



## COMPANY UPDATE | COMMENT

FEBRUARY 26, 2010

## Aquila Resources Ltd. (ASX: AQA)

### In-line Result, Focus on Eagle Downs

### Outperform Above Average Risk

Price:	9.47	Price Target:	11.50
Shares O/S (MM):	330.7	Implied All-In Return:	21%
Dividend:	0.00	Market Cap (MM):	3,132
NAVPS:	9.29	P/NAVPS:	1.0x
Float (MM):	193.0		

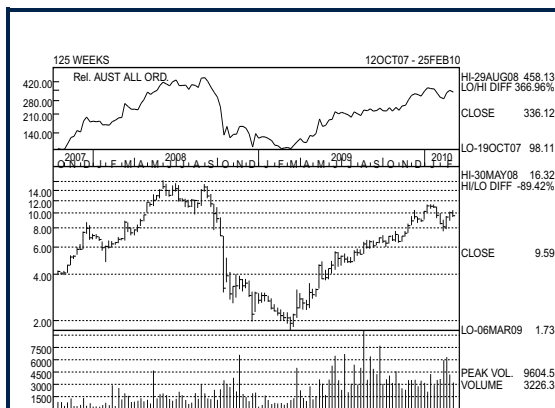
Priced as of the close on the ASX, 26 February 2010.

### Event

1H FY10 loss of A\$12m was ahead of our forecast but focus remains the Eagle Downs dispute with Vale.

### Investment Opinion

- **Loss due to exploration expense:** Reported loss for 1H of A\$12m (RBC: A\$16m) was due largely to expensing of the company's entire exploration and feasibility programmes, which totalled A\$31m. The accounts are clean and straight forward and largely as we expected. Isaac Plains mine EBITDA was A\$15m and revenue of A\$76m continues to grow with sales.
- **Revenue expected to increase in 2H:** The average received coal price for 1H FY10 of A\$101/t was well below the pcp at A\$169/t, as should be expected in light of the +50% decline in benchmark coal prices from the highs of JFY08. As a result, mine operating margin declined from 50% to 17%. This is entirely coal price driven as unit costs improved ~A\$1/t to A\$84/t. With higher coal benchmarks in JFY10 a near certainty, we forecast a better 2H of -A\$2m, inclusive of A\$28m exploration expense.
- **Cash rich:** Cash at 31 Dec 09 was A\$317m with just A\$16m debt. Cash was substantially boosted in 1H by Baosteel's purchase of 15% of Aquila that delivered A\$286m to the balance sheet.
- **Eagle Downs dispute:** On 23 Feb, Aquila disclosed a dispute with Eagle Downs JV partner, Vale, over signing of agreements for access to 4Mtpa capacity at the expanded Abbot Point terminal. The deadline for acceptance is 26 Feb 2010 after which time we understand allocated capacity will be lost. Aquila has issued Vale with a default notice, which will result in court hearings if Vale does not agree to enter into the prior infrastructure arrangements. Should the court find in favour of Aquila, we understand that the company then has the right to acquire Vale's 50% of the project at fair market value.
- **Valuation:** Our unchanged target of A\$11.50 is based on 1.25x NAV of A\$9.29. 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.



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FY Jun	2009A	2010E	2011E	2012E
Adj EPS - FD	(0.14)	(0.05)	0.13	0.14
Prev.		(0.02)		
P/AEPS	NM	NM	72.8x	67.6x
Annual Div. - FD	0.00	0.00	0.00	0.00
EV/EBITDA	NMx	NMx	41.7x	40.6x

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 6.

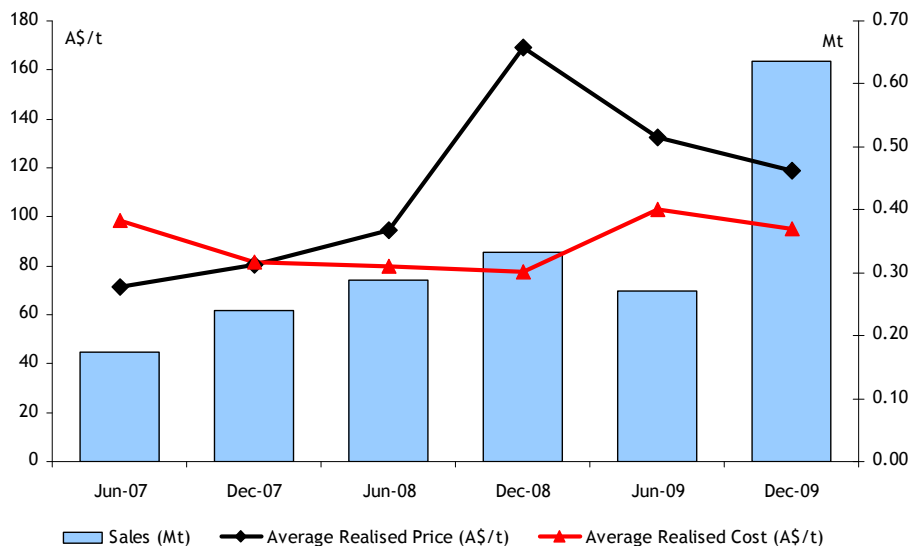
## A Clean Result

Aquila's 1H FY10 was a clean, straight forward loss of A\$12m and ahead of our forecast A\$16m loss. The main differences were due to lower-than-expected exploration expense of A\$31m and slightly lower revenue. The focus of Aquila is very much the development of its project portfolio; however, in the short term, the company is dealing with issues related to the Eagle Downs JV and its dispute with Vale.

Financial highlights were:

- **Loss of A\$12.4m:** Slightly better than the A\$16.3m loss we expected and compares to -A\$3.5m the pcg.
- **EBITDA:** Isaac Plains EBITDA was A\$15.4m (RBC: A\$24.3m), down 48% from the pcg due to lower received prices. Unit costs were stable over the period.
- **Cash & debt:** Cash is healthy with A\$317m at 31 Dec 09. We forecast this to fall to A\$289m by 31 June 10. The company has debt of just A\$16m.
- **Exploration:** Aquila spent A\$31m in 1H on exploration, all of it expensed. Going forward, we expect the expense to decrease as the DFS for the West Pilbara Iron Ore project is completed. For the 2H we anticipate A\$38m cash spend on exploration with A\$10m capitalized.

### Exhibit 1: Average Realised Prices & Costs (left) vs Coal Sales (right)



Source: Company reports, RBC Capital Markets estimates

## Project Summary and Highlights: All Systems Go

### Isaac Plains (50%, 2.8Mtpa saleable, PCI/SHCC/Thermal)

- **Sales:** All carry-over contracts have now been successfully renegotiated and trading has resumed with all term customers. The balance of FY10's production is almost fully committed to contract sales.
- **Stage 2 ramp-up:** Aquila is finalising approvals for a lift in ROM to 3.6Mtpa (2.8Mtpa saleable) with the conclusion of the public review period for environmental matters to final hearings at the Land Court during March 2010.
- Site operations have been consolidated under 2 contracts. The new contractor has now fully mobilised and was working at full capacity as of Dec 09.
- **Timeline:** We expect a final approval for stage 2 ramp-up in April.

**Eagle Downs (50%, 4.6Mtpa saleable HCC)**

- **Feasibility Study:** Completed during the half. Study results suggest A\$977m capex, inclusive of a A\$155m contingency, with operating costs of A\$73.20/t FOB ex royalty.
- **Vale dispute:** On 23 Feb, Aquila disclosed a dispute with Eagle Downs JV partner, Vale, over signing of agreements for access to 4Mtpa capacity at the expanded Abbot Point terminal. The deadline for acceptance is 26 Feb 2010 after which time we understand allocated capacity will be lost. Aquila has issued Vale with a default notice, which will result in court hearings if Vale does not agree to enter into the prior infrastructure arrangements. Should the court find in favour of Aquila, we understand that the company then has the right to acquire Vale's 50% of the project at fair market value.
- Aquila is dealing with issues related to the Eagle Downs JV and its dispute with Vale.

**Belvedere (24.5%, up to 9Mtpa saleable HCC)**

- **Pre-feasibility study:** Aquila has been working towards the completion of a pre-feasibility study during the half with technical work undertaken. Results due to be released in the current half.
- **Vale purchase option:** The first window in Vale's option to acquire Aquila's interest in Belvedere began Dec 09 and runs until early June 2010. Our current DCF valuation ascribes a value of A\$380m to Aquila's interest.

**Washpool (100%, 1.6Mtpa saleable HCC)**

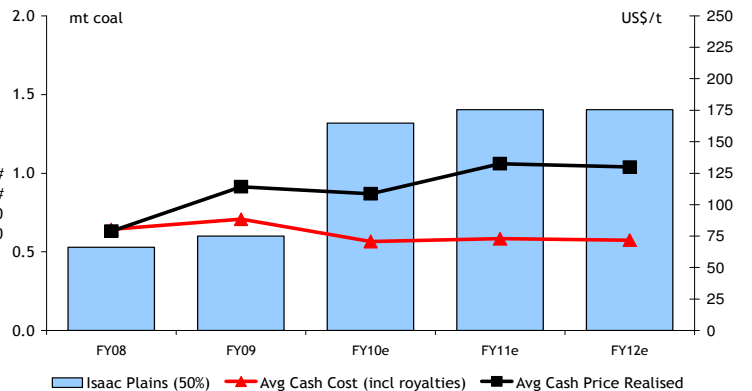
- **Feasibility study:** Currently being undertaken with the results scheduled to be released June 2010.
- Major field exploration activities were undertaken during 1H in order to upgrade the geological model and resource statement.
- A Mining Lease Application has been lodged with the Queensland Department of Employment, Economic Development and Innovation.
- Granting of the Mining Development License is imminent.

**West Pilbara Iron Ore (50% API JV, 30-40Mtpa direct ship channel iron ore & bedded iron ore)**

- **DFS:** Significant progress on the Definitive Feasibility Study has been made, with engineering works 85% complete.
- **Anketell Point port:** Work progressed on port process engineering and marine engineering during 1H.
- **Mining:** Work is progressing on optimising the mining and ore blending schedule.
- **Product development:** Phase 2 sinter testing of the West Pilbara Fines product was completed. Phase 3 sinter test-work is being prepared.
- **Timeline:** The DFS is due June 2010.

Exhibit 2: Aquila Summary Financials & Operations

Aquila Resources														
ASX: AQA	Share Price	9.47	Year end:	Jun	Stock Rating:	Outperform	Price Target:	A\$11.50						
	Mkt Cap:	3,132	Issued shares (m)	330.7	Risk Qualifier:	Above Average	NAV:	A\$9.29						
<b>ASSUMPTIONS</b>					<b>ATTRIBUTABLE MINE STATS</b>									
Exchange Rate	AS/US\$	0.90	FY08	FY09	FY10e	FY11e	FY12e	Coal Production (equity)		FY08	FY09	FY10e	FY11e	FY12e
Hard coking coal (FY avg)	US\$/t	148.5	257.3	143.0	185.0	178.8	178.8	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	100.0	130.0	123.8	123.8	Eagle Downs (50%)	mt	0.0	0.0	0.0	0.0	0.0
Thermal coal (FY avg)	US\$/t	73.6	111.5	75.8	90.0	87.5	87.5	Belvedere (24.5%)	mt	0.0	0.0	0.0	0.0	0.0
Hamersley Fines (FY avg)	USc/mtu	96.5	132.7	106.7	135.8	130.7	130.7	<b>Total coal production</b>	mt	<b>0.5</b>	<b>0.6</b>	<b>1.3</b>	<b>1.4</b>	<b>1.4</b>
Hamersley Lump (FY avg)	USc/mtu	127.4	179.3	123.2	156.8	150.9	150.9	<b>Coal Sales (equity)</b>						
<b>RATIO ANALYSIS</b>					<b>GROUP RESERVES AND RESOURCES</b>									
Diluted share capital	MM	255.0	254.5	330.7	330.7	330.7	330.7	Coal Reserves (ex AEL)	Proven	Probable	Total			
EPS (diluted and pre sig. items)	A¢	-11.7	-14.0	-4.6	13.1	13.5	13.5	Isaac Plains (50%)	26.0	39.5	65.5			
P/E	x	nmf	nmf	nmf	72.4x	70.1x	70.1x	Eagle Downs (50%)	97.9	59.6	157.5			
CFPS	A¢	0.9	(6.4)	13.4	25.8	22.7	22.7	<b>Total reserves</b>	<b>123.9</b>	<b>99.1</b>	<b>223.0</b>			
P/CF	x	nmf	nmf	70.8x	36.8x	41.7x	41.7x	<b>Coal Resources (ex AEL)</b>	M & I	Inferred	Total			
DPS	A¢	0.0	0.0	0.0	0.0	0.0	0.0	Isaac Plains (50%)	95	46	140			
Dividend yield	%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	Eagle Downs (50%)	518	376	894			
Franking Level	%	0%	0%	0%	0%	0%	0%	Belvedere (24.5%)	1,526	2,340	3,866			
Book value per share		0.79	0.61	1.31	1.44	1.57	1.57	Washpool (100%)	34	104	138			
P/Book value	x	11.9x	15.6x	7.2x	6.6x	6.0x	6.0x	<b>Total resources</b>	<b>2,172</b>	<b>2,866</b>	<b>5,038</b>			
R.O.E. (pre sig items)	%	-12%	-22%	-3%	9%	9%	9%	<b>West Pilbara Iron Resources</b>	Tonnes (mt)	Fe %				
R.O.A. (pre sig items)	%	-12%	-19%	-6%	11%	10%	10%	Channel iron deposits (39%)	586	56.5%				
Interest Cover	x	8.3x	-6.3x	6.7x	-12.2x	-9.3x	-9.3x	Bedded iron deposits (100%)	156	61.5%				
EBITDA per share	A\$ps	-0.13	-0.14	-0.06	0.21	0.21	0.21	<b>Total iron ore resources</b>	<b>742</b>	<b>57.5%</b>				
EV/EBITDA	x	nmf	nmf	nmf	41.6x	40.5x	40.5x	<b>EPS SENSITIVITIES</b>			FY10e	FY10e	FY11e	FY11e
<b>EARNINGS</b>					<b>ATTRIBUTABLE COAL PRODUCTION AND TRUE CASH COST PROFILE</b>									
Sales Revenue	A\$MM	47	92	163	215	218	218	Coal Prices (US\$/t)	+10%	0.6	113%	11.4	-13%	
Other Revenue	"	0	0	0	0	0	0	-10%	(5.7)	-24%	4.6	-65%		
<b>Total Revenue</b>	"	<b>47</b>	<b>92</b>	<b>164</b>	<b>215</b>	<b>218</b>	<b>218</b>	A\$/US\$ (USc)	+10%	(4.7)	-3%	4.9	-63%	
Operating costs	"	(43)	(53)	(116)	(118)	(121)	(121)	-10%	0.1	102%	11.8	-10%		
Operational EBITDA	"	4	39	48	97	97	97	<b>ISAC PLAINS (50%)</b>						
Exploration Expense/Write-offs	"	(23)	(64)	(59)	(20)	(20)	(20)	<b>Avg Cash Cost (incl royalties)</b>						
Corporate & Other Costs	"	(15)	(10)	(10)	(8)	(9)	(9)	<b>Avg Cash Price Realised</b>						
<b>EBITDA</b>	"	<b>(34)</b>	<b>(35)</b>	<b>(21)</b>	<b>68</b>	<b>69</b>	<b>69</b>							
D&A	"	(2)	(5)	(8)	(11)	(11)	(11)							
EBIT	"	(36)	(41)	(29)	57	58	58							
Net Interest	"	4	(6)	4	5	6	6							
<b>Profit Before Tax</b>	"	<b>(32)</b>	<b>(47)</b>	<b>(25)</b>	<b>62</b>	<b>64</b>	<b>64</b>							
Tax Expense	"	7	13	10	(19)	(19)	(19)							
Minorities	"	0	0	0	0	0	0							
<b>Net Profit After Tax</b>	"	<b>(24)</b>	<b>(35)</b>	<b>(14)</b>	<b>43</b>	<b>45</b>	<b>45</b>							
Significant Items (post tax)	"	122	9	0	0	0	0							
Reported NPAT	"	97	(26)	(14)	43	45	45							
<b>CASHFLOW</b>					<b>EQUITY DCF VALUATION</b>									
Operational Cash Flow	A\$MM	-1	20	32	88	89	89	Projects	A\$MM	A\$ps				
Net Interest	"	4	6	3	5	6	6	Isaac Plains (50%)	359	1.11				
Tax Paid and Other	"	0	(42)	10	(8)	(20)	(20)	Eagle Downs (50%)	582	1.81				
<b>Net Operating Cashflow</b>	"	<b>2</b>	<b>(16)</b>	<b>44</b>	<b>85</b>	<b>75</b>	<b>75</b>	Belvedere (24.5%)	380	1.18				
Exploration	"	(16)	(55)	(75)	(30)	(20)	(20)	Washpool (100%)	140	0.43				
Capital Expenditure	"	(13)	(18)	(32)	(42)	(2)	(2)	West Pilbara Iron Ore (39%) - 50% weighted	1016	3.15				
Investments	"	78	(2)	1	0	0	0	Aquila Exploration Ltd assets	200	0.62				
Sale of PPE and Other	"	79	8	(1)	0	0	0	Hedging	0	0.00				
<b>Net Investing Cashflow</b>	"	<b>127</b>	<b>(66)</b>	<b>(108)</b>	<b>(72)</b>	<b>(22)</b>	<b>(22)</b>	Corporate	(29)	-0.09				
Dividends Paid	"	0	0	0	0	0	0	Net Cash/(Debt) & liquids - incl option strikes	346	1.07				
Debt	"	(5)	(3)	(5)	0	0	0	<b>Net Equity Value (@ 8% real d.r.)</b>	<b>2,994</b>	<b>9.29</b>			<b>1.0x</b>	
Equity Issuance	"	1	2	286	0	0	0							
Other	"	0	(1)	(1)	0	0	0							
<b>Net Financing Cashflow</b>	"	<b>(4)</b>	<b>(2)</b>	<b>280</b>	<b>0</b>	<b>0</b>	<b>0</b>							
<b>Net change in cash</b>	"	<b>125</b>	<b>(85)</b>	<b>216</b>	<b>14</b>	<b>53</b>	<b>53</b>							



Source: Company data, RBC Capital Markets estimates



## Valuation

Our target of A\$11.50 is based on 1.25x NAV of A\$9.29. 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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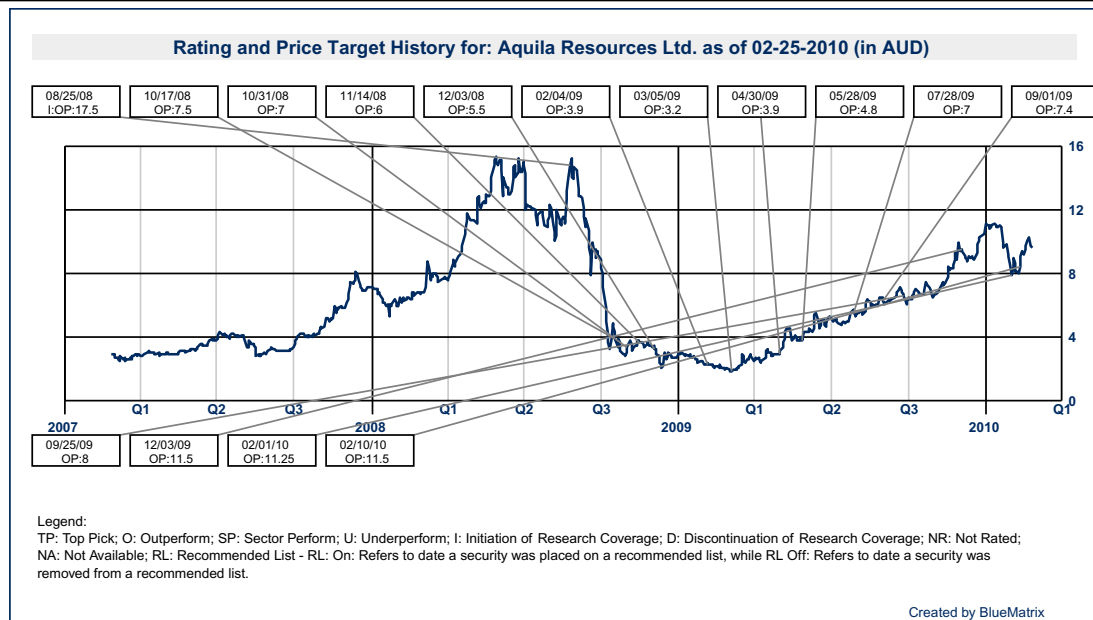
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	Count	Percent	Count	Percent
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HOLD[SP]	538	45.00	126	23.42
SELL[U]	64	5.40	7	10.94



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