>221</b>	<b>537</b>	Return on assets (%)	-8	2	1	8	13
Capex	-5	-155	-485	-1534	-1677	Return on equity (%)	-9	2	1	31	43
Investments	0	0	0	0	1	Return on funds empl'd (%)	-27	4	1	9	13
Asset sales	0	0	0	0	0	Dividend cover (x)	0	0	0	0	0
Net	-72	0	0	0	0	Effective tax rate (%)	33	30	30	30	30
<b>Investing cashflow</b>	<b>-77</b>	<b>-155</b>	<b>-485</b>	<b>-1534</b>	<b>-1677</b>	<b>LIQUIDITY AND LEVERAGE RATIOS</b>					
Change in borrowings	-8	0	400	1300	1000	<b>Y/e June 30</b>	<b>2010a</b>	<b>2011f</b>	<b>2012f</b>	<b>2013f</b>	<b>2014f</b>
Equity raised	0	8	0	23	0	Net debt/(cash) (\$m)	-268	-194	241	1531	2671
Dividends paid	0	0	0	0	0	Net debt/equity (%)	-66	-46	57	236	234
Other	284	0	0	0	0	Net interest cover (x)	6	0	0	11	10
<b>Financing cashflow</b>	<b>277</b>	<b>8</b>	<b>400</b>	<b>1323</b>	<b>1000</b>	Current ratio (x)	10	6	5	-16	0
<b>Net change in cash</b>	<b>207</b>	<b>-74</b>	<b>-36</b>	<b>11</b>	<b>-140</b>	Inventory turnover	0	10	10	2	0
<b>Cash at end of period</b>	<b>281</b>	<b>207</b>	<b>171</b>	<b>182</b>	<b>42</b>	Inventory/sales	6	8	8	4	7
<b>BALANCE SHEET</b>						<b>VALUATION</b>					
<b>Y/e June 30</b>	<b>2010a</b>	<b>2011f</b>	<b>2012f</b>	<b>2013f</b>	<b>2014f</b>		<b>\$M</b>	<b>\$/sh</b>	<b>+1yr</b>		
Cash	281	207	171	182	42	<b>Iron Ore</b>					
Receivables	16	0	0	0	0	West Pilbara 30Mt CID	-284	-0.83	-0.88		
Inventories	8	18	17	34	64	Hardey 10Mtpa BID	498	1.46	1.61		
Investments	0	0	0	0	0	Port sharing	449	1.31	1.44		
Other	11	-3	-33	-80	-110	Infrastructure sale	193	0.57	0.62		
<b>Current assets</b>	<b>316</b>	<b>221</b>	<b>156</b>	<b>136</b>	<b>-3</b>	Thabazimbi	102	0.30	0.35		
PPE	68	218	684	2184	3808	<b>Coal</b>					
Investments	25	0	0	0	0	Isaac Plains	335	0.98	0.91		
Intangibles	0	0	0	0	0	Eagle Downs	1005	2.94	3.27		
Other	25	25	25	25	25	Belvedere	306	0.90	0.98		
<b>Non-current assets</b>	<b>132</b>	<b>256</b>	<b>723</b>	<b>2222</b>	<b>3847</b>	Washpool	91	0.27	0.40		
<b>Total assets</b>	<b>448</b>	<b>478</b>	<b>879</b>	<b>2358</b>	<b>3843</b>	Manganese					
Payables	24	36	32	-9	-16	Avontuur	590	1.73	1.95		
Debt	13	13	413	1713	2713	<b>Other</b>					
Provisions	6	6	6	6	6	Corporate	-134	-0.39	-0.39		
Other	0	0	0	0	0	Investments	27	0.08	0.08		
<b>Total liabilities</b>	<b>43</b>	<b>56</b>	<b>451</b>	<b>1710</b>	<b>2703</b>	Options	31	0.09	0.09		
Shareholders' equity	405	422	427	649	1140	Cash	268	0.78	0.57		
Minorities	0	0	0	0	0	Other assets	150	0.44	0.44		
<b>Total shareholders funds</b>	<b>405</b>	<b>422</b>	<b>427</b>	<b>649</b>	<b>1140</b>	<b>Total</b>	<b>3626</b>	<b>10.60</b>	<b>11.44</b>		
<b>Total funds employed</b>	<b>137</b>	<b>228</b>	<b>669</b>	<b>2179</b>	<b>3810</b>	<b>PRODUCTION</b>					
<b>W/A diluted shares on Issue</b>	<b>322</b>	<b>339</b>	<b>339</b>	<b>340</b>	<b>342</b>	<b>Base Case Production</b>	<b>2010a</b>	<b>2011f</b>	<b>2012f</b>	<b>2013f</b>	<b>2014f</b>
						<b>Iron Ore</b>					
						West Pilbara (Mt)	0.0	0.0	0.0	0.0	0.0
						Thabazimbi (Mt) (74%)	0.0	0.0	0.0	0.0	1.9
						<b>Coal</b>					
						Isaac Plains (50%)	1.1	1.4	1.4	1.4	1.4
						Eagle Downs (50%)	0.0	0.0	0.0	0.0	0.0
						<b>ASSUMPTIONS</b>					
						<b>Y/e June 30</b>	<b>2010a</b>	<b>2011f</b>	<b>2012f</b>	<b>2013f</b>	<b>2014f</b>
						A\$	0.88	0.93	0.88	0.81	0.75
						Iron Ore Lump (US\$/%Fe)	141	225	221	207	180
						Iron Ore Fine (US\$/%Fe)	123	195	188	175	151
						HCC (US\$/t)	151	218	213	185	168
						PCI (US\$/t)	114	188	184	160	143
						Thermal (US\$/t)	75	98	97	95	94

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

**Recommendation structure**

Spec Buy: Expect >30% total return on a 12 month view but carries significantly higher risk than its sector

Buy: Expect >15% total return on a 12 month view

Accumulate: Expect total return between 0% and +15% on a 12 month view

Reduce: Expect -15% and 0% total return on a 12 month view

Sell: Expect <-15% total return on a 12 month view

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