

Resources

Quarterly Review

May 2010, Australia



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 **Investec**
Securities

Aquila Resources

Coal & Iron ore

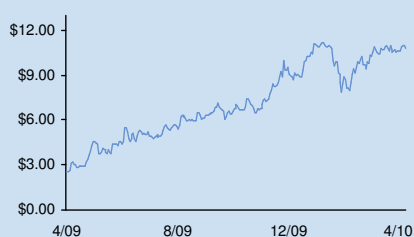
Hold	\$10.22
Target Price	A\$11.90
Forecast Total Return	10%

Company profile

Aquila Resources (AQA), established in 2000, is a Perth based company focussed on raw materials required by the steel producing sector: coking coal, iron ore and manganese. Production at this stage is limited to a single mine, Isaac Plains, which is a 50% owned, open cut operation located in the Bowen Basin.

The key projects include: the Belvedere underground coking coal project in the southern Bowen Basin (AQA 24.5%), the Eagle Downs underground hard coking coal project located in the central Bowen Basin (50% owned) and the Washpool and Red Hill projects (100% owned) located in the central and upper Bowen Basin. AQA has a 50% interest in the Australian Iron Ore JV (API) which controls 700mt of inferred and indicated iron ore resources in the West Pilbara. AQA also owns a 74% interest in the Avontuur manganese project located in the Northern Cape Province of South Africa.

Share price performance



1m 3m 12m

Price (7.1%) (6.2%) 236%

Source: Iress

Other Information

Iress / Bloomberg	AQA / AQA AU
Market cap	A\$3,384m
Enterprise value	A\$3,045m
Average daily volume (m)	0.910
Free float	29%
Number of shares in issue (m)	247.1
Reporting currency	AUD
Quote currency	AUD
Website	www.aquilarresources.com.au
Analyst(s)	Tim Gerrard +61 2 9293 2168 tim.gerrard@investec.com.au

Many growth options offer high leverage to bulk commodities

AQA will not be an earnings play for many years: it has one operating project and is reinvesting heavily in new developments not likely to have a significant impact until CY'15. It does, however, have strategic positions in the Bowen Basin (coking coal) and the Pilbara (iron ore) that in our view can justify the current price.

The relatively early stage of the projects, the uncertain production profile, uncertain capital costs and financing requirements do result in a wide range of possible values. This is compounded by the current boom in bulk commodity prices.

Our base case NPV of \$8.09/share suggests AQA is overvalued. However, by way of illustration we note that at a long-term iron ore price of US\$110/t and coking coal at US\$205/t (March Q'10 spot prices), the risked NPV could be as high as \$17.90/share and the un-risked NPV \$27.50/share. Until bulk markets show signs of retreating and considering the perceived risk to the upside we believe a Hold rating is justified.

- Recent news flow:** AQA lost \$12.4m in the DecH'09, which was a better outcome than we had expected due to higher realised PCI prices and sales volume. This result included \$31m expensed on exploration and evaluation, mainly on iron ore in the Pilbara. AQA is currently in dispute with Vale over planned port access for the Eagle Downs project, which may result in a breach of contract by Vale, and in Eagle Downs therefore reverting to 100% AQA ownership.
- Key issues:** AQA management focus is widespread with 2 projects in South Africa, 3 projects in the Bowen Basin and a major, complex project in the Pilbara. Almost all projects have complex JV relationships to manage and infrastructure challenges. Hence a key issue facing AQA is focus and achieving timelines.
- Valuation & target:** We value AQA at \$8.09/share, NPV based, using an 8% real discount rate, long-term (2015) iron ore fines price of US\$52/t and coking coal price of US\$113/t. Our NPV has been risked by an average of 26.5% to account for the early stage of many of the potential developments. Should the Company achieve its indicative targets our un-risked NPV increases to \$11.00/share. AQA is massively leveraged to a bulk prices. By way of example the risked NPV at current prices increases to \$18.00/share, or \$27.50/share un-risked. Our share price target of \$12.00/share is a 48% premium to our risked NPV
- Catalysts:** Potential sale of Belvedere around mid year could demonstrate value, release of the DFS on the West Pilbara Iron Ore JV, resource upgrades for Avontuur Manganese in South Africa.

Financials and valuation - IFRS compliant

Year end: 30 June

	2008	2009	2010E	2011E	2012E
Revenue (A\$m)	46.5	92.2	128.8	135.1	235.7
EBITDA (A\$m)	(31.2)	(36.2)	(45.0)	19.1	105.6
EBITA (A\$m)	(36.2)	(42.6)	(50.6)	13.1	91.6
PBT (normalised) (A\$m)	(31.8)	(39.0)	(44.9)	12.5	124.6
Net income (normalised) (A\$m)	(25.4)	(28.4)	(30.5)	6.7	87.2
EPS (normalised, continuing) - FD (cents)	(13.1)	(11.4)	(9.5)	2.1	25.4
FCFPS - FD (cents)	11.5	(3.5)	19.9	14.0	(0.5)
NAV per share (cents)	104.5	62.2	126.5	119.9	94.7
DPS (quote) (cents)	0.0	0.0	0.0	0.0	0.0
PE (normalised) (x)	(0.8)	(0.9)	(1.1)	4.9	0.4
Price/NAVPS (x)	0.1	0.2	0.1	0.1	0.1
EV/Revenue (x)	32.0	16.1	11.6	11.0	6.3
EV/EBITDA(x)	(47.7)	(41.1)	(33.1)	78.1	14.1
FCF yield(%)	112.5	(34.3)	194.3	137.1	(5.1)
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0

Source: AQA Company accounts/Investec Bank estimates

Readers in all geographies please refer to important disclosures at the end of this report.

Aquila Resources

A deep project pipeline in Australia and South Africa

- **Isaac Plains:** (50% owned) - Located at Moranbah in the Central Bowen Basin - 58.5mt reserves, 75% PCI and semi-hard coking coal, 25% thermal. Plan to ramp up from 1.7mtpa of saleable product to 2.8mtpa by FY'12, subject to Environmental and Mine approvals, increased wash plant capacity and construction of a dragline.
- **Eagle Downs:** (50% owned) - 159mt of hard coking coal reserves, located in the Central Bowen Basin. Mining approvals expected by the 4Q'10 for a 4.6mtpa (ROM) long-wall operation. Indicative capital \$988m, cash cost pre-royalty \$71/t.
- **Belvedere:** (24.5% owned) - This 2.47bn tonne inferred and indicated hard coking coal resource is located in the Southern Bowen Basin. The recent PFS has highlighted high capital costs in the order of \$2.8bn and cash FOB costs of \$70/t. AQA has the asset up for sale. We believe a realistic price, in the current market, should be in the order of \$300-400m (\$0.93 - \$1.24/share). Vale's exclusive right to purchase lapses after the 4th June.
- **West Pilbara:** (50% owned API JV) – Resources of 742mt identified to date (30% inferred) which may support a 30-40mtpa operation, new railway and new port at Anketell Point. The DFS is expected by mid year, with a target finance date by mid CY'11. Capital cost of \$3-4bn needs to be shared with partners, likely to include Fortescue Metals (FMG). Given the need to negotiate agreements on joint infrastructure development, we do not assume first production until FY'15.
- **Avontuur Manganese:** (74% owned). This inferred resource, located in the Northern Cape Province, is an extension of the well known Kalahari Manganese Field. The 34.3mt resources, grading 40%Mn is likely to support a 1mtpa operation for in excess of 15 years. An upgraded resource statement is still expected in the 2Q'10. Aquila is continuing to evaluate two export port options: Coega – near Port Elizabeth, and Saldanha.
- **Thabazimbi Iron Ore:** (74% owned). The project is located 200km north of Johannesburg in the Limpopo Province and may support a 1-3mtpa operation using existing rail infrastructure to domestic and export markets. A maiden resource of 21.9mt at 63.2%Fe direct shipping ore has recently been announced.

Marginal profitability as cash flow is directed to exploration and development

- We expect a loss of \$30.5m in FY'10E, up slightly from the loss of \$28.4m last year, as AQA continues to invest heavily in exploration and development.
- Cash from operations is expected to show improvement, up from a deficit of \$16m last year to \$41m, or \$0.127/share this year. No dividends are expected over the forecast period. We expect AQA will finish FY'10E with \$288m cash in hand.

Aquila Resources

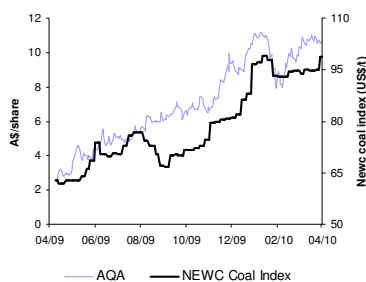
Key valuation & recommendation risks

- Upside risk on coking coal and iron ore prices
- Many projects at relatively early stages with risks to timing and capital cost estimates.
- Risks to operating cost estimates
- Management of JV relationships

Board members

Tony Poli Executive Chairman, MD
 Charles Bennett Bass, Non Executive Director
 Gordon Thomas Galt, Non Executive Director
 Derek Thomas Galt, Non Executive Director
 Zhihao Dai, Non Executive Director

AQA vs NEWC thermal coal index



Source: Iress, GlobalCoal

Attributable Production Profile (mt)		FY'09	FY'10E	FY'11E	FY'12E	FY'13E	FY'14E
Export thermal coal		0.3	0.6	0.3	0.4	2.4	2.4
PCI coal		0.2	0.3	0.4	1.1	1.1	1.4
Coking coal		0.2	0.3	0.2	0.0	0.0	0.4
Total coal sales		0.6	1.2	0.9	1.4	3.4	4.2
Met coal %		52%	53%	65%	75%	31%	43%
Iron Ore - lump		0.0	0.0	0.0	0.0	0.0	1.0
Iron Ore - fines		0.0	0.0	0.0	0.0	0.0	2.4
Total iron ore sales		0.0	0.0	0.0	0.0	0.0	3.3
Operating costs (A\$/t)		FY'09	FY'10E	FY'11E	FY'12E	FY'13E	FY'14E
Cash Operating Costs - coal		64.7	56.1	60.1	55.2	44.7	52.4
Total Operating Costs - coal		110.0	93.9	98.6	84.0	63.1	76.3
Average coal price received		145.5	109.3	157.3	163.4	110.7	115.0
EBIT Margin		35.5	15.4	58.7	79.4	47.6	38.6
Margin		24%	14%	37%	49%	43%	34%
Cash Operating Costs - iron ore						15.9	25.6
Total Operating Costs - iron ore						23.0	42.0
Average iron ore price received						98.8	93.0
Commodity price assumptions		FY'09	FY'10E	FY'11E	FY'12E	FY'13E	LT (2015)
Exchange Rate	A\$/US\$	0.75	0.89	0.93	0.95	0.92	0.80
Export thermal coal	US\$/t	111	77	98	97	91	68
Semi-soft coking coal	US\$/t	200	100	168	166	142	77
Coking coal	US\$/t	261	148	211	225	201	113
Iron ore - lump	US\$/t	117	93	138	124	116	68
Benchmark change (lump)	%	97%	-44%	88%	-9%	-5%	-26%
Iron ore - fines	US\$/t	82	75	110	99	93	52
Benchmark change (fines)	%	80%	-33%	83%	-9%	-5%	-28%
Key Financials		FY'09	FY'10E	FY'11E	FY'12E	FY'13E	FY'14E
Cash from Operations	A\$m	-15.9	41.0	20.1	-37.8	-0.3	179.0
Total Capex and Exploration	A\$m	-104.1	-94.9	-228.3	-1022.0	-1257.0	-925.1
Total borrowings	A\$m	21.5	21.5	821.5	2221.5	3071.5	3421.5
Closing Cash	A\$m	46.1	288.0	891.7	1238.9	838.6	463.1
Net Debt (Cash)	A\$m	-24.6	-266.5	-70.2	982.6	2232.9	2958.4
Gearing	%	-19%	-189%	-22%	75%	88%	88%
Half year details		1H'09	2H'09	1H'10E	2H'10E	1H'11E	2H'11E
AS:US\$ Exchange rate	A\$/US\$	0.78	0.71	0.87	0.92	0.92	0.95
Coal sales (mt)	Mt	0.33	0.30	0.75	0.42	0.43	0.43
Met coal %	%	38%	59%	53%	35%	35%	35%
Revenue (A\$m)	A\$m	56.3	35.9	76.1	52.7	67.8	67.3
EBIT (A\$m)	A\$m	-10.9	-31.7	-25.2	-25.5	5.8	7.3
Profit before tax (A\$m)	A\$m	-6.4	-32.7	-21.9	-23.0	5.5	7.0
Profit After Tax (A\$m)	A\$m	-3.6	-24.9	-12.4	-18.1	3.9	2.9
Reported profit (A\$m)	A\$m	-1.1	-24.9	-12.4	-18.1	3.9	2.9
Tax Rate	%	44%	24%	27%	43%	21%	32%
Valuation Breakdown		ASM	A\$/share	Risked to:	Share Res & Resource:	(Mt)	Life (Yrs)
Isaac Plains	378	\$1.10		Coal			
Belvedere	357	\$1.04	80%	Investec Est Coal Reserve	345	70.5	
Eagle Downs	179	\$0.52	70%	Coal Reserves	109	22.3	
Washpool Scorpio	127	\$0.37	55%	Coal Resources	1,331	n/a	
Botswana	59	\$0.17	20%				
West Pilbara	528	\$1.54	55%	Iron Ore			
East Pilbara	53	\$0.15	15%	Investec Est Iron Ore Res	277	24.8	
Other Projects & exploration	738	\$2.15		Iron Ore Reserves	0	0.0	
Investments	38	\$0.11		Iron Ore Resources	332	29.7	
Corporate & other	-67	-\$0.19					
Hedging	0	\$0.00					
Net cash	301	\$0.88					
Total NPV (risked)	2,776	\$8.09					

Source: Investec Estimates

Strengths	Weaknesses	Opportunities	Threats
<ul style="list-style-type: none"> Exposure to large scale coking coal and iron ore projects in key strategic basins (Bowen Basin and Pilbara) Demonstrated ability to add value to early stage development projects The relationship with Baosteel is expected to help underwrite project financing and help drive the project development timetable 	<ul style="list-style-type: none"> Projects are still at a relatively early stage. Project timing to development and capital costs remain uncertain Relations with JV partners have tended to be quite fractious Most projects have significant rail and port infrastructure challenges Iron Ore JV in the Pilbara partly dependent on small players with free carried interests 	<ul style="list-style-type: none"> Demonstrate value via the sale of various projects which may include Belvedere, Washpool and Avontuur Scope to share the cost of Pilbara rail and port infrastructure with FMG Baosteel may provide funding to accelerate project development Higher coking coal prices and fierce competition for quality coking coal assets may result in a premium to our valuation for Belvedere 	<ul style="list-style-type: none"> Delays to the development of the proposed Anketell Point port development in the Pilbara Lack of port access could delay Eagle Downs further The sale of Belvedere may be delayed if disputed valuations arise Lack of near-term cash flow and high potential capital commitments creates some market uncertainty

Aquila Resources

Summary financials - IFRS compliant

Year end: 30 June

Income Statement	2008	2009	2010E	2011E	2012E
Revenue	46.5	92.2	128.8	135.1	235.7
EBITDA	(31.2)	(36.2)	(45.0)	19.1	105.6
Depreciation and amortisation	(5.0)	(6.4)	(5.6)	(6.0)	(14.0)
Operating profit	(36.2)	(42.6)	(50.6)	13.1	91.6
Other income, JVs & associates	0.0	0.0	0.0	0.0	0.0
Net interest	4.4	3.6	5.7	(0.6)	33.0
Share-based payments	0.0	0.0	0.0	0.0	0.0
PBT (Normalised)	(31.8)	(39.0)	(44.9)	12.5	124.6
Impairment of acquired intangible assets	0.0	0.0	0.0	0.0	0.0
Non recurring items/Exceptionals	173.9	3.4	0.0	0.0	0.0
PBT (reported)	142.1	(35.6)	(44.9)	12.5	124.6
Taxation	(45.0)	9.6	14.4	(5.7)	(37.4)
Minorities & preference dividends	0.0	0.0	0.0	0.0	0.0
Discontinued / assets held for sale	0.0	0.0	0.0	0.0	0.0
Attributable profit	97.1	(26.0)	(30.5)	6.7	87.2
Net income (normalised)	(25.4)	(28.4)	(30.5)	6.7	87.2
EPS (reported) - FD (quote)	50.1	(10.4)	(9.5)	2.1	25.4
EPS (normalised, continuing) - FD (quote)	(13.1)	(11.4)	(9.5)	2.1	25.4
DPS (cents)	0.0	0.0	0.0	0.0	0.0
Average number of group shares - FD (m)	194.0	249.0	321.9	321.9	343.2
Average number of group shares (m)	194.0	249.0	321.9	321.9	343.2
Total number of shares in issue	194.0	249.0	321.9	321.9	343.2
Cash flow	2008	2009	2010E	2011E	2012E
Operating profit	(36.2)	(42.6)	(50.6)	13.1	91.6
Depreciation and amortisation	5.0	6.4	5.6	6.0	14.0
Other cash & non-cash movements	91.9	22.9	105.1	64.5	50.6
Change in working capital	(40.1)	49.9	0.0	0.0	0.0
Operating cash flow	20.6	36.6	60.1	83.6	156.2
Interest	3.7	3.6	5.7	(30.6)	(117.0)
Tax paid	0.0	(32.6)	14.4	(5.7)	(37.4)
Dividends from associates & JVs	0.0	0.0	0.0	0.0	0.0
Cash flow from operations	24.3	7.6	80.2	47.2	1.8
Maintenance CapEx	(2.0)	(16.3)	(16.3)	(2.1)	(3.6)
Free cash flow	22.3	(8.7)	63.9	45.1	(1.8)
Expansionary CapEx	(11.8)	(23.9)	(9.9)	(188.9)	(1,007.4)
Exceptionals & discontinued operations	0.0	0.0	0.0	0.0	0.0
Other financial	(57.1)	(85.6)	(107.9)	(64.5)	(50.6)
Acquisitions	0.0	0.0	0.0	0.0	0.0
Disposals	175.3	12.0	10.0	10.0	5.0
Net share issues	1.5	2.0	285.7	2.0	2.0
Dividends paid	0.0	0.0	0.0	0.0	0.0
Change in net debt	130.2	(104.3)	241.8	(196.3)	(1,052.8)
Net cash (debt)	144.1	52.0	293.9	97.6	(955.2)
FCFPS - FD (cents)	11.5	(3.5)	19.9	14.0	(0.5)
Balance sheet	2008	2009	2010E	2011E	2012E
Property, plant and equipment	38.9	62.8	73.3	248.4	1,240.4
Intangible assets	0.0	0.0	0.0	0.0	0.0
Investments & other non current assets	5.8	19.3	19.3	19.3	19.3
Cash & equivalents	159.4	73.5	315.4	919.1	1,266.3
Other current assets	88.7	55.1	55.1	55.1	55.1
Total Assets	292.8	210.7	463.1	1,241.9	2,581.1
Total debt	(15.3)	(21.5)	(21.5)	(821.5)	(2,221.5)
Preference shares	0.0	0.0	0.0	0.0	0.0
Other long term liabilities	(58.6)	(0.5)	(0.5)	(0.5)	(0.5)
Provisions & other current liabilities	(16.1)	(34.0)	(34.0)	(34.0)	(34.0)
Pension deficit & other adjustments	0.0	0.0	0.0	0.0	0.0
Total liabilities	(90.1)	(55.9)	(55.9)	(855.9)	(2,255.9)
Shareholder's equity	(202.7)	(154.8)	(407.2)	(385.9)	(325.1)
Minority interests	0.0	0.0	0.0	0.0	0.0
Total equity	(202.7)	(154.8)	(407.2)	(385.9)	(325.1)
Total equity and liabilities	(292.8)	(210.7)	(463.1)	(1,241.9)	(2,581.1)
Net working capital	73.5	23.6	23.6	23.6	23.6
NAV per share (cents)	104.5	62.2	126.5	119.9	94.7

Source: AQA Company accounts/Investec Bank estimates