



COMPANY UPDATE | COMMENT

JUNE 2, 2010

Aquila Resources Ltd. (ASX: AQA)
Sale of Belvedere Stake Appears Likely

Sector Perform
Above Average Risk

Table with 2 columns: Metric and Value. Includes Price (8.83), Price Target (11.00), Implied All-In Return (25%), Shares O/S (MM) (330.7), Dividend (0.00), Market Cap (MM) (2,920), NAVPS (9.19), Float (MM) (193.0), P/NAVPS (1.0x). Includes a note: 'Priced as of the close on the ASX, 2 June 2010.'

Event

Aquila in trading halt as Vale looks set to exercise Belvedere option

Investment Opinion

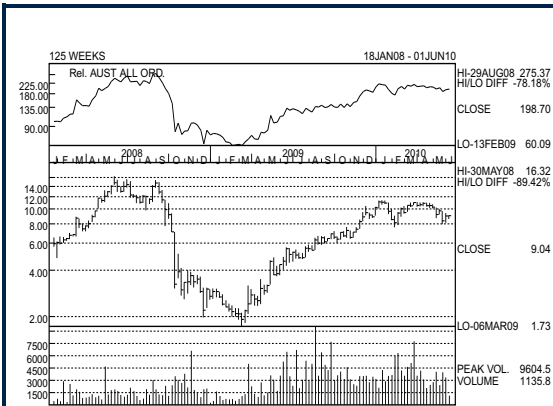
Aquila has gone into trading halt pending an announcement in relation to a transaction concerning one of its projects. Given Vale's option to acquire AQA's 24.5% stake in Belvedere expires June 3, we believe the trading halt indicates Vale has exercised this option.

Exercise price to be set at fair market value: Each party will submit its fair market value; if these are within 10% of each other, the exercise price is the average; if not, a 3rd party valuer is appointed whose value will be binding (this cannot be lower than the lower of the two submitted values).

AMCI deal indicates a floor price at A\$110m, but upside potential material: Vale recently acquired the AMCI holding company that owns the 24.5% AMCI stake in Belvedere for US\$92m (A\$110m). We expect this to provide a floor price. We believe AMCI was a willing seller - we understand it had outstanding financial obligations to Vale, while it has recently also finalised the deal to exit its 5% stake in the Minas Moatize coal project in Mozambique. In our NAV, we value Aquila's 24.5% stake at A\$143m. Given the large scale resource of 3.9bt (at 100%), transaction multiples would imply significantly higher values. RBCe average coal EV/Resource multiple of US\$1.56/t across historical met coal project acquisitions implies a value of A\$680m based on the 1.5bt M&I resource. However, given almost no transactions in the last 3yrs involving this scale of resource, read through here is limited (Vale acquired its 51% stake at US\$0.07/t in Jul-07).

Positive catalyst: While a final view on the transaction is dependent on pricing, we consider Vale's exercise of its option a positive for Aquila. Sale of Belvedere would allow Aquila to focus on its remaining development projects while further improving cash balances for project funding.

Maintain Sectorperform: We see value in the current AQA share price, however, given the current climate of uncertainty we believe the market will be less willing to ascribe value for longer dated, large capex projects such as those within the AQA portfolio. A key short term catalyst for AQA is the DFS on the West Pilbara Iron Ore Project due in June.



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Table with 5 columns: FY Jun, 2009A, 2010E, 2011E, 2012E. Rows include Adj EPS - FD, P/AEPS, Annual Div. - FD, EV/EBITDA.

All values in AUD unless otherwise noted.

Priced as of prior trading day's market close, EST (unless otherwise noted).

For Required Non-U.S. Analyst and Conflicts Disclosures, see page 4.

Exhibit 1: Summary financials

Aquila Resources																			
ASX: AQA	Share Price	8.83	Year end:		Jun	Stock Rating:	Sector Perform	Price Target:	A\$11.00										
	Mkt Cap:	2,920	Issued shares (m)		330.7	Risk Qualifier:	Above Average	NAV:	A\$9.19										
ASSUMPTIONS					ATTRIBUTABLE MINE STATS														
Exchange Rate	A\$/US\$	0.90	0.75	0.89	0.84	0.82	Coal Production (equity)												
Hard coking coal (FY avg)	US\$/t	148.5	257.3	146.8	247.5	216.3	Isaac Plains (50%)	mt	0.5	0.6	1.1	1.4	1.4						
LV PCI coal (FY avg)	US\$/t	111.9	206.3	110.5	178.3	155.5	Eagle Downs (50%)	mt	0.0	0.0	0.0	0.0	0.0						
Thermal coal (FY avg)	US\$/t	73.6	111.5	77.8	98.0	94.8	Belvedere (24.5%)	mt	0.0	0.0	0.0	0.0	0.0						
Hammersley Fines (FY avg)	USc/mtu	96.5	132.7	121.3	200.0	145.6	Total coal production	mt	0.5	0.6	1.1	1.4	1.4						
Hammersley Lump (FY avg)	USc/mtu	127.4	179.3	138.8	225.0	168.1	Coal Sales (equity)												
RATIO ANALYSIS					Iron Ore Production (equity)														
Diluted share capital	MM	255.0	254.5	330.7	330.7	330.7	Coking	mt	0.1	0.1	0.3	0.4	0.4						
EPS (diluted and pre sig. items)	A¢	-11.7	-14.0	-3.3	26.0	22.7	PCI/Semi-soft	mt	0.3	0.2	0.3	0.6	0.6						
P/E	x	nmf	nmf	nmf	33.9x	38.9x	Thermal	mt	0.2	0.3	0.5	0.4	0.4						
CFPS	A¢	0.9	(6.4)	9.9	40.5	31.3	Total coal sales	mt	0.5	0.6	1.1	1.4	1.4						
P/CF	x	nmf	nmf	89.1x	21.8x	28.2x	Avg Cash Price Realised	US\$/t	78.9	114.3	122.7	169.8	154.1						
DPS	A¢	0.0	0.0	0.0	0.0	0.0	Avg Cash Cost (incl royalties)	US\$/t	80.3	88.5	79.6	75.1	72.8						
Dividend yield	%	0.0%	0.0%	0.0%	0.0%	0.0%	Cash Margin	US\$/t	-1.4	25.8	43.2	94.7	81.3						
Franking Level	%	0%	0%	0%	0%	0%	Iron Ore Production (equity)												
Book value per share		0.79	0.61	1.32	1.58	1.81	West Pilbara Project (50%)	mt	0.0	0.0	0.0	0.0	0.0						
P/Book value	x	11.1x	14.5x	6.7x	5.6x	4.9x	GROUP RESERVES AND RESOURCES												
R.O.E. (pre sig items)	%	-12%	-22%	-2%	16%	13%	Coal Reserves (ex AEL)												
R.O.A. (pre sig items)	%	-12%	-19%	-5%	20%	15%	Proven	Probable	Total										
Interest Cover	x	8.3x	-6.3x	5.4x	-24.7x	-14.1x	Isaac Plains (50%)	26.0	39.5	65.5									
EBITDA per share	A\$ps	-0.13	-0.14	-0.05	0.39	0.34	Eagle Downs (50%)	97.9	59.6	157.5									
EV/EBITDA	x	nmf	nmf	nmf	20.1x	22.6x	Total reserves	123.9	99.1	223.0									
EARNINGS					Coal Resources (ex AEL)														
Sales Revenue	A\$MM	47	92	152	283	265	M & I	Inferred	Total										
Other Revenue	"	0	0	0	0	0	Isaac Plains (50%)	95	46	140									
Total Revenue	"	47	92	152	283	265	Eagle Downs (50%)	518	376	894									
Operating costs	"	(43)	(53)	(100)	(125)	(125)	Belvedere (24.5%)	1,002	1,473	2,475									
Operational EBITDA	"	4	39	52	158	140	Washpool (100%)	34	104	138									
Exploration Expense/Write-offs	"	(23)	(64)	(59)	(20)	(20)	Total resources	1,648	1,999	3,647									
Corporate & Other Costs	"	(15)	(10)	(10)	(8)	(9)	West Pilbara Iron Resources												
EBITDA	"	(34)	(35)	(17)	129	111	Tonnes (mt)	Fe %											
D&A	"	(2)	(5)	(6)	(11)	(11)	Channel iron deposits (39%)	586	56.5%										
EBIT	"	(36)	(41)	(23)	118	100	Bedded iron deposits (100%)	156	61.5%										
Net Interest	"	4	(6)	4	5	7	Total iron ore resources	742	57.5%										
Profit Before Tax	"	(32)	(47)	(19)	123	107	EPS SENSITIVITIES												
Tax Expense	"	7	13	9	(37)	(32)						FY10e	FY10e	FY11e	FY11e				
Minorities	"	0	0	0	0	0	Coal Prices (US\$/t)	+10%	0.6	118%	11.4	-56%							
Net Profit After Tax	"	(24)	(35)	(10)	86	75	-10%	(5.7)	-73%	4.6	-82%								
Significant Items (post tax)	"	122	9	0	0	0	A\$/US\$ (USc)	+10%	(4.7)	-43%	4.9	-81%							
Reported NPAT	"	97	(26)	(10)	86	75	-10%	0.1	103%	11.8	-55%								
CASHFLOW					ATTRIBUTABLE COAL PRODUCTION AND TRUE CASH COST PROFILE														
Operational Cash Flow	A\$MM	-1	20	21	149	131													
Net Interest	"	4	6	3	5	7													
Tax Paid and Other	"	0	(42)	10	(20)	(35)													
Net Operating Cashflow	"	2	(16)	33	134	104													
Exploration	"	(16)	(55)	(75)	(30)	(20) #													
Capital Expenditure	"	(13)	(18)	(32)	(42)	(2) #													
Investments	"	78	(2)	1	0	0 0													
Sale of PPE and Other	"	79	8	(1)	0	0 0													
Net Investing Cashflow	"	127	(66)	(108)	(72)	(22)													
Dividends Paid	"	0	0	0	0	0													
Debt	"	(5)	(3)	(5)	0	0													
Equity Issuance	"	1	2	286	0	0													
Other	"	0	(1)	(1)	0	0													
Net Financing Cashflow	"	(4)	(2)	280	0	0													
Net change in cash	"	125	(85)	205	62	82													
BALANCE SHEET					EQUITY DCF VALUATION														
Cash & Equivalents	A\$MM	159	74	278	340	422	Projects												
PP&E & Mine Development	"	39	63	91	121	112	Isaac Plains (50%)	438	1.36										
Exploration	"	3	3	13	23	23	Eagle Downs (50%)	592	1.84										
Total Assets	"	293	211	494	596	669	Belvedere (24.5%)	143	0.44										
Debt	"	15	21	16	16	16	Washpool (100%)	149	0.46										
Total Liabilities	"	90	56	57	74	71	West Pilbara Iron Ore (39%) - 50% weighted	1129	3.50										
Total Net Assets / Equity	"	203	155	436	522	597	Aquila Exploration Ltd assets	200	0.62										
Net Debt / (Cash)	"	(144)	(52)	(262)	(325)	(406)	Hedging	0	0.00										
Gearing (net debt/(nd + equity))	%	(246%)	(51%)	(151%)	(164%)	(213%)	Corporate	(34)	-0.11										
Gearing (net debt/equity)	%	(71%)	(34%)	(60%)	(62%)	(68%)	Net Cash/(Debt) & liquids - incl option strikes	346	1.07	P / NPV									
							Net Equity Value (@ 8% real d.r.)	2,963	9.19	1.0x									

Source: Company data, RBC Capital Markets estimates



Details

Aquila is in trading halt pending an announcement in relation to a transaction concerning one of its projects - We believe this relates to Aquila's 24.5% interest in the Belvedere project (Vale 51%; AMCI 24.5%).

Valuation

Our target of A\$11.00 is based on 1.20x NAV of A\$9.19, the average of our ASX coal coverage universe. We maintain our Sector Perform rating.

Price Target Impediment

Potential impediments to our price target include: (1) coal and iron ore price risk - a weakening in contract coal or iron ore prices would adversely affect earnings forecasts; (2) currency risk - a strengthening of the A\$/US\$ rate would adversely affect earnings forecasts; (3) development and financing risk - there are risks associated with the development and ramp-up of Aquila's coal and iron ore project base; and (4) operating risks - general mining and bulk transport risks, increases in key operating inputs (energy and labour costs) would adversely affect earnings forecasts.

Company Description

Aquila is an emerging coal and iron ore producer with a suite of large scale coal deposits in the Bowen Basin (Queensland) and channel iron deposits in the West Pilbara (Western Australia). The company also owns several earlier-stage coal, iron ore and manganese exploration assets in Australia and Africa.

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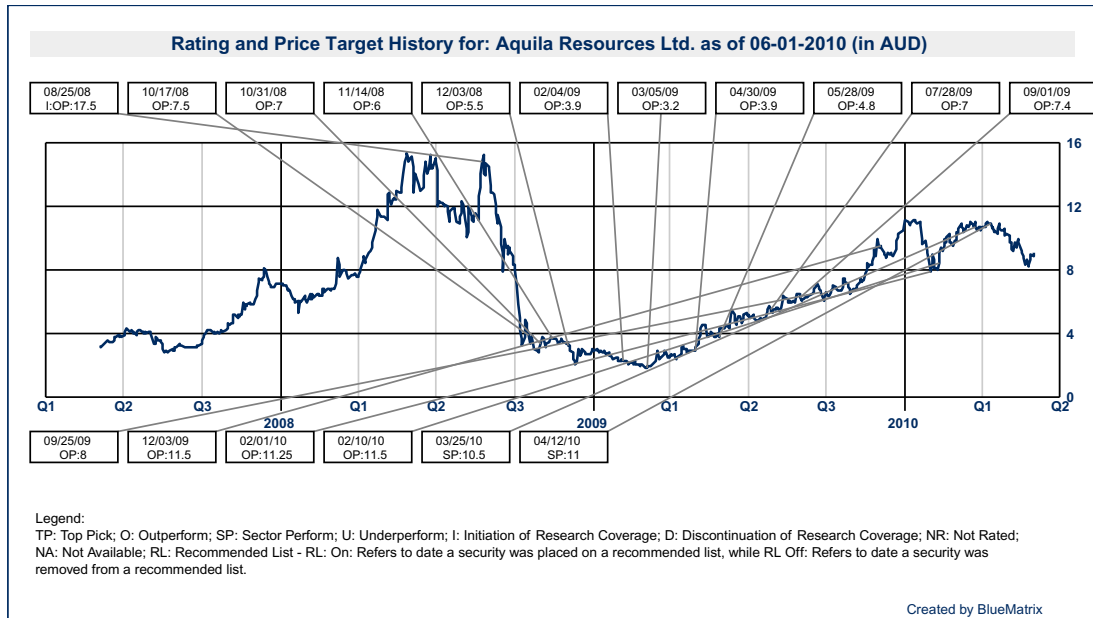
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