



COMPANY UPDATE | COMMENT

FEBRUARY 1, 2010

Aquila Resources Ltd. (ASX: AQA)

Building Confidence: Eagle Downs Resource Upgrade

Outperform
Above Average Risk

Price:	8.48	Price Target:	11.25
Shares O/S (MM):	327.8	Implied All-In Return:	33%
Dividend:	0.00	Market Cap (MM):	2,780
NAVPS:	8.98	Yield:	0.0%
Float (MM):	193.0	P/NAVPS:	0.9x

Substantial shareholders: Executive Chairman, Tony Poli (~25.7%), Baosteel (15%), Non-Executive Director, Charles Bass (~11%), AMCI (~7%).

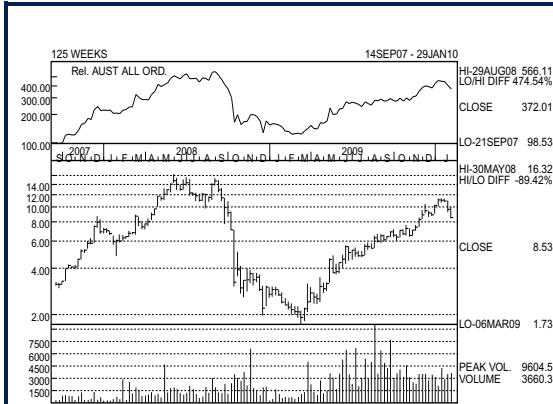
Priced as at 12:30pm, 2 February 2010, Australian Eastern Standard Time.

Event

Eagle Downs coking coal resource upgraded with 19% increase in Measured category to 340Mt

Investment Opinion

- Increase to M&I resource:** Aquila's upgraded coal resource for its 50%-owned Eagle Downs hard coking coal project represents a 1% increase in the total resource to 894Mt, but more importantly, it lifts the high confidence Measured & Indicated categories 19% and 8% to 340Mt and 179Mt, respectively. Thus, M&I resources have increased an aggregate 15% to 518Mt as coal was shifted from the Inferred category, which declined 13% to 376Mt.
- Potential Tier 1 asset:** Eagle Downs is planned as an underground, longwall mine with initial production of 4.6Mtpa hard coking coal and ultimately up to 8Mtpa. Production is expected from 2014 at an average operating cost of A\$73/t excluding royalties, and mine life is in excess of 40 years. Capex is estimated by Aquila at just under A\$1bn (100%). Eagle Downs is just one of a number of met coal and iron ore projects that include Washpool and Belvedere and the West Pilbara projects.
- What to look for in the short term:** Aquila foreshadowed a resource upgrade for Eagle Downs in its Dec Q 09 report. Other development milestones for the project due in the next six months are signing of long-term take-or-pay contracts (we assume 15 years) with Abbot Point coal terminal and completion of 3D seismic surveys to support the geological model and mine layout planning. We are also looking forward to the release of Belvedere's PFS this Q, feasibility work for Washpool and a decision on the expansion of Isaac Plains to 3.6Mtpa ROM.
- Valuation:** Our target of A\$11.25 is based on 1.25x NAV of A\$8.98. We give producing met coal companies a premium rating of 1.25x and add that Aquila also holds significant iron ore and manganese assets that it is advancing in tandem with its coal projects. Our target implies a 33% return from the current share price. We reiterate our Outperform rating.



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FY Jun	2008A	2009A	2010E	2011E
Adj EPS - FD	(0.12)	(0.14)	(0.03)	0.08
P/AEPS	NM	NM	NM	NM
Annual Div. - FD	0.00	0.00	0.00	0.00
EV/EBITDA	NMx	NMx	NMx	56.0x

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 5.

Increasing Confidence in Resource

Aquila has released an updated resource estimate for its 50%-owned Eagle Downs hard coking coal project in Queensland's Bowen Basin. While the total resource (Measured, Indicated & Inferred) is only 1% greater than the previous estimate of 884Mt, there has been a substantial increase in the Measured and Indicated categories and a decrease in Inferred resources (Exhibit 1).

Exhibit 1: Previous & Revised JORC Resource for Eagle Downs Project (100% basis) (Mt)

	Measured	Indicated	M&I	Inferred	Total resource
Updated resource	340	179	518	376	894
Previous resource	286	165	450	434	884
% change	19%	8%	15%	-13%	1%

Note: numbers are rounded to nearest whole

Source: Company reports

Thus, resources have been moved from the lower confidence Inferred category to the more robust M&I category. Importantly, 340Mt rests in the highest-confidence Measured category, an increase of 19% from the previous estimate. The increase comes with the addition of new data that included 83 holes, 7 of which are new and the remainder processed since the last statement, preliminary results from 3D seismic work and geostatistical analysis of the relevant seams.

To recap, features of Eagle Downs are:

- **Ownership:** Aquila 50%, Vale 50%
- **Reserves:** 159Mt
- **Resources:** 894Mt
- **Products:** hard coking coal
- **Mining method:** underground, 2x longwall
- **Production:** Stage 1 = 4.6Mtpa; Stage 2 = 8Mtpa
- **Operating cost:** A\$73/t excluding royalties
- **Mine life:** +40 years; development to commence 2012 and production beginning 2014
- **Capex:** A\$977m
- **Logistics:** "Foundation Customer" of Goonyella Abbot Point Expansion. Offer of 4Mtpa at Abbot Point X50 expansion (15Mtpa addition to take capacity to 50Mtpa) subject to long-term take-or-pay contracts, which are expected in the current Q.

We view Eagle Downs and the proposed 9Mtpa Belvedere project as potential Tier 1 assets that would rank amongst the largest Bowen Basin underground mines. Our valuation for Aquila's share of Eagle Downs is A\$582m or about one-fifth total NAV of A\$2.8bn and is based on a long-term hard coking coal price of US\$110/t and A\$/US\$ rate of 0.75.

We like Aquila's mix of coking and thermal coal, iron ore and manganese and rate the company Outperform. Aquila remains our preferred choice for hard coking coal exposure. In our view, its assets are at least equal to peers' as are its strategic partnerships, and it is well placed to take advantage of all-important port and rail expansions in Queensland. Our 12-month price target is A\$11.25, which implies a return of 33%.

Exhibit 2: Aquila Resources Financial & Production Summary

Aquila Resources																		
ASX: AQA	Share Price: 8.48	Year end: Jun	Stock Rating: Outperform		Price Target: A\$11.25													
	Mkt Cap: (2,804	Issued shares (m)	Risk Qualifier: Above Average		NAV: A\$8.98													
ASSUMPTIONS																		
		FY08	FY09	FY10e	FY11e	FY12e	ATTRIBUTABLE MINE STATS					FY08	FY09	FY10e	FY11e	FY12e		
Exchange Rate	A\$/US\$	0.90	0.75	0.87	0.87	0.84	Coal Production (equity)											
Hard coking coal (FY avg)	US\$/t	148.5	257.3	134.3	150.0	146.3	Isaac Plains (50%)	mt	0.5	0.6	1.3	1.4	1.4					
LV PCI coal (FY avg)	US\$/t	111.9	206.3	93.8	105.0	102.5	Eagle Downs (50%)	mt	0.0	0.0	0.0	0.0	0.0					
Thermal coal (FY avg)	US\$/t	73.6	111.5	73.3	80.0	78.8	Belvedere (24.5%)	mt	0.0	0.0	0.0	0.0	0.0					
Hammersley Fines (FY avg)	USc/mtu	96.5	132.7	101.9	116.4	113.5	Total coal production	mt	0.5	0.6	1.3	1.4	1.4					
Hammersley Lump (FY avg)	USc/mtu	127.4	179.3	117.6	134.4	131.0	Coal Sales (equity)											
RATIO ANALYSIS																		
		FY08	FY09	FY10e	FY11e	FY12e	Coking	mt	0.1	0.1	0.4	0.4	0.4					
Diluted share capital	MM	255.0	254.5	330.7	330.7	330.7	PCI/Semi-soft	mt	0.3	0.2	0.4	0.7	0.7					
EPS (diluted and pre sig. items)	A¢	-11.7	-14.0	-2.5	8.0	10.0	Thermal	mt	0.2	0.3	0.5	0.4	0.4					
P/E	x	nfm	nfm	nfm	105.6x	84.7x	Total coal sales	mt	0.5	0.6	1.3	1.4	1.4					
CFPS	A¢	0.9	(6.4)	9.5	15.2	15.2	Avg Cash Price Realised	US\$/t	78.9	114.3	105.4	109.1	108.8					
P/CF	x	nfm	nfm	89.6x	55.7x	55.8x	Avg Cash Cost (incl royalties)	US\$/t	80.3	88.5	70.0	70.6	69.7					
DPS	A¢	0.0	0.0	0.0	0.0	0.0	Cash Margin	US\$/t	-1.4	25.8	35.4	38.6	39.1					
Dividend yield	%	0.0%	0.0%	0.0%	0.0%	0.0%	Iron Ore Production (equity)											
Franking Level	%	0%	0%	0%	0%	0%	West Pilbara Project (50%)	mt	0.0	0.0	0.0	0.0	0.0					
Book value per share		0.79	0.61	1.22	1.30	1.40	GROUP RESERVES AND RESOURCES											
P/Book value	x	10.7x	13.9x	6.9x	6.5x	6.0x	Coal Reserves (ex AEL)			Proven	Probable	Total						
R.O.E. (pre sig items)	%	-12%	-22%	-2%	6%	7%	Isaac Plains (50%)	26.0	39.5	65.5								
R.O.A. (pre sig items)	%	-12%	-19%	-3%	7%	8%	Eagle Downs (50%)	97.9	59.6	157.5								
Interest Cover	x	8.3x	-6.3x	5.8x	-6.5x	-6.3x	Total reserves	123.9	99.1	223.0								
EBITDA per share	A\$ps	-0.13	-0.14	-0.01	0.13	0.16	Coal Resources (ex AEL)			M & I	Inferred	Total						
EV/EBITDA	x	nfm	nfm	nfm	56.7x	47.2x	Isaac Plains (50%)	95	46	140								
EARNINGS																		
		FY08	FY09	FY10e	FY11e	FY12e	Eagle Downs (50%)	518	376	894								
Sales Revenue	A\$MM	47	92	159	177	183	Belvedere (24.5%)	1,526	2,340	3,866								
Other Revenue	"	0	0	0	0	0	Washpool (100%)	34	104	138								
Total Revenue	"	47	92	159	177	183	Total resources	2,172	2,866	5,038								
Operating costs	"	(43)	(53)	(110)	(115)	(117)	West Pilbara Iron Resources			Tonnes (mt)	Fe %							
Operational EBITDA	"	4	39	49	63	66	Channel iron deposits (39%)	586	56.5%									
Exploration Expense/Write-offs	"	(23)	(64)	(43)	(10)	(5)	Bedded iron deposits (100%)	156	61.5%									
Corporate & Other Costs	"	(15)	(10)	(8)	(8)	(9)	Total iron ore resources	742	57.5%									
EBITDA	"	(34)	(35)	(3)	44	52	EPS SENSITIVITIES								FY10e	FY10e	FY11e	FY11e
D&A	"	(2)	(5)	(11)	(11)	(11)	Coal Prices (US\$/t)	+10%	Acps	%	Acps	%						
EBIT	"	(36)	(41)	(14)	33	41	-10%	0.6	124%	11.4	42%							
Net Interest	"	4	(6)	2	5	6		(5.7)	-125%	4.6	-43%							
Profit Before Tax	"	(32)	(47)	(11)	38	47	A\$/US\$ (USc)	+10%	(4.7)	-86%	4.9	-39%						
Tax Expense	"	7	13	3	(11)	(14)	-10%	0.1	104%	11.8	47%							
Minorities	"	0	0	0	0	0	ATTRIBUTABLE COAL PRODUCTION AND TRUE CASH COST PROFILE											
Net Profit After Tax	"	(24)	(35)	(8)	27	33												
Significant Items (post tax)	"	122	9	0	0	0												
Reported NPAT	"	97	(26)	(8)	27	33												
CASHFLOW																		
		FY08	FY09	FY10e	FY11e	FY12e												
Operational Cash Flow	A\$MM	-1	20	22	54	57												
Net Interest	"	4	6	3	5	6												
Tax Paid and Other	"	0	(42)	7	(9)	(13)												
Net Operating Cashflow	"	2	(16)	31	50	50												
Exploration	"	(16)	(55)	(43)	(10)	(5)												
Capital Expenditure	"	(13)	(18)	(30)	(32)	(2)												
Investments	"	78	(2)	0	0	0												
Sale of PPE and Other	"	79	8	0	0	0												
Net Investing Cashflow	"	127	(66)	(73)	(42)	(7)												
Dividends Paid	"	0	0	0	0	0												
Debt	"	(5)	(3)	(6)	0	0												
Equity Issuance	"	1	2	286	0	0												
Other	"	0	(1)	0	0	0												
Net Financing Cashflow	"	(4)	(2)	280	0	0												
Net change in cash	"	125	(85)	238	9	44												
BALANCE SHEET																		
		FY08	FY09	FY10e	FY11e	FY12e												
Cash & Equivalents	A\$MM	159	74	312	320	364												
PP&E & Mine Development	"	39	63	82	102	93												
Exploration	"	3	3	3	3	3												
Total Assets	"	293	211	459	488	522												
Debt	"	15	21	16	16	16												
Total Liabilities	"	90	56	54	56	57												
Total Net Assets / Equity	"	203	155	405	431	464												
Net Debt / (Cash)	"	(144)	(52)	(296)	(305)	(348)												
Gearing (net debt/(nd + equity))	%	(246%)	(51%)	(271%)	(240%)	(299%)												
Gearing (net debt/equity)	%	(71%)	(34%)	(73%)	(71%)	(75%)												
EQUITY DCF VALUATION																		
							A\$MM	A\$ps										
Projects							Isaac Plains (50%)	306	0.95									
							Eagle Downs (50%)	582	1.81									
							Belvedere (24.5%)	380	1.18									
							Washpool (100%)	140	0.43									
							West Pilbara Iron Ore (39%) - 50% weighted	970	3.01									
							Aquila Exploration Ltd assets	200	0.62									
							Hedging	0	0.00									
							Corporate	(29)	-0.09									
							Net Cash/(Debt) & liquids - incl option strikes	346	1.07									
							Net Equity Value (@ 8% real d.r.)	2,894	8.98									
									P / NPV									
									0.9x									

Source: Company data, RBC Capital Markets estimates



Valuation

Our target of A\$11.25 is based on 1.25x NAV of A\$8.98. We give producing met coal companies a premium rating of 1.25x and add that Aquila also holds significant iron ore and manganese assets that it is advancing in tandem with its coal projects.

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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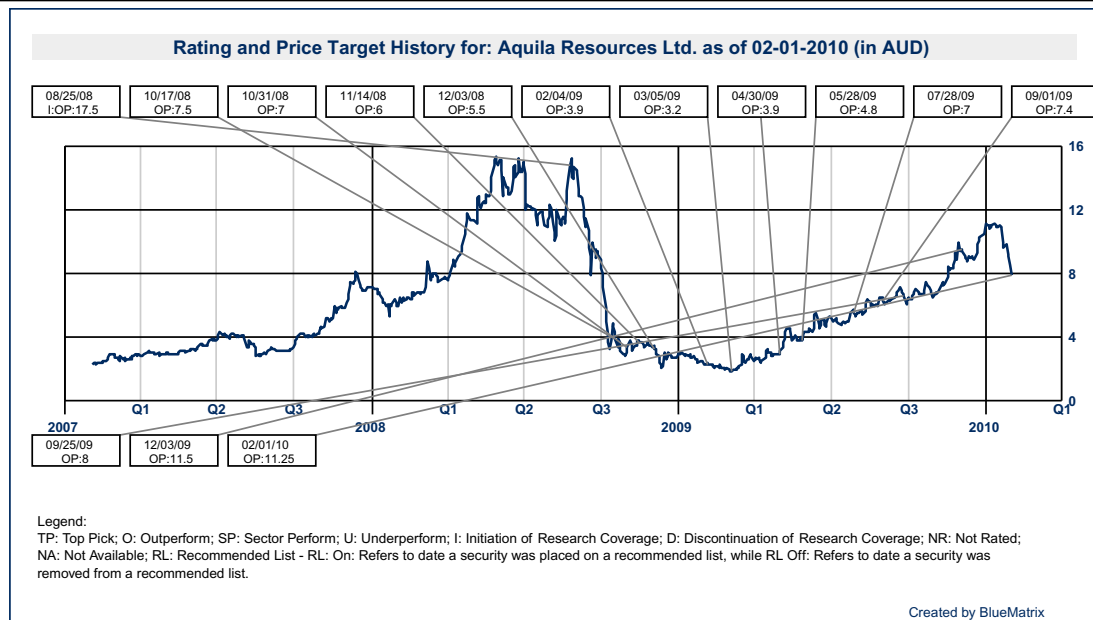
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HOLD[SP]	531	44.40	122	22.98
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