

# Aquila Resources (AQA.AX / AQA AU)

**INCREASE TARGET PRICE**

|                              |                               |
|------------------------------|-------------------------------|
| Rating                       | <b>UNDERPERFORM* [V]</b>      |
| Price (28 Aug 09, A\$)       | 7.15                          |
| Target price (A\$)           | (from 2.50) 7.00 <sup>†</sup> |
| Market cap. (A\$m)           | 1,780.56                      |
| Yr avg. mthly trading (A\$m) | 52                            |
| Last month's trading (A\$m)  | 142                           |
| <b>Projected return:</b>     |                               |
| Capital gain (%)             | -2.1                          |
| Gross yield (%)              | —                             |
| Total return (%)             | -2.1                          |
| 52-week price range (A\$)    | 16.20 - 2.00                  |

\* Stock ratings are relative to the relevant country benchmark.

<sup>†</sup>Target price is for 12 months.

[V] = Stock considered volatile (see Disclosure Appendix).

## Research Analysts

### Paul McTaggart

61 2 8205 4698  
paul.mctaggart@credit-suisse.com

### Matthew Cross

61 3 9280 1754  
matthew.cross@credit-suisse.com

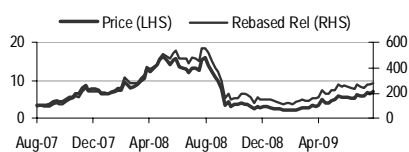
### James Gurry

61 2 8205 4779  
james.gurry@credit-suisse.com

## Taking a bow

- **Raising Target Price to \$7:** While we have been sceptical of AQA's ability to fund its grand growth ambitions, Baosteel joining AQA as a 15% shareholder and a strategic partner changes this dynamic. Our revised Target Price recognises the fact that the all-goes well valuation of \$8.20 is still subject to risk as it is inevitable - given the scale of the iron ore project and the financing required - there will be some project delays along the way.
- **AMCI and iron ore JV:** the \$286mn raised should allow AQA to purchase AMCI's interest in WPIOP assuming that the latter opts out – and this would enable Baosteel to take a direct stake in the project. Being able to get 100% ownership of this project will be key to a deal with Baosteel at the asset level and which could bring in financing. On the basis that WPIOP capex could be around A\$5bn, then if the project were financed 50% with debt, AQA would still need to find A\$1.25bn for its equity contribution.
- **Underperform rating maintained:** Our revised Target Price of \$7 is a balance between the bull and bear cases for AQA. We see the floor in the share price now as the \$6.5 that Baosteel is paying for its 15% stake. Recognising the new reality of having a valuable strategic partner (with access to large amounts of capital) our Target Price is set 15% below the 'everything turns out well' \$8.2 valuation (which essentially assigns a 100% weighting to Eagle Downs and West Pilbara projects).
- **Risk:** Remember this is subject to risk as it is inevitable - given the scale of the iron ore project and the financing required - there will be some project delays along the way. AQA is a junior miner with one project in ramp-up. We retain our Underperform rating and note that this will be one of the more interesting companies to watch over the next 12 months – and hopefully, less volatile than it has been of late.

## Share price performance



The price relative chart measures performance against the Australia S&P/ASX 200 index which closed at 4489.6 on 28/08/09

On 28/08/09 the spot exchange rate was A\$1.24/US\$1

| Performance Over | 1M   | 3M   | 12M   |
|------------------|------|------|-------|
| Absolute (%)     | 19.0 | 72.3 | -53.3 |
| Relative (%)     | 11.3 | 52.7 | -41.9 |

## Financial and valuation metrics

| Year                         | 06/08A   | 06/09E   | 06/10E   | 06/11E   |
|------------------------------|----------|----------|----------|----------|
| Production (mboe/d)          | —        | —        | —        | —        |
| Revenue (A\$m)               | 220.6    | 127.3    | 74.8     | 190.8    |
| EBITDAX (A\$m)               | 141.9    | -23.7    | 1.0      | 55.8     |
| EBIT (A\$m)                  | 137.9    | -27.4    | -2.8     | 52.2     |
| Net income (A\$m)            | 97.3     | -14.5    | 6.4      | 51.7     |
| EPS (CS adj., Ac)            | 50.08    | -5.85    | 2.39     | 17.74    |
| Change from previous EPS (%) | n.a.     | —        | 844.4    | 10.3     |
| Consensus EPS (Ac)           | n.a.     | -4.30    | 2.70     | 15.10    |
| EPS growth (%)               | n.a.     | n.a.     | n.a.     | 641.9    |
| P/E (x)                      | 14.3     | NM       | 299.0    | 40.3     |
| Dividend (Ac)                | —        | —        | —        | —        |
| Dividend yield (%)           | —        | —        | —        | —        |
| EV / EBITDAX (x)             | 11.53    | -72.16   | 1,376.23 | 24.30    |
| Net debt/equity (%)          | net cash | net cash | net cash | net cash |

Source: Company data, ASX, Credit Suisse estimates. \* Adj. for goodwill, notional interest and unusual items. Relative P/E against ASX/S&P200 based on pre GW in AUD. Company PE calculation is based on displayed EPS Currency

**DISCLOSURE APPENDIX CONTAINS ANALYST CERTIFICATIONS AND THE STATUS OF NON-US ANALYSTS. U.S. Disclosure:** Credit Suisse does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the Firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

Figure 1: Financial summary

(crucial as this also resizes chart axes)

**AQUILA RESOURCES LIMITED**

In A\$m, unless otherwise stated

Year ending 30 Jun

Share Price: A\$7.15

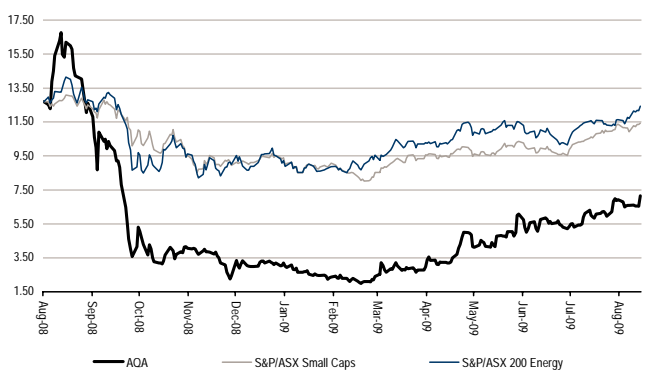
| Profit & Loss             | 2007A | 2008A  | 2009F | 2010F | 2011F |
|---------------------------|-------|--------|-------|-------|-------|
| Sales revenue             | 14.6  | 46.5   | 114.4 | 74.6  | 190.6 |
| EBITDA                    | -17.1 | 141.9  | -23.7 | 1.0   | 55.8  |
| Depr. & Amort.            | 1.1   | 4.0    | 3.7   | 3.9   | 3.6   |
| Goodwill amort.           | na    | na     | na    | na    | na    |
| EBIT                      | -18.2 | 137.9  | -27.4 | -2.8  | 52.2  |
| Equity adjustment         | na    | na     | na    | na    | na    |
| Net interest              | -1.1  | -4.3   | -5.4  | -12.0 | -21.6 |
| Profit before tax         | -17.1 | 142.3  | -22.0 | 9.2   | 73.9  |
| Income tax                | -4.6  | 45.0   | -7.5  | 2.8   | 22.2  |
| Profit after tax          | -12.5 | 97.3   | -14.5 | 6.4   | 51.7  |
| Minorities                | 0.0   | 0.0    | 0.0   | 0.0   | 0.0   |
| Net profit after tax      | -12.5 | 97.3   | -14.5 | 6.4   | 51.7  |
| Preferred dividends       | na    | na     | na    | na    | na    |
| Net profit after tax      | -12.5 | 97.3   | -14.5 | 6.4   | 51.7  |
| Unusual item after tax    | 0.0   | 0.0    | 0.0   | 0.0   | 0.0   |
| Reported profit after tax | -12.5 | 97.3   | -14.5 | 6.4   | 51.7  |
| Balance Sheet             | 2007A | 2008A  | 2009F | 2010F | 2011F |
| Cash & equivalents        | 34.2  | 159.4  | 85.2  | 378.4 | 737.1 |
| Inventories               | 3.7   | 4.5    | 5.3   | 2.0   | 6.3   |
| Receivables               | 8.6   | 11.8   | 16.5  | 6.1   | 19.5  |
| Other current assets      | 29.7  | 70.2   | 22.9  | 22.9  | 22.9  |
| Current assets            | 76.2  | 246.0  | 130.0 | 409.4 | 785.8 |
| Property, plant & equip.  | 31.2  | 38.9   | 46.0  | 42.2  | 38.6  |
| Intangibles               | 0.0   | 0.0    | 0.0   | 0.0   | 0.0   |
| Other non-current assets  | 5.9   | 7.9    | 23.3  | 23.3  | 23.3  |
| Non-current assets        | 37.2  | 46.9   | 69.3  | 65.5  | 61.9  |
| Total assets              | 113.3 | 292.8  | 199.3 | 474.9 | 847.8 |
| Payables                  | 10.3  | 15.2   | 26.1  | 9.7   | 30.8  |
| Interest bearing debt     | 20.3  | 15.3   | 12.4  | 12.4  | 312.4 |
| Other liabilities         | 4.9   | 59.6   | 20.8  | 20.8  | 20.8  |
| Total liabilities         | 35.5  | 90.1   | 59.3  | 42.8  | 364.0 |
| Net assets                | 77.9  | 202.7  | 140.0 | 432.0 | 483.7 |
| Ordinary equity           | 77.9  | 202.7  | 140.0 | 432.0 | 483.7 |
| Minority interests        | 0.0   | 0.0    | 0.0   | 0.0   | 0.0   |
| Preferred capital         | 0.0   | 0.0    | 0.0   | 0.0   | 0.0   |
| Total shareholder funds   | 77.9  | 202.7  | 140.0 | 432.0 | 483.7 |
| Cashflow                  | 2007A | 2008A  | 2009F | 2010F | 2011F |
| EBIT                      | -18.2 | 137.9  | -27.4 | -2.8  | 52.2  |
| Net interest              | 1.6   | 3.7    | 6.4   | 12.0  | 21.6  |
| Depr & Amort              | 1.1   | 4.0    | 3.7   | 3.9   | 3.6   |
| Tax paid                  | 14.0  | 0.0    | -36.5 | -2.8  | -22.2 |
| Working capital           | 9.6   | 0.8    | 5.4   | -2.7  | 3.5   |
| Other                     | -1.5  | -144.2 | 36.3  | 10.0  | 10.0  |
| Operating cashflow        | 6.6   | 2.2    | -12.1 | 17.6  | 68.7  |
| Capex                     | -16.8 | -13.2  | -10.1 | 0.0   | 0.0   |
| Acquisitions & Invest     | -1.3  | -0.1   | 0.0   | 0.0   | 0.0   |
| Asset sale proceeds       | 6.9   | 0.0    | 0.0   | 0.0   | 0.0   |
| Other                     | -10.3 | -16.2  | -63.5 | -10.0 | -10.0 |
| Investing cashflow        | -21.5 | -29.5  | -73.6 | -10.0 | -10.0 |
| Dividends paid            | 0.0   | 0.0    | 0.0   | 0.0   | 0.0   |
| Equity raised             | 0.3   | 1.5    | 2.0   | 285.6 | 0.0   |
| Net borrowings            | 0.0   | 0.0    | 0.0   | 0.0   | 0.0   |
| Other                     | 5.1   | -5.1   | -3.0  | 0.0   | 300.0 |
| Financing cashflow        | 5.5   | -3.7   | -1.0  | 285.6 | 300.0 |
| Net cashflow              | -9.4  | -31.0  | -86.7 | 293.2 | 358.7 |

| Financial Summary     |      | 2007A  | 2008A | 2009F  | 2010F  | 2011F |
|-----------------------|------|--------|-------|--------|--------|-------|
| NPAT                  | \$mn | -12.5  | 97.3  | -14.5  | 6.4    | 51.7  |
| Credit Suisse NPAT    | \$mn | -12.5  | 97.3  | -14.5  | 6.4    | 51.7  |
| Credit Suisse EPS     | c    | -6.6   | 50.1  | -5.9   | 2.4    | 17.7  |
| EPS growth            | %    | -468.0 | 854.5 | -111.7 | 140.8  | 641.9 |
| P/E                   | x    | -107.7 | 14.3  | -122.1 | 299.0  | 40.3  |
| P/Earnings Growth     | x    | na     | -0.2  | na     | 1.8    | -32.1 |
| Dividend payout ratio | %    | 0.0    | 0.0   | 0.0    | 0.0    | 0.0   |
| Dividend              | c    | 0.0    | 0.0   | 0.0    | 0.0    | 0.0   |
| Yield                 | %    | 0.0    | 0.0   | 0.0    | 0.0    | 0.0   |
| Franking              | %    | 100    | 100   | 100    | 100    | 100   |
| Operating CFPS        | c    | 3.5    | 1.1   | -4.9   | 6.5    | 23.6  |
| P/OCF                 | x    | 204.0  | 625.2 | -146.5 | 109.4  | 30.3  |
| EV/EBITDA             | x    | -96.0  | 11.5  | -69.2  | 1592.2 | 29.3  |
| FCF yield             | %    | -0.8   | -0.8  | -1.3   | 0.9    | 3.3   |

| Financial Ratios      |               | 2007A  | 2008A  | 2009F  | 2010F  | 2011F  |        |
|-----------------------|---------------|--------|--------|--------|--------|--------|--------|
| Profitability Ratios  | EBITDA margin | %      | -116.8 | 305.2  | -20.7  | 1.4    | 29.3   |
| EBIT margin           | %             | -124.7 | 296.7  | -23.9  | -3.8   | 27.4   |        |
| Return on equity      | %             | -16.1  | 48.0   | -10.3  | 1.5    | 10.7   |        |
| Return on assets      | %             | -23.0  | 103.4  | -24.0  | -2.9   | 47.2   |        |
| ROCE                  | %             | -35.5  | 225.0  | -43.5  | -4.3   | 83.6   |        |
| Effective tax rate    | %             | 26.9   | 31.6   | 34.1   | 30.0   | 30.0   |        |
| Balance Sheet Ratios  | Net debt      | \$mn   | -13.9  | -144.1 | -72.8  | -366.0 | -424.7 |
| Net debt/Equity       | %             | -17.8  | -71.1  | -52.0  | -84.7  | -87.8  |        |
| Net debt/Capital      | %             | -21.7  | -245.8 | -108.4 | -554.6 | -719.9 |        |
| Interest cover        | x             | 16.9   | -31.8  | 5.1    | 0.2    | -2.4   |        |
| Capex/Sales           | %             | -115.3 | -28.5  | -8.8   | 0.0    | 0.0    |        |
| Capex/Deprn           | %             | -14.7  | -3.3   | -2.7   | 0.0    | 0.0    |        |
| Working capital/Sales | %             | 65.4   | 1.8    | 4.7    | -3.6   | 1.8    |        |

| Share Items              |    | 2007A | 2008A | 2009F | 2010F | 2011F |
|--------------------------|----|-------|-------|-------|-------|-------|
| Equiv. FPO (period avg.) | mn | 189   | 194   | 247   | 269   | 291   |

Share Price Performance 52 week range: \$2.00 - \$16.75



Source: ASX

Share price as of 28 Aug 09, 20:25 AET

Source: Company data, Credit Suisse estimates

# Taking a bow

## The Baosteel deal

Aquila Resources has announced a strategic co-operation deal with China's largest steelmill, Baosteel Group, via a proposed \$286mn placement for 15% of AQA shares at \$6.50/share. AQA advises that the share placement will be carried out in two tranches. The first placement of 34.25mn shares is not subject to shareholder approval (and would take Baosteel to ~12%) and the second of 9.7mn shares will require shareholder approval.

AQA's new strategic partner is China's largest steel mill.

### Key details:

- Two agreements signed, Strategic Co-operation as well as the share Subscription Agreement.
- Share placement at \$6.50 (slightly below last trade of \$6.55) for 43.95mn shares (15% of total).
- Vice President of Baosteel to join AQA board.
- Deal subject to FIRB approvals (and China regulatory approvals also).
- Shareholder meeting to be held to approve the 9.7mn share placement.
- Standstill agreement preventing Baosteel going past 19.99% until August 2010 with an anti-dilution agreement until August 2010.
- Lock-up agreement where Baosteel is not to sell any of its interest in AQA before Aug-2010 (subject to some conditions).
- \$2.85mn break fee (payable if a third party makes an offer for AQA that receives approval from the directors).
- Non-shop provisions prior to the placement so that no other party can go past 4.99% before the placement is finalised (excludes direct takeover approach from a third party).
- Baosteel will have a preferential opportunity to directly invest in and co-develop most of AQA's projects (this gives Baosteel a period of exclusive due diligence up to August 2010).
- Baosteel will work with AQA to assist in sourcing low cost financing from Chinese institutions for a number of these projects (including the Pilbara iron ore project).
- AQA and Baosteel will work towards establishing a joint sales arrangement for its products into PRC and raw material off-take agreements.

Placement priced in line with last traded price \$6.50.

No shop provision to discourage other 'friendly' parties stepping forward between now and the date of placement.

**FIRB probably not an issue at this stage.** We do not expect the FIRB to have an issue with this transaction as it is a minority stake and will support project development in coal and iron ore. In the event that Baosteel would look to take control of AQA (or increase its stake materially) at some later stage, FIRB concerns might come into play again.

We do not see FIRB standing in the way of this placement...but different story if full control sought later.

**It boils down to two key projects...**

That said, AQA is not a near-term earnings story as its only producing asset is the 1.4mt Isaac Plains coal mine. The AQA story is all about delivery on its project pipeline and this deal will certainly help. The two key growth projects are Eagle Downs (hard coking coal) and the West Pilbara iron ore project.

**Isaac Plains (50%).** 1.4mtpa targeted production of 50% PCI/25% semi-hard coking/25% thermal coal in the Bowen Basin, Queensland. Isaac Plains is in ramp-up and is owned 50% by Vale.

**Eagle Downs (50%)** will have an installed capacity of 4mtpa (u/ground, single longwall) from 2012 on the proposed timeline (Aquila's share is 50%, Vale 50%). Management's forecast production for the first two years (2012 and 2013) is less than 0.5mtpa, or around 12% of capacity. The slow ramp-up is due to insufficient port capacity allocation at Abbot Point. The infrastructure constraints will be relieved with completion of the Stage 3 expansion of Abbot Point due, perhaps, in 2014-2015. Aquila estimates its share of the stage 1 capex for Eagle Downs will be around A\$450mn. Management is also investigating Stage 2 (second longwall), which would increase capacity to 8mtpa from 2016-2017 at a cost to AQA of ~ \$200mn. In August AQA announced the Feasibility Study had confirmed both the technical and financial viability of the project.

**West Pilbara Iron Ore Project (WPIOP) (50%).** Aquila has an iron ore footprint of around 10,000km<sup>2</sup> of tenements in the Pilbara. AQA accesses these tenements through its 50% interest in the Australian Premium Iron Joint Venture (the other 50% is owned by AMCI) which has around an 80% interest in the various iron ore tenements. WPIOP has a JORC resources of 493mt at an average Fe grade of ~57%. A pre-feasibility study completed last year confirmed the viability of a 25mtpa operation based on new rail and port infrastructure at Anketell Point, with first production targeted for 2012. A definitive feasibility study is expected to be completed in April 2010. Capex for the 25mtpa base case was estimated at A\$4.15 billion, including EPCM, contingency and owners' costs and \$1.8bn of new port and rail infrastructure. AQA's share of capex would be 50%, around \$2.1 billion. These capex estimates will be updated with the completion of the feasibility work and will probably be revised upwards.

Belvedere (24.5%). AQA had intended to fund WPIOP, in part, by selling its 24.5% stake in the Belvedere coking coal project and the remaining 50% with project debt. Belvedere has a resource of 3.9 billion tonnes of high quality hard coking coal, making Aquila's share 950mt. Vale owns 51% of Belvedere having purchased its share from AMCI and Aquila (24.5% each) in 2005 for US\$95mn. Vale has the right to buy Aquila's stake during a window that opens December 2009 and closes March 2010. It is a strange deal as Vale needs to state whether it wishes to exercise its purchase option and then an independent expert will determine the price - after which Aquila is able to sell the stake to a third party. Vale has an open ended pre-emptive right to buy AMCI's 24.5% stake in the project. Belvedere aims to use Wiggins Island as an export port, and we think the project will be severely infrastructure constrained until at least 2015. We have put a value of A\$190mn on Aquila's 24.5% share of the Belvedere project - well short of the equity funding required for the WPIOP project. Not surprisingly, the Belvedere project is not listed within the assets contemplated to form part of the Baosteel Strategic Co-operation.

WPIOP iron ore will work for Baosteel and other Chinese steel mills...

Based on the measured resource for the West Pilbara channel iron deposits (CID), the chemical characteristics seem to lie midway between BHP Billiton's Yandi and Rio Tinto's Robe River mines, except for alumina which is higher. However, the alumina content is lower than the 4% maximum in the *Metal Bulletin* iron ore index, so is not out of step, but no steel mill runs on feed from a single source. Iron ore is about blending rather than grade and the sintering characteristics are of equal importance to the chemistry. The trick is to create a suitable blend.

China seems the most likely market for such an ore. China's domestic iron ore is typically very fine-grained magnetite concentrate that is not ideal for sintering. The Pilbara CIDs on the other hand are known for excellent sintering characteristics that can greatly improve plant productivity.

## Dealing with AMCI

We understand that AMCI is considering a sale of its interest in WPIOP and AQA has a pre-emptive right. We think that AQA would certainly want to acquire AMCI's 50% if the price was suitable as this would give it control of the project – particularly given Baosteel's expressed interest in taking direct investments in AQA projects. However, it is not clear that any bidder for AMCI's 50% stake would be willing to make AMCI an offer knowing that AQA has a pre-emptive.

AMCI and AQA have had a less than smooth relationship over the WPIOP project and if AMCI stays in, the year ahead will be challenging as the capital commitments start to rise (with a capex budget of \$80-90m in FY10). AQA expects that a decision to proceed with WPIOP can be taken in mid CY10 and if AMCI chooses not to participate, then AQA can purchase AMCI's 50% interest at a fair value price to be determined by an independent expert. The timing ties in with the Baosteel Strategic Co-operation.

## Share deal helps funding requirements

Management had earlier intended to fund its A\$450m share of Eagle Downs capex 50% with internally generated cash flows and 50% project finance using Isaac Plains as collateral. We reckoned that Aquila would need cash of A\$225m on the balance sheet by mid to late CY2010 for this to be viable. Certainly, the A\$286m placement by Baosteel ensures the funds will be available and we are forecasting a cash balance in at 30 June 2010 of A\$372mn.

In addition, the cash raised should allow AQA to purchase AMCI's interest in WPIOP assuming that the latter opts out – and this would enable Baosteel to take a direct stake in the project.

Clearly, there will be much larger funding requirements given the scale of the WPIOP project. However, being able to get 100% ownership of this project will be key to a deal with Baosteel at the asset level and which could bring in financing. On the basis that WPIOP capex could be around A\$5bn, then if the project were financed 50% with debt, AQA would still need to find A\$1.25bn for its share of the equity.

## Blue sky

### Baosteel is 69% confident

AQA has always been a pretty difficult company to value given the uncertainties around project viability and funding. The fact that Baosteel has agreed to pay A\$6.50/share gives us a means of imputing the probability factors that Baosteel might be assigning. We have taken our base case valuation and weighted Isaac Plains at 100% (it is in ramp-up), valued the Belvedere interest at A\$189mn and adjusted the weightings on Eagle Downs and WIOP until we get our DCF valuation to match the price being paid by Baosteel (\$6.50). We would have to assign probability weightings of 69% to Eagle Downs and WPIOP to get to \$6.50 – and this is probably not unreasonable if you as the investor can guarantee a good portion of the off-take.

**Figure 2: DCF valuation based on Baosteel \$6.5/share entry price**

| Year End June 30                  | Weighting  | NPV A\$m     | A\$/sh      |
|-----------------------------------|------------|--------------|-------------|
| Isaac Plains valuation            | 100%       | 421          | 1.44        |
| Eagle Downs valuation             | <b>69%</b> | 342          | 1.17        |
| West Pilbara Iron Ore valuation   | <b>69%</b> | 753          | 2.59        |
| Belvedere valuation               | 20%        | 189          | 0.65        |
| Value of operating assets         |            | 1,706        | 5.85        |
| Corporate costs valuation         | 100%       | (95)         | (0.33)      |
| Exploration expenditure valuation | 100%       | (68)         | (0.23)      |
| (Net debt)/ cash, 31 Dec 2008     | 100%       | 358          | 1.23        |
| <b>Net asset value - DCF</b>      |            | <b>1,901</b> | <b>6.52</b> |

Source: Credit Suisse estimates

### What if Baosteel was 100% confident?

Using this same approach and assuming that Baosteel was to assign 100% weightings to the valuations of both Eagle Downs and WPIOP, then our DCF valuation would increase to A\$8.20/shr.

**Figure 3: The 'everything goes well' DCF valuation for AQA...**

| Year End June 30                  | Weighting   | NPV A\$m     | A\$/sh      |
|-----------------------------------|-------------|--------------|-------------|
| Isaac Plains valuation            | 100%        | 421          | 1.44        |
| Eagle Downs valuation             | <b>100%</b> | 496          | 1.70        |
| West Pilbara Iron Ore valuation   | <b>100%</b> | 1,092        | 3.75        |
| Belvedere valuation               | 20%         | 189          | 0.65        |
| Value of operating assets         |             | 2,198        | 7.54        |
| Corporate costs valuation         | 100%        | (95)         | (0.33)      |
| Exploration expenditure valuation | 100%        | (68)         | (0.23)      |
| (Net debt)/ cash, 31 Dec 2008     | 100%        | 358          | 1.23        |
| <b>Net asset value - DCF</b>      |             | <b>2,393</b> | <b>8.21</b> |

Source: Credit Suisse estimates

### Do not rule out further capital raisings

However, it is a dual edged sword as this approach imputes a valuation of A\$750mn for AQA's interest in WPIOP – and no doubt that the independent expert who may have to value this stake for AMCI will take note of the valuation implied by the share price. \$450mn capex for Eagle downs, \$750mn to buy out AMCI, \$1.25bn for the equity component of WPIOP – it all adds up.

## Does Baosteel remove the possibility of takeout, or is AQA in play?

While the Baosteel deal is an unambiguous positive insofar as the development of AQA's key projects is concerned, it also means that AQA is becoming less attractive as a takeover target to any prospective acquirer. Would a larger mining house want to acquire a company with a large cornerstone shareholder who might be an unlikely seller? Would Baosteel ever be allowed to take control of AQA?

For us the Baosteel deal is both a positive and a negative. The deal may well be the catalyst which enables the AQA projects to move ahead in a timeframe that would have otherwise been unachievable. However, it also probably precludes a takeover offer from another mining house unless a deal could be struck with Baosteel as to a direct asset purchase.

However, it is also worth noting that if any other mining house had been looking at AQA (and we are not aware of any), there is a rather small window of opportunity. Baosteel now has 12% of AQA and the standstill agreement holds Baosteel to 19.99% for 12 months with some exceptions (including if there is a party control transaction). The second tranche of shares does not get issued to Baosteel until the shareholders meeting approves so, in theory, if someone has been looking, they had best act now! That said, we think this unlikely.

## The way forward

How will all this play out? We think the most likely outcome is:

- No alternate bidder surfaces.
- Baosteel ends up with 15% of AQA.
- WPIOP go ahead decision falls due and AMCI declines to participate, 50% interest gets valued at around \$750mn and AQA takes on Baosteel as a 50:50 partner (with Baosteel paying \$750mn to AQA and AQA paying an equivalent amount to AMCI).
- AQA is left with 50% of the WPIOP project and still needs to fund A\$1.25bn of equity with a similar level of debt funding to be put in place.

This would mean that Baosteel would end up with an attributable interest in the WPIOP project of over 50% so it may well be that any direct interest in WPIOP will be set so that it's attributable interest in the project is no more than 49% (effectively enabling a 40% direct stake).

## Raising Target Price

Having been a sceptic regarding AQA's ability to fund its grand ambitions, there is not much left to do but to recognise that the Baosteel deal changes this dynamic materially. We raised our 12-month Target Price to A\$7 – this recognises the fact that the all-goes well valuation of A\$8.20 is still subject to risk as it is inevitable - given the scale of the iron ore project and the financing required - there will be some project delays along the way. Lets not forget the fact that AQA is a junior miner with one project in ramp-up. We retain our Underperform rating and note that this will be one of the more interesting companies to watch over the next 12 months – and hopefully, less volatile than it has been of late.

***We look forward to more updates when AQA reports its results to the market in mid-September.***

**Figure 4: Investments from China based companies in Australian resources**

| Date    | Purchasor                                  | Acquired / (or proposed)   | Commodity              | Approx. Value (US\$) | Comment   |
|---------|--|--|------------------------|----------------------|---|
| Current | <b>BaoSteel Group</b>                      | Aqualia Resources (15% stake)  | Coal / Iron ore        | US\$230mn (A\$285mn) | Share placement, last 10% subject to approval by shareholders. Seeing approval from FIRB for a maximum of 19.99%.                   |
| Current | Yanzhou Coal (HK listed)                   | Felix Resources  | Coal (thermal and PCI) | US\$2.8bn            | Scheme of arrangement.  |
| May-09  | Anshan Iron and Steel Group (Ansteel)      | Gindalbie Metals Ltd (36% stake)   | Iron ore               | US\$236mn (A\$162mn) | FIRB approval on condition of support for development of associated infrastructure.   |
| Mar-09  | Hunan Valin Iron and Steel Group           | Fortescue Metals Group (17.55% stake)  | Iron ore               | US\$430mn (A\$558mn) | FIRB approval conditional on information segregation arrangements and director representation restrictions.                         |
| Feb-09  | Chinalco                                   | Rio Tinto (various assets and shareholding)  | Aluminium / Iron ore   | US\$19.5bn           | Did not proceed   |
| Feb-09  | Min Metals                                 | Oz Minerals  | Copper / Zinc          | US\$1.2bn            | FIRB approval for transaction except for Prominent Hill asset on national security grounds (as it is near Woomera Prohibited Area). |
| Mar-09  | Hunan Valin                                | Fortescue Metals Group (17.4% stake)   | Iron ore               | US\$300mn            |   |
| Feb-09  | Shenzhen Zhongjin Normfemet                | Perilya Limited  | Zinc                   | US\$30mn (A\$45mn)   |   |
| Sep-08  | Sinosteel Corporation                      | Murchison Metals Ltd (50% stake)   | Iron ore               | US\$90mn             | FIRB approval granted up to 50% stake. Initial Sino Steel application was to acquire 100% but withdrawn.                            |
| Aug-08  | Sinosteel Corporation                      | Midwest Corporation Limited (97% stake)  | Iron ore               | US\$90mn             |   |
| Aug-08  | China Shenhua Energy Co                    | A coal exploration license - Shenhua's first foreign exploration permit is a 190-square kilometer area near Gunnedah in New South Wales.           | Coal                   | US\$261mn            |   |
| Jun-08  | PetroChemical Corp                         | Puffin Oil field on North West Shelf WA  | Petroleum              | US\$1bn              |   |
| Feb-08  | Chinalco                                   | Rio Tinto (9% shareholding)  | Various                | US\$11bn             | Minority shareholding. FIRB approved shareholding up to 11% of group (15% of Plc stock).  |
| Feb-08  | China Metallurgical Group Corporation      | Cape Lambert Iron Ore (purchased 100% of the Cape Lambert mine)  | Iron ore               | US\$250mn            |   |
| Jan-08  | Shougang Corp                              | Mt Gibson iron ore company (20% stake)   | Iron ore               | US\$400              |   |
| Jul-07  | CITIC                                      | MacArthur Coal (20% stake)   | Coal                   | US\$80mn             |   |
| Jan-04  | <b>BaoSteel group</b>                      | Rio Tinto - Eastern Range iron ore mine (Joint venture between Hamersley Iron (54 per cent) and Shanghai Baosteel Group Corporation (46 per cent)) | Iron ore               | US\$1bn              |   |
| May-03  | CNOOC                                      | North West Shelf assets  | Petroleum              | US\$2bn              |   |
| Sep-07  | Chalco                                     | Queensland, Aurukun bauxite project (agreed to purchase and develop the project)   | Alumina                | US\$2bn              |   |
| Sep-07  | Anshan Iron & Steel                        | Gindalbie Metals (13% stake + A\$1.8bn JV agreement for development)   | Iron ore               | US\$20mn             |   |
| Mar-07  | Shougang Corporation                       | Australian Resources (unlisted) (13% stake + US2.1bn JV development of Balmoral South project)   | Iron ore               | US\$40mn             |   |
| 1990s   | CITIC                                      | Alcoa Portland Aluminium Smelter (took a 22.5% stake)  | Aluminium              | US\$500mn            |   |
| Jan-92  | Sinosteel Corporation                      | Rio Tinto iron ore (Channar mine) (Joint venture between Hamersley Iron (60 per cent) and Sinosteel Corporation (40 per cent).                     | Iron ore               | US\$1bn              |   |
| 1987    | Chinese Ministry of Metallurgical Industry | Hamersley Iron JV with RIO agreed (Channar mine) (later to be superseded by Sinosteel agreement)   | Iron ore               | A\$420mn             |   |

Source: Company data, Credit Suisse estimates

**Companies Mentioned** (Price as of 28 Aug 09)

Aquila Resources (AQA.AX, A\$7.15, UNDERPERFORM [V], TP A\$7.00)  
 Baoshan Iron & Steel (600019.SS, Rmb7.17, OUTPERFORM [V], TP Rmb10.50)  
 BHP Billiton Limited (BHP.AX, A\$37.85, NEUTRAL, TP A\$42.00)  
 Rio Tinto Limited (RIO.AX, A\$57.30, NEUTRAL [V], TP A\$68.00)

## Disclosure Appendix

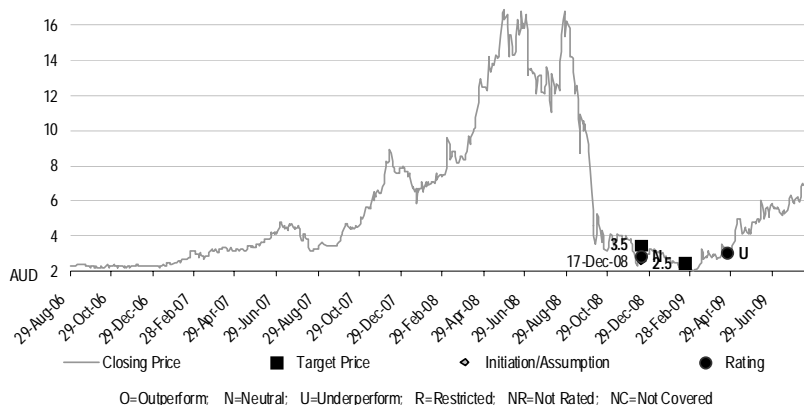
### Important Global Disclosures

I, Paul McTaggart, certify that (1) the views expressed in this report accurately reflect my personal views about all of the subject companies and securities and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

See the Companies Mentioned section for full company names.

### 3-Year Price, Target Price and Rating Change History Chart for AQA.AX

| AQA.AX    | Closing Price (AUD) | Target Price (AUD) | Initiation/ Rating | Assumption |
|-----------|---------------------|--------------------|--------------------|------------|
| 17-Dec-08 | 2.9                 | 3.5                | N                  | X          |
| 19-Feb-09 | 2.49                | 2.5                |                    |            |
| 22-Apr-09 | 3.09                |                    | U                  |            |



The analyst(s) responsible for preparing this research report received compensation that is based upon various factors including Credit Suisse's total revenues, a portion of which are generated by Credit Suisse's investment banking activities.

### Analysts' stock ratings are defined as follows:

**Outperform (O):** The stock's total return is expected to outperform the relevant benchmark\* by at least 10-15% (or more, depending on perceived risk) over the next 12 months.

**Neutral (N):** The stock's total return is expected to be in line with the relevant benchmark\* (range of ±10-15%) over the next 12 months.

**Underperform (U):** The stock's total return is expected to underperform the relevant benchmark\* by 10-15% or more over the next 12 months.

\*Relevant benchmark by region: As of 29<sup>th</sup> May 2009, Australia, New Zealand, U.S. and Canadian ratings are based on (1) a stock's absolute total return potential to its current share price and (2) the relative attractiveness of a stock's total return potential within an analyst's coverage universe\*\*, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. Some U.S. and Canadian ratings may fall outside the absolute total return ranges defined above, depending on market conditions and industry factors. For Latin American, Japanese, and non-Japan Asia stocks, ratings are based on a stock's total return relative to the average total return of the relevant country or regional benchmark; for European stocks, ratings are based on a stock's total return relative to the analyst's coverage universe\*\*. For Australian and New Zealand stocks a 22% and a 12% threshold replace the 10-15% level in the Outperform and Underperform stock rating definitions, respectively, subject to analysts' perceived risk. The 22% and 12% thresholds replace the +10-15% and -10-15% levels in the Neutral stock rating definition, respectively, subject to analysts' perceived risk.

\*\*An analyst's coverage universe consists of all companies covered by the analyst within the relevant sector.

**Restricted (R):** In certain circumstances, Credit Suisse policy and/or applicable law and regulations preclude certain types of communications, including an investment recommendation, during the course of Credit Suisse's engagement in an investment banking transaction and in certain other circumstances.

**Volatility Indicator [V]:** A stock is defined as volatile if the stock price has moved up or down by 20% or more in a month in at least 8 of the past 24 months or the analyst expects significant volatility going forward.

### Analysts' coverage universe weightings are distinct from analysts' stock ratings and are based on the expected performance of an analyst's coverage universe\* versus the relevant broad market benchmark\*\*:

**Overweight:** Industry expected to outperform the relevant broad market benchmark over the next 12 months.

**Market Weight:** Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.

**Underweight:** Industry expected to underperform the relevant broad market benchmark over the next 12 months.

\*An analyst's coverage universe consists of all companies covered by the analyst within the relevant sector.

*\*\*The broad market benchmark is based on the expected return of the local market index (e.g., the S&P 500 in the U.S.) over the next 12 months.*

---

**Credit Suisse's distribution of stock ratings (and banking clients) is:**

|                           | Global Ratings Distribution |                       |
|---------------------------|-----------------------------|-----------------------|
| <b>Outperform/Buy*</b>    | 37%                         | (56% banking clients) |
| <b>Neutral/Hold*</b>      | 43%                         | (59% banking clients) |
| <b>Underperform/Sell*</b> | 18%                         | (49% banking clients) |
| <b>Restricted</b>         | 2%                          |                       |

*\*For purposes of the NYSE and NASD ratings distribution disclosure requirements, our stock ratings of Outperform, Neutral, and Underperform most closely correspond to Buy, Hold, and Sell, respectively; however, the meanings are not the same, as our stock ratings are determined on a relative basis. (Please refer to definitions above.) An investor's decision to buy or sell a security should be based on investment objectives, current holdings, and other individual factors.*

Credit Suisse's policy is to update research reports as it deems appropriate, based on developments with the subject company, the sector or the market that may have a material impact on the research views or opinions stated herein.

Credit Suisse's policy is only to publish investment research that is impartial, independent, clear, fair and not misleading. For more detail please refer to Credit Suisse's Policies for Managing Conflicts of Interest in connection with Investment Research: [http://www.csfb.com/research-and-analytics/disclaimer/managing\\_conflicts\\_disclaimer.html](http://www.csfb.com/research-and-analytics/disclaimer/managing_conflicts_disclaimer.html)

Credit Suisse does not provide any tax advice. Any statement herein regarding any US federal tax is not intended or written to be used, and cannot be used, by any taxpayer for the purposes of avoiding any penalties.

*See the Companies Mentioned section for full company names.*

**Price Target:** (12 months) for (AQA.AX)

**Method:** Aquila's (AQA) target price of \$7 is a balance between the bull and bear cases. Our target price is set 15% below the everything turns out well \$8.20 valuation (which essentially assigns a 100% weighting to Eagle Downs and West Pilbara projects). Beta 1.1, weighted average cost of capital (WACC) 12.7%.

**Risks:** Risks to our \$7 target price on Aquila are significant and include the risk of failing to come up with financing for its proposed projects as well as execution and development risk as it embarks on the significant West Pilbara and Eagle Downs projects.

Please refer to the firm's disclosure website at [www.credit-suisse.com/researchdisclosures](http://www.credit-suisse.com/researchdisclosures) for the definitions of abbreviations typically used in the target price method and risk sections.

---

**Important Regional Disclosures**

The analyst(s) involved in the preparation of this report have not visited the material operations of the subject company (AQA.AX) within the past 12 months.

Restrictions on certain Canadian securities are indicated by the following abbreviations: NVS--Non-Voting shares; RVS--Restricted Voting Shares; SVS--Subordinate Voting Shares.

Individuals receiving this report from a Canadian investment dealer that is not affiliated with Credit Suisse should be advised that this report may not contain regulatory disclosures the non-affiliated Canadian investment dealer would be required to make if this were its own report.

For Credit Suisse Securities (Canada), Inc.'s policies and procedures regarding the dissemination of equity research, please visit [http://www.csfb.com/legal\\_terms/canada\\_research\\_policy.shtml](http://www.csfb.com/legal_terms/canada_research_policy.shtml).

Credit Suisse Securities (Europe) Limited acts as broker to RIO.AX.

The following disclosed European company/ies have estimates that comply with IFRS: RIO.AX.

As of the date of this report, Credit Suisse acts as a market maker or liquidity provider in the equities securities that are the subject of this report.

Principal is not guaranteed in the case of equities because equity prices are variable.

Commission is the commission rate or the amount agreed with a customer when setting up an account or at anytime after that.

To the extent this is a report authored in whole or in part by a non-U.S. analyst and is made available in the U.S., the following are important disclosures regarding any non-U.S. analyst contributors:

The non-U.S. research analysts listed below (if any) are not registered/qualified as research analysts with FINRA. The non-U.S. research analysts listed below may not be associated persons of CSSU and therefore may not be subject to the NASD Rule 2711 and NYSE Rule 472 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account.

- Paul McTaggart, non-U.S. analyst, is a research analyst employed by Credit Suisse Equities (Australia) Limited.
- Matthew Cross, non-U.S. analyst, is a research analyst employed by Credit Suisse Equities (Australia) Limited.
- James Gurry, non-U.S. analyst, is a research analyst employed by Credit Suisse Equities (Australia) Limited.

For Credit Suisse disclosure information on other companies mentioned in this report, please visit the website at [www.credit-suisse.com/researchdisclosures](http://www.credit-suisse.com/researchdisclosures) or call +1 (877) 291-2683.

Disclaimers continue on next page.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject Credit Suisse, the Swiss bank, or its subsidiaries or its affiliates ("CS") to any registration or licensing requirement within such jurisdiction. All material presented in this report, unless specifically indicated otherwise, is under copyright to CS. None of the material, nor its content, nor any copy of it, may be altered in any way, transmitted to, copied or distributed to any other party, without the prior express written permission of CS. All trademarks, service marks and logos used in this report are trademarks or service marks or registered trademarks or service marks of CS or its affiliates.

The information, tools and material presented in this report are provided to you for information purposes only and are not to be used or considered as an offer or the solicitation of an offer to sell or to buy or subscribe for securities or other financial instruments. CS may not have taken any steps to ensure that the securities referred to in this report are suitable for any particular investor. CS will not treat recipients as its customers by virtue of their receiving the report. The investments or services contained or referred to in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about such investments or investment services. Nothing in this report constitutes investment, legal, accounting or tax advice or a representation that any investment or strategy is suitable or appropriate to your individual circumstances or otherwise constitutes a personal recommendation to you. CS does not offer advice on the tax consequences of investment and you are advised to contact an independent tax adviser. Please note in particular that the bases and levels of taxation may change.

CS believes the information and opinions in the Disclosure Appendix of this report are accurate and complete. Information and opinions presented in the other sections of the report were obtained or derived from sources CS believes are reliable, but CS makes no representations as to their accuracy or completeness. Additional information is available upon request. CS accepts no liability for loss arising from the use of the material presented in this report, except that this exclusion of liability does not apply to the extent that liability arises under specific statutes or regulations applicable to CS. This report is not to be relied upon in substitution for the exercise of independent judgment. CS may have issued, and may in the future issue, a trading call regarding this security. Trading calls are short term trading opportunities based on market events and catalysts, while stock ratings reflect investment recommendations based on expected total return over a 12-month period as defined in the disclosure section. Because trading calls and stock ratings reflect different assumptions and analytical methods, trading calls may differ directionally from the stock rating. In addition, CS may have issued, and may in the future issue, other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them and CS is under no obligation to ensure that such other reports are brought to the attention of any recipient of this report. CS is involved in many businesses that relate to companies mentioned in this report. These businesses include specialized trading, risk arbitrage, market making, and other proprietary trading.

Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information, opinions and estimates contained in this report reflect a judgement at its original date of publication by CS and are subject to change without notice. The price, value of and income from any of the securities or financial instruments mentioned in this report can fall as well as rise. The value of securities and financial instruments is subject to exchange rate fluctuation that may have a positive or adverse effect on the price or income of such securities or financial instruments. Investors in securities such as ADR's, the values of which are influenced by currency volatility, effectively assume this risk.

Structured securities are complex instruments, typically involve a high degree of risk and are intended for sale only to sophisticated investors who are capable of understanding and assuming the risks involved. The market value of any structured security may be affected by changes in economic, financial and political factors (including, but not limited to, spot and forward interest and exchange rates), time to maturity, market conditions and volatility, and the credit quality of any issuer or reference issuer. Any investor interested in purchasing a structured product should conduct their own investigation and analysis of the product and consult with their own professional advisers as to the risks involved in making such a purchase.

Some investments discussed in this report have a high level of volatility. High volatility investments may experience sudden and large falls in their value causing losses when that investment is realised. Those losses may equal your original investment. Indeed, in the case of some investments the potential losses may exceed the amount of initial investment, in such circumstances you may be required to pay more money to support those losses. Income yields from investments may fluctuate and, in consequence, initial capital paid to make the investment may be used as part of that income yield. Some investments may not be readily realisable and it may be difficult to sell or realise those investments, similarly it may prove difficult for you to obtain reliable information about the value, or risks, to which such an investment is exposed.

This report may provide the addresses of, or contain hyperlinks to, websites. Except to the extent to which the report refers to website material of CS, CS has not reviewed the linked site and takes no responsibility for the content contained therein. Such address or hyperlink (including addresses or hyperlinks to CS's own website material) is provided solely for your convenience and information and the content of the linked site does not in any way form part of this document. Accessing such website or following such link through this report or CS's website shall be at your own risk.

This report is issued and distributed in Europe (except Switzerland) by Credit Suisse Securities (Europe) Limited, One Cabot Square, London E14 4QJ, England, which is regulated in the United Kingdom by The Financial Services Authority ("FSA"). This report is being distributed in Germany by Credit Suisse Securities (Europe) Limited Niederlassung Frankfurt am Main regulated by the Bundesanstalt fuer Finanzdienstleistungsaufsicht ("BaFin"). This report is being distributed in the United States by Credit Suisse Securities (USA) LLC ; in Switzerland by Credit Suisse; in Canada by Credit Suisse Securities (Canada), Inc.; in Brazil by Banco de Investimentos Credit Suisse (Brasil) S.A.; in Japan by Credit Suisse Securities (Japan) Limited, Financial Instrument Firm, Director-General of Kanto Local Finance Bureau (Kinsho) No. 66, a member of Japan Securities Dealers Association, The Financial Futures Association of Japan; elsewhere in Asia/Pacific by whichever of the following is the appropriately authorised entity in the relevant jurisdiction: Credit Suisse (Hong Kong) Limited, Credit Suisse Equities (Australia) Limited, Credit Suisse Securities (Thailand) Limited, Credit Suisse Securities (Malaysia) Sdn Bhd, Credit Suisse Singapore Branch, Credit Suisse Securities (India) Private Limited, Credit Suisse Securities (Europe) Limited, Seoul Branch, Credit Suisse Taipei Securities Branch, PT Credit Suisse Securities Indonesia, and elsewhere in the world by the relevant authorised affiliate of the above. Research on Taiwanese securities produced by Credit Suisse Taipei Securities Branch has been prepared by a registered Senior Business Person. Research provided to residents of Malaysia is authorised by the Head of Research for Credit Suisse Securities (Malaysia) Sdn. Bhd., to whom they should direct any queries on +603 2723 2020.

In jurisdictions where CS is not already registered or licensed to trade in securities, transactions will only be effected in accordance with applicable securities legislation, which will vary from jurisdiction to jurisdiction and may require that the trade be made in accordance with applicable exemptions from registration or licensing requirements. Non-U.S. customers wishing to effect a transaction should contact a CS entity in their local jurisdiction unless governing law permits otherwise. U.S. customers wishing to effect a transaction should do so only by contacting a representative at Credit Suisse Securities (USA) LLC in the U.S.

Please note that this report was originally prepared and issued by CS for distribution to their market professional and institutional investor customers. Recipients who are not market professional or institutional investor customers of CS should seek the advice of their independent financial advisor prior to taking any investment decision based on this report or for any necessary explanation of its contents. This research may relate to investments or services of a person outside of the UK or to other matters which are not regulated by the FSA or in respect of which the protections of the FSA for private customers and/or the UK compensation scheme may not be available, and further details as to where this may be the case are available upon request in respect of this report.

Any Nielsen Media Research material contained in this report represents Nielsen Media Research's estimates and does not represent facts. NMR has neither reviewed nor approved this report and/or any of the statements made herein.

If this report is being distributed by a financial institution other than Credit Suisse, or its affiliates, that financial institution is solely responsible for distribution. Clients of that institution should contact that institution to effect a transaction in the securities mentioned in this report or require further information. This report does not constitute investment advice by Credit Suisse to the clients of the distributing financial institution, and neither Credit Suisse, its affiliates, and their respective officers, directors and employees accept any liability whatsoever for any direct or consequential loss arising from their use of this report or its content.

Copyright 2009 CREDIT SUISSE and/or its affiliates. All rights reserved.

**CREDIT SUISSE EQUITIES (Australia) Limited**  
Australia: +61 2 8205 4400