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Consolidated Interim Financial Report

Aquila Resources Limited is pleased to announce the release of its Consolidated Interim Financial Report for the half-year ended 31 December 2006.

Significant developments for the Company during the period reported on include:

- The first coal shipment from Isaac Plains Coal Mine (Aquila 50%) in November 2006. Following the completion of minor rectification and modification work and formal commissioning of the Coal Handling and Preparation Plant ("CHPP"), production from the mine is expected to ramp up to 2.8Mtpa of product over the next two years;
- Commencement by the Australian Premium Iron Joint Venture ("API" - Aquila 50%) of a pre-feasibility study for the development of its West Pilbara Iron Ore Project. Recruitment of the management team to assist Kevin Watters (Manager Development – Iron Ore) is ongoing, with several positions recently filled;
- Continuing exploration success achieved by API, including the calculation of resource estimates, which are expected to be available in coming months;
- Companhia Vale do Rio Doce ("CVRD") nearing completion of its Exploration Study on the Belvedere Coal Underground Project (Aquila 50%); and
- CVRD entering into a transaction to acquire 100% of AMCI Holdings Australia Pty Limited. This transaction will result in CVRD becoming Aquila's 50% partner in both the Isaac Plains Coal Mine and Bowen Central Coal Joint Venture.

With cash reserves and liquid investments at 31 December 2006 totalling \$63 million, the Company is in a sound financial position to capitalise on new and existing opportunities in coal and iron ore during the period ahead.



Tony Poli
Executive Chairman

For further information regarding this announcement, please contact Tony Poli.

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AQUILA RESOURCES LIMITED

(ACN: 092 002 769)

and its Controlled Entities

Consolidated
Interim Financial Report
31 December 2006

AQUILA RESOURCES LIMITED
and its Controlled Entities

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AQUILA RESOURCES LIMITED

and its Controlled Entities

DIRECTORS' REPORT

The Directors of Aquila Resources Limited ("*Aquila*" or the "*Company*") present their report together with the consolidated financial report for the half-year ended 31 December 2006 and the auditors' review report thereon.

1. DIRECTORS

The Directors of the Company at any time during or since the end of the half-year are:

Tony Poli (48)

Executive Chairman

Mr Poli, a qualified accountant, has been a member of the Board since the incorporation of the Company on 14 March 2000 and is responsible for the operations of the Company.

Charles Bennett Bass (57)

Non-Executive Director

Mr Bass is a qualified geologist and mining engineer with 30 years experience in mineral exploration, development and production in Australia, Canada and the United States and has been a member of the Board of the Company since it was incorporated on 14 March 2000.

Derek Thomas Cowlan (73)

Non-Executive Director

Mr Cowlan is a businessman with a wealth of experience in financial and business management and has been a member of the Board of the Company since it was incorporated on 14 March 2000.

He currently presides as the Chairman of the Ross North Group, a large home building company operating in Western Australia.

AQUILA RESOURCES LIMITED
and its Controlled Entities

DIRECTORS' REPORT

2. LEAD AUDITOR'S INDEPENDENCE DECLARATION UNDER SECTION 307C OF THE CORPORATIONS ACT 2001

The Lead Auditor's Independence Declaration is set out on page 12 and forms part of the Directors' Report for the half-year ended 31 December 2006.

3. REVIEW OF OPERATIONS

3.1 COAL - AUSTRALIA

1. ISAAC PLAINS COAL MINE

(Aquila Resources Limited 50%)

Construction and Commissioning

The construction of the Isaac Plains Coal Mine is substantially complete. Minor rectification and modification work is in progress within the Coal Handling and Preparation Plant (CHPP) prior to formal commissioning and acceptance testing.

Operation

Mining operations continued with development of the N1 and N2 pits. Run of mine coal inventories established at the end of December were:

LHD (tops)	67,500t
LHD (bottoms)	154,500t

Commissioning and start-up of CHPP operations commenced by Roche Mining JR in December.

Product inventories at the end of December were:

Coking Coal:	7,500t
PCI:	16,000t
Thermal Coal:	7,000t

The Project shipped its first thermal coal cargo of 61,000t in November 2006 with further PCI and thermal coal shipments completed subsequent to reporting date.

Integrated Isaac Plains Project

The terms of reference for the Integrated Isaac Plains Project (IIPP) Environmental Impact Statement have been distributed for public review.

The IIPP Feasibility Study includes a bankable feasibility study to determine the economic benefits associated with the introduction of the Isaac Plains South coal resource and use of a BE1370 dragline to optimise life of mine operating productivities and costs.

AQUILA RESOURCES LIMITED

and its Controlled Entities

DIRECTORS' REPORT

3. REVIEW OF OPERATIONS (CONT'D)

Technical review, financial modelling and investigation of financing options are currently in progress.

Purchase arrangements for a pre-used BE1370 dragline were completed in December. This machine is secured and ready for disassembly and transport subject to acceptable IIPP study outcomes.

2. BELVEDERE COAL UNDERGROUND PROJECT

(Aquila Resources Limited 50%)

During the period Companhia Vale do Rio Doce (CVRD) completed its field operations and demobilised field staff as it nears completion of the Exploration Study on the project.

In total, 73 holes for a total of 52,472m were drilled, including 11,659m cored holes.

Seismic survey programmes and interpretation were also completed over the primary exploration area during the period and evaluation of survey information is continuing.

Coal quality analysis work continued during the period with raw quality results over 57 holes, floats at 1.5RD totalling 38 holes and full washability analyses available over 21 holes.

Coke oven testing is in progress.

Gas and geotechnical field and laboratory programmes are also underway and preliminary results appear consistent with previous work and confirm the expected low permeabilities. Geotechnical testing is complete and analysis of data remains in progress.

Engineering and related studies were commissioned by CVRD during the period and are in progress. The studies address environmental, gas, geotechnical, logistical, marketing, CHPP and infrastructure matters relating to the Belvedere Coal Underground Project.

CVRD has an option to acquire 51% of the project by paying each of the Company and AMCI Holdings Australia Pty Ltd USD\$45 million and further options to acquire the balance of the project at fair market value.

3. PEAK DOWNS EAST UNDERGROUND COAL PROJECT

(Aquila Resources Limited 50%)

Following the completion of the Stage 1 drilling programme, the Stage 2 exploration programme was commenced focussing on the northern part of the resource.

This next stage of exploration was undertaken in order to assess product coke strength, investigate the gas regime and further identify critical structural constraints.

The original exploration scope was completed in December with additional holes completed in January for resource definition purposes.

Coal quality, geotechnical and gas test work progressed slowly due to heavy industry demands placed on the laboratories at present. An initial resource estimate for the Peak Downs East Underground Coal Project will be developed following completion of this work.

AQUILA RESOURCES LIMITED
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DIRECTORS' REPORT

3. REVIEW OF OPERATIONS (CONT'D)

4. BOWEN BASIN PROJECTS

(Aquila Resources Limited 100%)

Washpool Coal Project

During the period, coal quality data was received from the initial Washpool Coal Project drilling programme, which focussed on the shallow Scorpio seam. This work identified the potential for coal containing low levels of sulphur and phosphorous with high swell and moderate fluidities.

The second stage of exploration and test work will commence shortly, targeting the following:

- Infill drilling to further define the northern extend of the Scorpio seam;
- Additional coal quality and washability data; and
- Validation of existing drill hole and coal data.

3.2 COAL – SOUTHERN AFRICA

1. MOÇAMBIQUE

(Aquila Resources Limited 100%)

Diamond drilling was conducted during the period with nine diamond boreholes being drilled for a total of 1,989m. Low level airborne geophysical surveys were conducted over five of the licences in the Moatize region. The total survey length flown was 6,750km. Processing of the data is well advanced and it is expected that the modelling and interpretation will be completed shortly.

Five boreholes were drilled on the West Moatize tenement to determine the coal-bearing stratigraphy within the coal basin, stepping out into the basin down dip from the previous drill holes.

The coal quality results indicate that the best quality coal is present in the lowermost plies of the Chipanga Seam. All the seams show good coking properties with crucible swell numbers generally above 8 and volatile matter above 30%. The yields at low ash (9-12%) are quite variable and the thickest intersections are generally recorded from the deeper holes. The coal occurs in a series of sub-basins defined by face variation and by post-depositional faulting. Correlation of individual seams between holes is challenging, due to the 2km drillhole spacing.

Three shallow diamond core holes were drilled on the North Moatize licence for a total of 208m, down dip from outcropping coal in the Murrongozi River. Geological mapping shows the area to comprise a shallow sub-basin aligned along a northwest-southeast trend and the new drilling demonstrates that it contains two coal seams, thought to be equivalent to the Upper and Lower Sousa Pinto seams, the basal coal horizon of the Productive Series. No evidence has been found to indicate that the Chipanga Seam is present. The coal has been sampled and submitted to the laboratory for analysis.

The Muarazi project comprises three prospecting licences which are centred some 30km southeast of the Moatize coal mining centre. Portions of the area were explored in the early 1980s when outcrops of coal were mapped and a drill hole intersected a coal horizon at shallow depth. A diamond drill hole was completed to follow up this earlier work. The hole was drilled to a total depth of 358m and intersected two coal-bearing horizons: an upper zone, 95m thick and a lower zone 36m thick. The coal is mostly dull and shaly and is interbedded with calcareous mudstone, sandstone and shale.

AQUILA RESOURCES LIMITED and its Controlled Entities

DIRECTORS' REPORT

3. REVIEW OF OPERATIONS (CONT'D)

2. BOTSWANA

(Aquila Resources Limited 100%)

The Company holds five prospecting licences for coal in eastern Botswana. The tenements cover coal deposits that were originally defined in the 1970s and 1980s by oil companies looking to mine thermal coal for export.

Diamond drilling was conducted on the Lechana and Dukwe prospecting licences during the period.

At Lechana, the drilling intersected the three coal seams as predicted, but found the depth of oxidation at 45m to be more than expected.

Dukwe is an exploration project that is close to a small power station (Sowa Pan), a rail line and sealed roads, some 130km northwest of Francistown. The target coal seam is uniformly developed and shows a shallow dip to the west from the sub crop. Although some 30+ holes have been drilled previously, the Northern Block area with coal resource potential has had little drilling and no coal quality determination. Analysis of coal drilling in the Central Block area demonstrates encouraging yield qualities that correspond to coal mined at the Morupule Coal Mine.

Diamond drilling of 5 holes was conducted to test the coal properties of the seam by collecting core samples for analysis and wash testing. If the quality measurements show that the coal has good metallurgical properties, such that the economics of developing an underground mine are attractive, a resource drill out on 500m centres will be considered.

3.3 IRON ORE - AUSTRALIAN PREMIUM IRON JOINT VENTURE

(Aquila Resources Limited 50%)

During the period the Australian Premium Iron Joint Venture (API) commenced a Pre-Feasibility Study on the West Pilbara projects and continued the drill evaluation of channel iron deposits (CID's) within its West Pilbara project area and assessment of the bedded iron deposit at the Hardey Project, located 50km north west of Paraburadoo.

1. PRE-FEASIBILITY STUDY

Project Definition

A Port Options Study was commissioned during the period and preliminary results are currently being evaluated. Rail operator Australian Railroad Group has created a model to provide both below and above rail construction and operating data. Conceptual pooling diagrams were generated for a 150km rail line at potential mine production profiles of 10, 15 and 20 million tonnes per annum.

Advice has been received on the capacity of road haulage at high tonnages, concluding 10mt per annum is the realistic capacity limit, based on port distances and the number of trucks and drivers required to operate effectively and safely.

Consideration is being given to the benefits of Continuous Surface Miners for their selective mining capacity and the added benefit of avoiding the requirement for primary crushing.

Diamond drill core from the Red Hill North, Cardo Bore and Catho Well deposits were transported to AMMTEC analytical laboratory and iron ore processing consultant Mr Noel Poetschka has been engaged to oversee the technical work.

AQUILA RESOURCES LIMITED and its Controlled Entities

DIRECTORS' REPORT

3. REVIEW OF OPERATIONS (CONT'D)

Pre-Feasibility Study (PFS)

Work progressed during the period on developing the structure and schedule for the PFS. Consultants Evans & Peck Pty Ltd were engaged to assist with management and coordination activities, together with environmental consultants Aquaterra, who will assist with the environmental approvals schedule.

An important part of the schedule is the land based flora and fauna surveys and preliminary discussions were held with Biota (fauna) and Landcare Holdings (flora) to determine programme requirements. In addition, a marine environment consultant has been selected to address marine impacts associated with the project.

A preliminary overall project schedule is being developed, based on the statutory approvals programme.

Calibre Projects Pty Ltd have been selected to prepare preliminary designs and estimates for infrastructure at the mine and port, excluding marine structures. Calibre partner Engenium Pty Ltd will study transport corridors for road and rail options.

2. IRON ORE – EXPLORATION

The focus of exploration undertaken during the period has continued to be the drill evaluation of the channel iron deposits (CID) within its West Pilbara project area and assessment of the bedded iron deposit at the Hardey Project located 50 kilometres north-west of Paraburdoo. Both areas are located within the Pilbara region of Western Australia.

During the period, more than 33,000 metres of reverse circulation drilling and 786 metres of diamond drilling was completed on the Pilbara projects. Final results have been received from the ongoing reverse circulation drilling programme targeting the channel iron deposits at Ken's Bore, Trinity Bore, Red Hill North and Upper Cane and for the bedded iron deposit identified at the Hardey project. The most encouraging results received to date have been returned from the Ken's Bore and Upper Cane prospects.

At the end of the reporting period, resource modelling on all key prospect areas had commenced.

WEST PILBARA – MT STUART PROJECT (API 70%)

Catho Well

Reverse circulation drilling has been completed, infilling and extending the north-western portion of the Catho Well CID. All drill holes intersected pisolitic iron material up to 20m in thickness, consistent with earlier drill results returned from the prospect. Better intercepts returned include:

Hole ID	From	To	Intercept	Al ₂ O ₃ %	SiO ₂ %	P%	S%	LOI%
Catho Well								
CWRC251	14	32	18m @ 56.71 % Fe	2.13	5.15	0.044	0.014	11.15
CWRC252	16	36	20m @ 57.46 % Fe	1.84	4.95	0.037	0.006	10.54
CWRC253	14	32	18m @ 56.43 % Fe	2.24	6.35	0.038	0.008	9.95
CWRC257	8	28	20m @ 55.32 % Fe	2.52	6.25	0.038	0.012	10.52
CWRC262	16	36	20m @ 55.77 % Fe	2.46	6.67	0.039	0.015	10.63

The drilling extended the mineralised zone to the north west and remains open. Additional drilling is planned for 2007. The Catho Well CID has been traced for over 5km in length.

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DIRECTORS' REPORT

3. REVIEW OF OPERATIONS (CONT'D)

WEST PILBARA – RED HILL PROJECT (API 60% earning 80%)

Cardo Bore East

Drilling continued during the period, defining a mineralised channel extending over 2.5km in length and ranging from 250m to 1000m in width. Thickness of the mineralised zone ranges between 15 to 26 metres. Better results received during the period include:

Hole ID	From	To	Intercept	Al ₂ O ₃ %	SiO ₂ %	P%	S%	LOI%
Cardo Bore East								
CBRC133	0	24	24m @ 58.66 % Fe	2.90	5.11	0.078	0.023	7.56
CBRC142	14	36	22m @ 57.25 % Fe	4.34	5.19	0.059	0.013	7.90
CBRC143	14	38	24m @ 58.50 % Fe	3.74	3.95	0.065	0.018	8.08
CBRC147	24	50	26m @ 61.21 % Fe	3.15	3.02	0.078	0.011	5.58

Red Hill North

Follow up reverse circulation drilling has been completed at the Jewel, Cochrane and Farnum prospects and has confirmed the continuation and continuity of the mineralised CID at all prospects. Better results received during the period include:

Hole ID	From	To	Intercept	Al ₂ O ₃ %	SiO ₂ %	P%	S%	LOI%
Red Hill North								
Jewel								
RNRC104	28	48	20m @ 58.01 % Fe	3.86	4.23	0.068	0.021	8.40
Cochrane								
RNRC177	12	34	22m @ 58.45 % Fe	3.16	4.07	0.110	0.021	8.37

Ken's Bore

Reverse circulation drilling completed at the Ken's Bore prospect has identified a broad mineralised pisolitic channel iron deposit greater than 30 metres thick over a wide area. Results have now been received for the 76 drill holes completed to date. The mineralised CID extends over 2.5km in length and ranges up to 1km in width. Better results received during the period include:

Hole ID	From	To	Intercept	Al ₂ O ₃ %	SiO ₂ %	P%	S%	LOI%
Ken's Bore								
KBRC041	4	52	48m @ 58.67 % Fe	3.36	3.91	0.077	0.007	8.45
KBRC052	8	46	38m @ 59.99 % Fe	2.78	3.24	0.075	0.007	7.71

Upper Cane

Reverse circulation drilling commenced at the Upper Cane prospect, located approximately 1km east of the Cardo Bore East prospect, in November 2006. The Upper Cane prospect is the continuation of the Cardo Bore palaeochannel.

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DIRECTORS' REPORT

3. REVIEW OF OPERATIONS (CONT'D)

Drilling has intersected thick, hematite-rich pisolite channel iron up to 50m from the surface. The stratigraphy is relatively consistent over the 3.5km length of the prospect and 250 to 500m width of the channel. Better results received during the period include:

Hole ID	From	To	Intercept	Al ₂ O ₃ %	SiO ₂ %	P%	S%	LOI%
Upper Cane								
UCRC012	0	46	46m @ 58.80 % Fe	3.20	5.47	0.064	0.014	0.00
UCRC014	0	50	50m @ 58.98 % Fe	3.44	4.24	0.070	0.022	0.00
UCRC052	0	52	52m @ 58.61 % Fe	3.35	4.88	0.094	0.013	7.35

WEST PILBARA – YALLEEN PROJECT (API earning 70%)

During the period, the Company announced the discovery of a buried channel iron deposit on the West Pilbara – Yalleen Iron Ore project located approximately 50km east south-east of the Pilbara township of Pannawonica. The initial drill programme tested the first of seven priority targets identified from the Hoist EM survey.

A programme of infill diamond drilling was completed to infill the initial Barber drilling located along the major axis of the Hoist EM anomaly. Results returned from the diamond drill programme confirmed the thickness and high grade of the channel iron. All drill holes intersected variable thickness of mineralised pisolitic iron, up to 30m, overlain by approximately 10–12m of “shingle” (gravel and cobble sized unconsolidated clasts). The number, thickness and spread of the intercepts returned are encouraging. Better results received during the period include:

Hole ID	From	To	Intercept	Al ₂ O ₃ %	SiO ₂ %	P%	S%	LOI%
Yalleen								
YABA001	10	46	36m @ 58.42 % Fe	3.19	5.40	0.048	0.016	7.38
YABA007	17	47	30m @ 60.47 % Fe	2.85	3.17	0.055	0.019	7.11
YADD019	12	40	28m @ 57.14 % Fe	3.69	5.95	0.050	0.019	8.02
YADD021	34	55	21m @ 59.36 % Fe	2.76	4.80	0.055	0.022	6.79

EAST PILBARA – HARDEY PROJECT (API 100%)

During the period programmes of reverse circulation and diamond drilling have been completed at the wholly-owned Hardey project located 50km west of Paraburdoo. Drilling has targeted the Dales Gorge and Marra Mamba formations, both major hosts to iron ore deposits in the Pilbara. The Hardey project covers the eastern nose of the Hardey syncline.

The Dales Gorge zone has been extensively drilled establishing continuity to the mineralisation over a wide area. Significant widths, over 100m, of haematic mineralisation have been returned from the reverse circulation drilling completed. Better results received during the period include:

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DIRECTORS' REPORT

3. REVIEW OF OPERATIONS (CONT'D)

Hole ID	From	To	Intercept	Al ₂ O ₃ %	SiO ₂ %	P%	S%	LOI%
Hardey								
Dales Gorge								
HARC047	33	154	121m @ 61.26 % Fe	3.22	4.53	0.115	0.005	4.24
HARC051	56	154	98m @ 64.83 % Fe	1.65	1.89	0.149	0.007	3.56
HARC059	4	133	129m @ 63.20 % Fe	1.45	3.75	0.099	0.005	4.14

Drilling of the Marra Mamba target has also returned promising results. Better results received during the period include:

Hole ID	From	To	Intercept	Al ₂ O ₃ %	SiO ₂ %	P%	S%	LOI%
Hardey								
Marra Mamba								
HARC067	7	42	35m @ 59.67 % Fe	2.25	4.48	0.063	0.012	7.20
HARC068	1	53	52m @ 59.32 % Fe	3.10	5.71	0.071	0.023	5.95

4. ROUNDING OFF

The consolidated entity is of a kind referred to in ASIC Class Order 98/100 dated 10 July 1998 and in accordance with that Class Order, amounts in the financial report and Directors' Report have been rounded off to the nearest thousand dollars, unless otherwise stated.

5. EVENTS SUBSEQUENT TO REPORTING DATE

On 10 January 2007, Aquila Steel Pty Ltd, a wholly owned subsidiary of the Company, entered into a share subscription agreement with Red Hill Iron Limited whereby, subject to the terms and conditions of the subscription agreement, the company subscribed for 5,882,353 ordinary fully paid shares in Red Hill Iron Limited at \$1.3435 per share, representing 15% of that company's issued share capital following the placement.

This placement was completed on 15 February 2007.

AQUILA RESOURCES LIMITED
and its Controlled Entities

DIRECTORS' REPORT

Dated at Perth this 14th day of March 2007.

Signed in accordance with a resolution of the Directors.

A handwritten signature in black ink, consisting of several overlapping, slanted lines that form the name 'Tony Poli'. The signature is positioned above a horizontal line.

Tony Poli
Executive Chairman



Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

To: the directors of Aquila Resources Limited

I declare that, to the best of my knowledge and belief, in relation to the review for the half-year ended 31 December 2006 there have been:

- (i) no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the review; and
- (ii) no contraventions of any applicable code of professional conduct in relation to the review.

KPMG
KPMG

A handwritten signature in black ink, appearing to read 'T R Hart', written over a light blue horizontal line.

T R Hart
Partner

Perth
14 March 2007

AQUILA RESOURCES LIMITED
and its Controlled Entities

CONSOLIDATED INTERIM INCOME STATEMENT
For the half-year ended 31 December 2006

	<i>Note</i>	<i>Consolidated</i> 31 Dec 2006 \$'000	<i>Consolidated</i> 31 Dec 2005 \$'000
Revenue from sale of product	2	2,154	-
Cost of sales		(2,697)	-
Gross profit (loss)		(543)	-
Other income	3	1,961	4,585
Exploration and evaluation expenses		(4,823)	(1,012)
Mine evaluation expenses		-	(1,023)
Administration expenses		(1,554)	(1,006)
Share based payment expense		(251)	(6,265)
Profit (loss) from operating activities		(5,210)	(4,721)
Financial income		1,966	160
Financial expenses		(869)	(75)
Net finance income		1,097	85
Profit (loss) before income tax		(4,113)	(4,636)
Income tax benefit		838	170
Profit (loss) for the period		(3,275)	(4,466)
Profit (loss) attributable to members of the parent entity		(3,275)	(4,466)
Basic earnings per share		(\$0.035)	(\$0.088)

Potential ordinary shares are not considered dilutive and accordingly diluted earnings per share has not been calculated or disclosed.

The Income Statement is to be read in conjunction with the Notes to the Consolidated Interim Financial Report set out on pages 17 to 36.

AQUILA RESOURCES LIMITED
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CONSOLIDATED INTERIM BALANCE SHEET
as at 31 December 2006

	<i>Note</i>	<i>Consolidated</i> 31 Dec 2006 \$'000	<i>Consolidated</i> 30 June 2006 \$'000
CURRENT ASSETS			
Cash assets		60,116	52,596
Trade and other receivables		3,270	15,690
Inventories	4	4,046	-
Investments		4,426	3,461
Other current assets		326	50
Total Current Assets		72,184	71,797
NON-CURRENT ASSETS			
Receivables		245	54
Property, plant and equipment	5	31,146	26,504
Exploration and evaluation expenditure	6	2,782	150
Intangible assets		43	14
Total Non-current Assets		34,216	26,722
TOTAL ASSETS		106,400	98,519
CURRENT LIABILITIES			
Trade and other payables		8,063	4,151
Interest bearing liabilities		3,037	-
Income tax payable		901	-
Provisions		139	68
Total Current Liabilities		12,140	4,219
NON-CURRENT LIABILITIES			
Interest bearing liabilities		17,151	14,770
Deferred tax liabilities		1,670	2,795
Provisions		628	454
Total Non-current Liabilities		19,449	18,019
TOTAL LIABILITIES		31,589	22,238
NET ASSETS		74,811	76,281
EQUITY			
Issued capital	7	72,376	72,238
Reserves		9,369	7,702
Accumulated (losses)	8	(6,934)	(3,659)
TOTAL EQUITY		74,811	76,281

The Balance Sheet is to be read in conjunction with the Notes to the Consolidated Interim Financial Report set out on pages 17 to 36.

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STATEMENT OF CHANGES IN EQUITY
For the half-year ended 31 December 2006

	<i>Note</i>	<i>Consolidated</i> 31 Dec 2006 \$'000	<i>Consolidated</i> 31 Dec 2005 \$'000
Total equity at the beginning of the period		76,281	5,947
Gain on revaluation of available-for-sale financial assets			
- recognised in income statement		(258)	-
- recognised in fair value reserve		944	1,303
Gain on fair value of cash flow hedges			
- recognised in income statement		(90)	-
- recognised in hedging reserve		842	-
Amounts recognised directly in equity		1,438	1,303
Profit (loss) for the period		(3,275)	(4,466)
Total recognised income and expense for the period		(1,837)	(3,163)
Transactions with equity holders in their capacity as equity holders:			
Exercise of options	7	116	6,470
Equity settled share based payment transactions		251	6,265
Total equity at the end of the period	8	74,811	15,519
Total recognised income and expense for the period attributable to equity holders of the parent		(1,837)	(3,163)

The above amounts are stated net of tax where applicable.

The Statement of Changes in Equity is to be read in conjunction with the Notes to the Consolidated Interim Financial Report set out on pages 17 to 36.

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STATEMENT OF CASH FLOWS
For the half-year ended 31 December 2006

	<i>Consolidated</i> 31 Dec 2006 \$'000	<i>Consolidated</i> 31 Dec 2005 \$'000
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash receipts in the course of operations	2,542	3,250
Cash payments in the course of operations	(6,193)	(1,812)
Cash payments for exploration and evaluation expenditure	(4,000)	(1,010)
Cash receipts from legal settlement	14,000	-
Interest received	1,701	163
Interest paid	(555)	-
Net cash provided by operating activities	7,495	591
CASH FLOWS FROM INVESTING ACTIVITIES		
Payments for property, plant and equipment	(5,634)	(3,383)
Payments for mineral properties	(70)	-
Proceeds from farm-out of mineral properties	87	155
Proceeds from sale of equity investments	752	-
Payments for equity investments	(375)	-
Proceeds from sale of property, plant and equipment	1	-
Net cash used in investing activities	(5,239)	(3,228)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issue of shares	116	6,470
Proceeds from borrowings	5,148	-
Net cash provided by financing activities	5,264	6,470
Net increase in cash held	7,520	3,833
Cash at the beginning of the financial period	52,596	4,349
Cash at the end of the financial period	60,116	8,182

The Statement of Cash Flows is to be read in conjunction with the Notes to the Interim Financial Report set out on pages 17 to 36.

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

1. Statement of significant accounting policies

Aquila Resources Limited ("the Company") is a company domiciled in Australia.

The consolidated interim financial report of the Company for the six months ended 31 December 2006 comprise the Company and its subsidiaries (together referred to as the "consolidated entity") and the consolidated entity's interest in jointly controlled operations.

The consolidated interim financial report was authorised for issue by the Directors on 14 March 2007.

(a) Statement of compliance

The consolidated interim financial report is a general purpose financial report which has been prepared in accordance with AASB 134: *Interim Financial Reporting* and the Corporations Act 2001.

The consolidated interim financial report does not include all of the information required for a full annual financial report.

The interim financial report is to be read in conjunction with the consolidated annual financial report of the consolidated entity as at and for the year ended 30 June 2006. This report must also be read in conjunction with any public announcements made by Aquila Resources Limited during the half-year in accordance with continuous disclosure obligations arising under the Corporations Act 2001.

The consolidated entity is of a kind referred to in ASIC Class Order 98/100 dated 10 July 1998 and, in accordance with the Class Order, amounts in the financial report have been rounded to the nearest thousand dollars, unless otherwise stated.

(b) Basis of preparation

The financial report is presented in Australian dollars. It has been prepared on the historical cost basis, except for derivative financial instruments and financial investments classified as available-for-sale, which are recorded at fair value.

The preparation of an interim financial report in conformity with AASB 134 *Interim Financial Reporting* requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses.

These estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The accounting policies have been applied consistently throughout the consolidated entity for the purposes of this condensed consolidated interim financial report.

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

1. Statement of significant accounting policies (cont)

(c) Principles of consolidation

Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the condensed consolidated interim financial report from the date that control commences until the date that control ceases.

Associates

Associates are those entities for which the consolidated entity has significant influence, but not control, over the financial and operating policies. The condensed consolidated interim financial statements include the consolidated entity's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases.

When the consolidated entity's share of losses exceeds its interest in an associate, the consolidated entity's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the consolidated entity has incurred legal or constructive obligations or made payments on behalf of an associate.

Joint ventures

Joint ventures are those entities over whose activities the consolidated entity has joint control, established by contractual agreement.

Jointly controlled entities

In the condensed consolidated interim financial report, investments in jointly controlled entities, including partnerships, are accounted for using equity accounting principles. Investments in joint venture entities are carried at the lower of the equity accounted amount and recoverable amount.

The consolidated entity's share of the jointly controlled entity's net profit or loss is recognised in the condensed consolidated interim income statement from the date joint control commences until the date joint control ceases. Other movements in reserves are recognised directly in consolidated reserves.

Jointly controlled operations and assets

The interests of the consolidated entity in unincorporated joint ventures and jointly controlled assets are brought to account by recognising in its financial statements the assets it controls and the liabilities that it incurs, and the expenses it incurs and its share of income that it earns from the sale of goods or services produced by the joint venture.

Transactions eliminated on consolidation

Intragroup balances, and any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the condensed consolidated interim financial statements.

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

1. Statement of significant accounting policies (cont)

(d) Revenue recognition

Revenue is measured at the fair value of consideration received or receivable, net of the amount of goods and services tax.

Sale of goods

Revenue from the sale of coal is recognised (net of penalties, returns, discounts, allowances and hedging gains/losses) in the income statement when the significant risks and rewards of ownership have been transferred to the buyer. No revenue is recognised if:

- (i) there are significant uncertainties regarding recovery of the consideration due;
- (ii) the costs incurred or to be incurred cannot be measured reliably;
- (iii) there is a risk of return of goods; or
- (iv) there is continuing management involvement with the goods.

(e) Finance income and expenses

Finance income comprises interest income, which is recognised as it accrues, using the effective interest rate.

Finance expense comprises interest expenses on borrowing, which is recognised in profit or loss using the effective interest rate.

(f) Goods and services tax

Revenue, expenses and assets are recognised net of the amount of goods and services tax (GST), except where the amount of GST incurred is not recoverable from the taxation authority. In these circumstances, the GST is recognised as part of the cost of acquisition of the asset or as part of the expense.

Receivables and payables are stated with the amount of GST included. The net amount of GST recoverable from, or payable to, the ATO is included as a current asset or liability in the statement of financial position.

Cash flows are included in the statement of cash flows on a gross basis. The GST components of cash flows arising from investing and financing activities which are recoverable from, or payable to, the ATO are classified as operating cash flows.

(g) Foreign currency

Transactions

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to Australian dollars at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Australian dollars at foreign exchange rates ruling at the dates the fair value was determined.

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

1. Statement of significant accounting policies (cont)

(h) Income tax

Income tax on the income statement for the periods presented comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Tax consolidation

The Company and its wholly-owned Australian resident entities have formed a tax-consolidated group with effect from 1 July 2003 and are therefore taxed as a single entity from that date. The head entity within the tax-consolidated group is Aquila Resources Limited.

Current tax expense/income, deferred tax liabilities and deferred tax assets arising from temporary differences of the members of the tax-consolidated group are recognised in the separate financial statements of the members of the tax-consolidated group using the 'stand alone taxpayer' approach by reference to the carrying amounts in the separate financial statements of each entity and the tax values applying under tax consolidation.

Current tax liabilities and assets and deferred tax assets arising from unused tax losses and tax credits of the members of the tax-consolidated group are recognised by the Company (as head entity in the tax-consolidated group). Deferred tax assets and deferred tax liabilities are measured by reference to the carrying amounts of the assets and liabilities in the Company's balance sheet and their tax values applying under tax consolidation.

Any current tax liabilities (or assets) and deferred tax assets arising from unused tax losses assumed by the head entity from the subsidiaries in the tax-consolidated group are recognised as amounts receivable or payable to other entities in the tax-consolidated group in conjunction with any tax funding arrangement amounts (refer below).

The Company recognises deferred tax assets arising from unused tax losses of the tax-consolidated group to the extent that it is probable that future taxable profits of the tax-consolidated group will be available against which the asset can be utilised.

Any subsequent period adjustments to deferred tax assets arising from unused tax losses assumed from subsidiaries are recognised by the head entity only.

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

1. Statement of significant accounting policies (cont)

(h) Income tax (cont)

Tax funding and sharing agreements

The members of the tax-consolidated group have entered into a funding arrangement that sets out the funding obligations of members of the tax-consolidated group in respect of tax amounts. The tax funding arrangements require payments to/from the head entity equal to the current tax liability (asset) assumed by the head entity and any tax-loss deferred tax asset assumed by the head entity, resulting in the head entity recognising an inter-entity receivable (payable) in the separate financial statements of the members of the tax-consolidated group equal in amount to the tax liability (asset) assumed. The inter-entity receivables (payables) are at call.

The head entity recognises the assumed current tax amounts as current tax liabilities (assets), adding to its own current tax amounts, since they are also due to or from the same taxation authority. The current tax liabilities (assets) are equivalent to the tax balances generated by external transactions entered into by the tax-consolidated group. Contributions to fund the current tax liabilities are payable as per the tax funding arrangement and reflect the timing of the head entity's obligation to make payments for tax liabilities to the relevant tax authorities.

The members of the tax-consolidated group have also entered into a tax sharing agreement. The tax sharing agreement provides for the determination of the allocation of income tax liabilities between the entities should the head entity default on its tax payment obligations. No amounts have been recognised in the financial statements in respect of this agreement as payment of any amounts under the tax sharing agreement is considered remote.

(i) Earnings per share

Basic earnings per share

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the half-year, adjusted for bonus shares issued during the half-year.

Diluted earnings per share

Diluted earnings per share is calculated by dividing basic earnings per share (adjusted by the after tax effect of financing costs associated with dilutive potential ordinary shares and the effect of revenues and expenses associated with the conversion to ordinary shares of dilutive potential ordinary shares) by the weighted average number of ordinary shares and dilutive potential ordinary shares, adjusted for bonus shares issued during the half-year.

(j) Cash and cash equivalents

Cash and cash equivalents comprise of cash balances and call deposits with an original maturity of three months or less. Bank overdrafts that are repayable on demand and form an integral part of the consolidated entity's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

1. Statement of significant accounting policies (cont)

(k) Acquisition of assets

The purchase method of accounting is used to account for all acquisitions of assets regardless of whether equity instruments or other assets are acquired. Cost is measured as the fair value of the assets given, shares issued or liabilities incurred or assumed at the date of exchange, together with costs directly attributable to the acquisition.

Where equity instruments are issued in an acquisition, the value of the instruments is their published market price as at the date of exchange, unless it can be demonstrated that the published price at the date of exchange is an unreliable indicator of fair value and that other evidence and valuation methods provide a more reliable measure of fair value.

Transaction costs arising on the issue of equity instruments are recognised directly in equity.

Where settlement of any part of the consideration is deferred, the amounts payable in the future are discounted to their present value as at the date of exchange. The discount rate used is the consolidated entity's incremental borrowing rate, being the rate at which a similar borrowing could be obtained from an independent financier under comparable terms and conditions.

Sale of non-current assets

Disposals of non-current assets are recognised at the date control of the assets passes to the buyer, usually when an unconditional contract of sale is signed.

The gain or loss on disposal is calculated as the difference between the carrying amount of the asset at the time of disposal and the net proceeds on disposal, and is disclosed as other income.

(l) Property, plant and equipment

Owned assets

Items of property, plant and equipment are stated at cost or deemed cost less accumulated depreciation and impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour, and an appropriate proportion of production overheads. The cost of self-constructed assets and acquired assets includes (i) the initial estimate at the time of installation and during the period of use, when relevant, of the costs of dismantling and removing the items and restoring the site on which they are located, and (ii) changes in the measurement of existing liabilities recognised for these costs resulting from changes in the timing or outflow of resources required to settle the obligation or from changes in the discount rate.

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

Leased assets

Leases in terms of which the consolidated entity assumes substantially all of the risks and rewards of ownership are classified as finance leases. Assets under finance lease are stated at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and impairment losses.

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

1. Statement of significant accounting policies (cont)

(l) Property, plant and equipment (cont)

Subsequent costs

The consolidated entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred, if it is probable that the future economic benefits embodied within the item will flow to the consolidated entity and the cost of the item can be measured reliably. All other costs are recognised in the income statement as an expense as incurred.

Depreciation

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each item of property, plant and equipment. Land is not depreciated. Mining property and development assets are depreciated over the life of economically recoverable reserves. The estimated useful lives in the current and comparative periods are as follows:

- plant and equipment 2-5 years
- buildings and infrastructure 10 years
- mine property and development 12 years

The residual value, the useful lives and the depreciation methods used are reassessed annually.

Development expenditure

Once a development decision has been taken, all capitalised exploration and evaluation expenditure, together with development costs, are carried forward to the extent that it is reasonably assured that they will be recouped from revenue to be derived from the sale of production of minerals from the relevant area of interest. No depreciation or amortisation is provided for in relation to development expenditure until the commencement of production.

The carrying value of capitalised development costs associated with each area of interest is reviewed each reporting period.

Joint venture assets

Expenditure on property, plant and equipment comprising part of unincorporated joint ventures in which the consolidated entity has an interest are accounted for in accordance with the policy detailed above.

(m) Mineral properties

Exploration and evaluation expenditure

Exploration and evaluation costs are only carried forward as an asset where rights to tenure are current and the costs:

- (i) relate to acquisitions and activities have not yet reached a stage which permits reasonable assessment of the existence of economically recoverable reserves; or
- (ii) are expected to be recouped through successful development and exploitation of the area of interest or by its sale.

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

1. Statement of significant accounting policies (cont)

(m) Mineral properties (cont)

Expenditure on exploration and evaluation activities in relation to areas of interest which have not yet reached a stage which permits reasonable assessment of the existence or otherwise of economically recoverable reserves are expensed as incurred.

Identifiable exploration assets acquired are accounted for in accordance with the consolidated entity's policy on acquisition of assets.

Where an area of interest has been relinquished, abandoned or sold or the Directors decide that it is not commercial, all carrying costs in respect of that project area are written off in the year the decision is made.

The carrying value of exploration and evaluation assets is assessed annually for impairment in accordance with AASB 6 *Exploration for and Evaluation of Mineral Resources* and the Company's policy in relation to impairment.

(n) Overburden in advance

Expenditure incurred to remove overburden or waste material from coal deposits is deferred to the extent it gives rise to future economic benefits and charged to operating costs on a units of production basis using the estimated average stripping ratio for the area being mined. Changes in estimates of average stripping ratios are accounted for prospectively.

For the purpose of assessing impairment, overburden in advance is grouped with other assets of the relevant cash generating unit.

(o) Intangible assets

Intangible assets that are acquired by the consolidated entity are stated at cost less accumulated amortisation and impairment losses.

Expenditure on internally generated goodwill and brands is recognised in the income statement as an expense as incurred.

Subsequent expenditure

Subsequent expenditure on capitalised intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets unless such lives are indefinite. Goodwill and intangible assets with an indefinite useful life are systematically tested for impairment at each reporting date. Other intangible assets are amortised from the date they are available for use. The estimated useful lives in the current and comparative periods are as follows:

- software and software licences 2-3 years

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

1. Statement of significant accounting policies (cont)

(p) Inventories

Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

The cost of mining inventories is determined using a weighted average basis. Cost includes direct material, overburden removal, mining, processing, labour, related transportation costs to the point of sale, mine rehabilitation costs incurred in the extraction process and other fixed and variable overhead costs directly related to mining activities.

(q) Other financial assets

Classification

Other financial assets are classified into the following categories:

(a) Financial assets at fair value through profit and loss

This category includes financial assets held for trading and those designated at fair value through profit and loss on initial recognition. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or, if so designated, where there exists the possibility it will be sold in the short term and the financial asset is subject to frequent changes in fair value. Derivatives are categorised as held for trading unless they are designated as hedges.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

(c) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that are intended and able to be held-to-maturity.

(d) Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets, such as marketable equity securities, that are either designated in this category or are not classified in any of the other categories.

Recognition

Financial assets classified as held for trading or available-for-sale are recognised/derecognised by the consolidated entity on the date it commits to purchase/sell the investments. Held-to-maturity investments are recognised/derecognised on the day they are transferred to/by the consolidated entity.

Measurement

Financial assets are initially recognised at fair value plus, in the case of items not carried at fair value through profit and loss, transaction costs directly attributable to the acquisition.

Subsequent to initial recognition, financial assets at fair value through profit and loss and available-for-sale financial assets are carried at fair value. Loans and receivables and held-to-maturity investments are recorded at amortised cost (using the effective interest method).

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

1. Statement of significant accounting policies (cont)

(q) Other financial assets (cont)

Measurement (cont)

Realised and unrealised gains and losses arising from changes in the fair value of financial assets at fair value through profit and loss are included in the income statement in the period in which they arise.

Unrealised gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised in equity in the available-for-sale asset revaluation reserve, until the financial asset is sold or impaired, at which point the cumulative gain or loss is transferred to the income statement.

Where financial assets are interest-bearing, interest calculated using the effective interest method is recognised in the income statement.

Impairment losses arising in relation to financial assets are recognised in the income statement.

The fair value of quoted financial assets is based on their bid price at the balance sheet date, however in the case of financial assets without active markets, fair value is established using relevant valuation techniques.

(r) Derivative financial instruments

The consolidated entity uses derivative financial instruments to hedge its exposure to foreign exchange risks arising from operating activities. The consolidated entity does not hold derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

Derivative financial instruments are initially recognised at fair value. Subsequent to initial recognition, derivative financial instruments are stated at fair value and the gain or loss on remeasurement to fair value is recognised immediately in profit or loss. However, where derivatives qualify for hedge accounting, the effective component of any resultant gain or loss is recognised directly in equity and then is subsequently recognised in profit or loss in the period during which the hedge transaction affects profit or loss.

(s) Hedging

On entering into a hedging relationship, the consolidated entity formally designates and documents the hedge relationship and the risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in cash flows and are assessed on an ongoing basis to determine that they actually have been highly effective throughout the financial reporting periods for which they are designated.

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a highly probably forecast transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in equity in the hedging reserve.

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

1. Statement of significant accounting policies (cont)

(s) Hedging (cont)

The associated cumulative gain or loss is subsequently removed from equity and recognised in the income statement in the same period or periods during which the forecast hedge transaction affects profit or loss. The ineffective part of any gain or loss on the derivative financial instrument is recognised in the income statement.

When a hedging instrument expires or is sold, terminated or exercised, or the consolidated entity revokes designation of the hedge relationship, but the forecast hedged transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, the cumulative unrealised gain or loss recognised in equity is recognised immediately in the income statement.

(t) Impairment

The carrying amounts of the consolidated entity's assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.

Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of goodwill (if any) allocated to the cash-generating unit (group of units) and then, to reduce the carrying amount of the other assets in the unit (group of units) on a *pro rata* basis.

When a decline in the fair value of an available-for-sale financial asset has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised directly in equity is recognised in profit or loss even though the financial asset has not been derecognised. The amount of the cumulative loss that is recognised in profit or loss is the difference between the acquisition cost and current fair value, less any impairment loss on that financial asset previously recognised in profit or loss.

Calculation of recoverable amount

The recoverable amount of the consolidated entity's investments in held-to-maturity securities and receivables carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate (i.e. the effective interest rate computed at initial recognition of these financial assets). Receivables with a short duration are not discounted.

Impairment of receivables is not recognised until objective evidence is available that a loss event has occurred. Significant receivables are individually assessed for impairment.

The recoverable amount of other assets is the greater of their fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

1. Statement of significant accounting policies (cont)

(t) Impairment (cont)

Reversal of impairment

An impairment loss in respect of a held-to-maturity security or receivable carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss in respect of an investment in an equity instrument classified as available for sale is not reversed through profit or loss. If the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss shall be reversed, with the amount of the reversal recognised in the income statement.

In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(u) Payables

Trade and other payables are stated at amortised cost.

(v) Provisions

A provision is recognised in the balance sheet when the consolidated entity has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, when appropriate, the risks specific to the liability.

Mine rehabilitation and restoration

Provisions are made for the estimated cost of rehabilitation relating to areas disturbed during exploration and development activity up to reporting date but not yet rehabilitated. Provision has been made in full for all disturbed areas at the reporting date based on current estimates of costs to rehabilitate such areas, discounted to their present value based on expected future cashflows. The estimated cost of rehabilitation includes the current cost of recontouring, topsoiling and revegetation employing legislative requirements. Changes in estimates are dealt with on a prospective basis as they arise.

Significant uncertainty exists as to the amount of rehabilitation obligations which will be incurred due to the impact of changes in environmental legislation. The amount of the provision relating to rehabilitation of mine infrastructure and dismantling obligations is recognised at the commencement of the mining project and/or construction of the assets where a legal or constructive obligation exists at that time. The provision is recognised as a non-current liability with a corresponding asset included in mine development assets.

At each reporting date the rehabilitation liability is re-measured in line with changes in discount rates, and the timing or amount of the costs to be incurred. Changes in the liability relating to rehabilitation of mine infrastructure and dismantling obligations are added to or deducted from the related asset, other than the unwinding of the discount, which is recognised as a finance cost in the income statement as it occurs.

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

1. Statement of significant accounting policies (cont)

(v) Provisions (cont)

If the change in the liability results in a decrease in the liability that exceeds the carrying amount of the asset, the asset is written-down to nil and the excess is recognised immediately in the income statement. If the change in the liability results in an addition to the cost of the asset, the recoverability of the new carrying amount is considered. Where there is an indication that the new carrying amount is not fully recoverable, an impairment test is performed with the write-down recognised in the income statement in the period in which it occurs.

The amount of the provision relating to rehabilitation of environmental disturbance caused by ongoing production and extraction activities is recognised in the income statement as incurred. Changes in the liability are charged to the income statement as rehabilitation expense, other than the unwinding of the discount, which is recognised as a finance cost.

(w) Employee benefits

Wages, salaries and annual leave

Liabilities for employee benefits for wages, salaries and annual leave comprise present obligations resulting from employees' services provided to reporting date, calculated at undiscounted amounts based on remuneration wage and salary rates that the consolidated entity expects to pay as at reporting date, including related on-costs such as workers' compensation insurance and payroll tax.

Long service leave

The consolidated entity's net obligation in respect of long-term service benefits, other than pension plans, is the amount of future benefit that employees have earned in return for their service in the current and prior periods.

The obligation is calculated using expected future increases in wage and salary rates including related on-costs and expected settlement dates, and is discounted using the rates attached to the Commonwealth Government bonds at the balance sheet date which have maturity dates approximating to the terms of the consolidated entity's obligations.

Retirement benefits

Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred.

(x) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

AQUILA RESOURCES LIMITED
and its Controlled Entities

NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

1. Statement of significant accounting policies (cont)

(y) Share based payments

The fair value of options granted is recognised as an expense with a corresponding increase in equity.

The fair value is measured at grant date and spread over the period during which the option holders become unconditionally entitled to the options. The fair value of the options granted is measured using an option pricing model, taking into account the exercise price, the term of the option, the vesting and performance criteria, the impact of dilution, the non-tradeable nature of the option, the share price at the date of grant, the expected volatility of the underlying share, the expected dividend yield and the risk-free interest rate for the term of the option.

The fair value of the options granted includes market performance conditions such as the target price of the underlying share. Non-market vesting conditions such as project development criteria, are taken into account in assumptions regarding the number of options that are expected to become exercisable. At each reporting date, the consolidated entity revises its estimate of the number of options that are expected to become exercisable.

The amount recognised as an expense is adjusted to reflect the actual number of share options that vest, except where forfeiture is only due to share prices not achieving the threshold for vesting.

Upon exercise of the options, the balance of the share based payments reserve relating to those options is transferred to share capital.

AQUILA RESOURCES LIMITED
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NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

2. Segment reporting

Segment information is presented in the condensed consolidated interim financial statements in respect of the consolidated entity's business segments. The primary format, business segments, is based on the consolidated entity's management and internal reporting structure.

<i>Business segments</i>	<i>Coal</i>		<i>Iron Ore</i>		<i>Other minerals</i>		<i>Consolidated</i>	
	<i>Dec 2006</i> \$'000	<i>Dec 2005</i> \$'000	<i>Dec 2006</i> \$'000	<i>Dec 2005</i> \$'000	<i>Dec 2006</i> \$'000	<i>Dec 2005</i> \$'000	<i>Dec 2006</i> \$'000	<i>Dec 2005</i> \$'000
Segment revenue	2,154	-	-	-	-	-	2,154	-
Segment result	(3,977)	2,724	(40)	(141)	(42)	(40)	(4,059)	2,543
Unallocated expenses							(1,151)	(7,264)
Profit (loss) from operating activities							(5,210)	(4,721)

AQUILA RESOURCES LIMITED
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NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

	<i>Consolidated</i>	<i>Consolidated</i>
	<i>31 Dec 2006</i>	<i>31 Dec 2005</i>
	<i>\$'000</i>	<i>\$'000</i>
	<hr/>	<hr/>
3. Other income		
Proceeds from grant of mineral rights	-	3,324
Administration overheads charged	188	6
Gain on farm-out of mineral properties ⁽ⁱ⁾	1,306	1,255
Gain on disposal of equity investments	365	-
Other	102	-
	<hr/>	<hr/>
Total other income	1,961	4,585
	<hr/>	<hr/>

- (i) Following satisfaction of third party farm-in expenditure obligations in October 2006 relating to the Australian Premium Iron Joint Venture (2005: the Isaac Plains and Bowen Central Coal Joint Ventures), the consolidated entity commenced cash contributions towards the joint venture and recognised a net gain of \$1,306,000 (2005: \$1,255,000) on the joint venture farm-out transaction, being the disposal of a 50% interest in the mineral properties held by the joint venture(s).

These gains represent the net assets acquired within the joint venture(s) during the period for which the consolidated entity was not required to contribute funding amounts.

	<i>Consolidated</i>	<i>Consolidated</i>
	<i>31 Dec 2006</i>	<i>30 June 2006</i>
	<i>\$'000</i>	<i>\$'000</i>
	<hr/>	<hr/>
4. Inventories		
Coal stocks	4,046	-
	<hr/>	<hr/>

5. Property, plant and equipment

Acquisitions

During the half-year ended 31 December 2006, the consolidated entity acquired property, plant and equipment with a cost of \$4,869,000 (2005: \$6,910,000) including the consolidated entity's interest in joint venture assets amounting to \$4,393,000 (2005: \$6,888,000).

AQUILA RESOURCES LIMITED
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NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

	<i>Consolidated</i> 31 Dec 2006 \$'000	<i>Consolidated</i> 30 June 2006 \$'000
6. Exploration and evaluation expenditure		
Total capitalised exploration and evaluation expenditure at beginning of period	150	80
<i>add</i> – capitalised exploration and evaluation expenditure recognised following completion of farm-in requirement by third party	2,632	-
<i>add</i> – exploration and evaluation costs incurred	4,823	3,247
<i>less</i> – exploration and evaluation costs written off	(4,823)	(3,177)
Total exploration and evaluation expenditure	2,782	150
The ultimate recoupment of the carrying amount of exploration and evaluation expenditure is dependent on the successful development and commercial exploitation or sale of the respective areas of interest.		

	<i>Consolidated</i> 31 Dec 2006 \$'000	<i>Consolidated</i> 30 June 2006 \$'000
7. Contributed equity		
<i>Share capital</i>		
168,750,144 fully paid ordinary shares (June 2006: 84,298,072)	74,400	74,262
<i>less</i> – issue costs	(2,024)	(2,024)
Total contributed equity	72,376	72,238

AQUILA RESOURCES LIMITED
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NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

	<i>Consolidated</i> 31 Dec 2006 \$'000	<i>Consolidated</i> 30 June 2006 \$'000
7. Contributed equity (cont)		
Issued and paid-up capital		
Balance at beginning of period: 84,298,072 ordinary shares (June 2005: 48,894,940)	72,238	12,692
Ordinary shares issued during the period:		
- 605,000 ordinary shares by means of the exercise of 550,000 options at \$0.40 per share	-	220
- 4,949,927 ordinary shares issued at no cost by means of a bonus issue of 1 share for every 10 shares held (2 December 2005)	-	-
- 18,150,000 ordinary shares by means of the exercise of 15,000,000 options at \$0.25 per share	-	3,750
- 3,065,332 ordinary shares by means of the exercise of 2,533,333 options at \$1.00 per share	-	2,533
- 128,333 ordinary shares by means of the exercise of 116,666 options at \$2.50 per share	-	292
- 8,504,540 ordinary shares issued at \$6.35 per share by means of a private placement	-	54,004
- 40,333 ordinary shares by means of the exercise of 33,333 options at \$1.00 per share	33	-
- 36,667 ordinary shares by means of the exercise of 33,333 options at \$2.50 per share	83	-
- 84,375,072 ordinary shares issued at no cost by means of a bonus issue of 1 share for every 1 share held (11 December 2006)	-	-
Transfer from share based payment reserve upon exercise of options.	22	243
Issue costs	-	(1,496)
Balance at end of period: 168,750,144 ordinary shares (June 2006: 84,298,072)	72,376	72,238

Options

As at 31 December 2006, the following options remain outstanding:

- 1,033,334 options exercisable at \$1.00 each on or before 31 December 2007.
- 300,001 options exercisable at \$2.50 each on or before 31 December 2008.
- 2,000,000 options exercisable at \$4.00 each on or before 31 December 2008.
- 5,000,000 options exercisable at \$4.00 each on or before 31 December 2010.

Conversion rights attaching to the options are adjusted to incorporate the effects of bonus issues.

AQUILA RESOURCES LIMITED
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NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

8. Reconciliation of movements in capital and reserves

Attributable to equity holders of the parent

Consolidated	Share capital	Available- for-sale fair value reserve	Share based payment reserve	Hedging reserve	Accumulated losses	Total
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
2006						
Balance 1 July 2006	72,238	739	6,705	258	(3,659)	76,281
Total recognised income and expense	-	686	-	752	(3,275)	(1,837)
Shares issued	116	-	-	-	-	116
Equity settled transactions	-	-	251	-	-	251
Transfer on exercise of share options	22	-	(22)	-	-	-
Balance 31 December 2006	72,376	1,425	6,934	1,010	(6,934)	74,811
2005						
Balance 1 July 2005	12,692	-	277	-	(7,022)	5,947
Total recognised income and expense	-	1,303	-	-	(4,466)	(3,163)
Shares issued	6,470	-	-	-	-	6,470
Equity settled transactions	-	-	6,265	-	-	6,265
Transfer on exercise of share options	188	-	(188)	-	-	-
Balance 31 December 2005	19,350	1,303	6,354	-	(11,488)	15,519

9. Related parties

Transactions with key executives

Key executives received compensation during the period in accordance with arrangements detailed in the 2006 Annual Report.

The total amount of fees and compensation (including share based payments expenses) referable to key executives during the period was \$740,000 (31 Dec 2005: \$6,269,000).

AQUILA RESOURCES LIMITED
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NOTES TO THE FINANCIAL STATEMENTS
For the half-year ended 31 December 2006

10. Events subsequent to reporting date

On 10 January 2007, Aquila Steel Pty Ltd (Aquila 100%) entered into a share subscription agreement with Red Hill Iron Limited whereby, subject to the terms and conditions of the subscription agreement, the company subscribed for 5,882,353 ordinary fully paid shares in Red Hill Iron Limited at \$1.3435 per share, representing 15% of that company's issued share capital following the placement.

This placement was completed on 15 February 2007.

AQUILA RESOURCES LIMITED
and its Controlled Entities

DIRECTORS' DECLARATION
For the half-year ended 31 December 2006

In the opinion of the Directors of Aquila Resources Limited:

1. the financial statements and notes set out on pages 13 to 36 are in accordance with the Corporations Act 2001, including:
 - (a) giving a true and fair view of the financial position of the Consolidated Entity as at 31 December 2006 and of its performance, as represented by the results of its operations and cash flows for the half-year ended on that date; and
 - (b) complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the Corporations Regulations 2001, and
2. there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

Dated at Perth this 14th day of March 2007.

Signed in accordance with a resolution of the Directors:



Tony Poli
Executive Chairman



Independent auditor's review report to the members of Aquila Resources Limited

Report on the Financial Report

We have reviewed the accompanying interim financial report of Aquila Resources Limited, which comprises the consolidated interim balance sheet as at 31 December 2006, interim income statement, statement of changes in equity and cash flow statement for the half-year ended on that date, a statement of accounting policies and other explanatory notes and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the half-year's end or from time to time during the half-year.

Directors' Responsibility for the Financial Report

The directors of the company are responsible for the preparation and fair presentation of the interim financial report in accordance with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Act 2001*. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the interim financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express a conclusion on the interim financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 *Review of an Interim Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the interim financial report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the consolidated entity's financial position as at 31 December 2006 and its performance for the half-year ended on that date; and complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As auditor of Aquila Resources Limited, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of an interim financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the interim financial report of Aquila Resources Limited is not in accordance with the *Corporations Act 2001*, including:

- (a) giving a true and fair view of the consolidated entity's financial position as at 31 December 2006 and of its performance for the half-year ended on that date; and



- (b) complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the Corporations Regulations 2001.

KPMG

KPMG

A handwritten signature in black ink, appearing to read 'T R Hart', written in a cursive style.

T R Hart
Partner

Perth
14 March 2007