



PRICE TARGET REVISION | COMMENT

FEBRUARY 1, 2010

Aquila Resources Ltd. (ASX: AQA)
A Busy Schedule

Outperform
Above Average Risk

Price:	7.91	Price Target:	11.25 ↓ 11.50
Shares O/S (MM):	327.8	Implied All-In Return:	42%
Dividend:	0.00	Market Cap (MM):	2,593
NAVPS:	8.98	Yield:	0.0%
Float (MM):	193.0	P/NAVPS:	0.9x

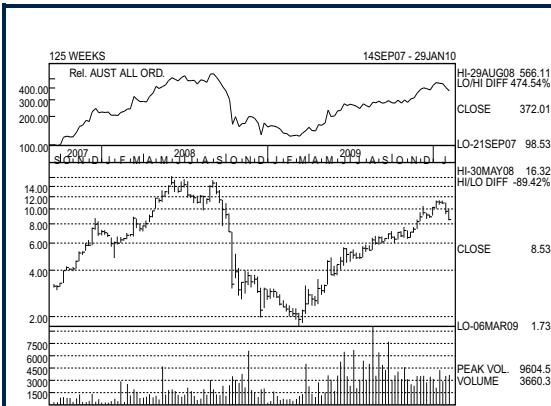
Substantial shareholders: Executive Chairman, Tony Poli (~25.7%), Baosteel (15%), Non-Executive Director, Charles Bass (~11%), AMCI (~7%).
 Priced as of market close, 1 February 2010, Australian Eastern Standard Time.

Event

Record coal sales in the Dec Q and projects advancing on many fronts. Maintain OP.

Investment Opinion

- **Record sales, solid production:** Sales from Isaac Plains (50%) were a record at 0.8Mt (100%) and ahead of our 0.6Mt as some coal was sold from stockpile. Met coal accounted for ~51% of sales, or 0.4Mt. Despite interruptions from wet weather and contractor changes, production was a respectable 0.6Mt (RBC: 0.6Mt). On an annualised basis, output is running ahead of the 2Mtpa ROM capacity and applications to expand to 0.6Mtpa ROM are well advanced.
- **Juggling many projects:** Aquila is attempting to advance many large projects, most of which currently target 2013-14 for start-up. They include: the 8Mtpa Eagle Downs (AQA: 50%); 9Mtpa Belvedere (24.5%) and 1.6Mtpa (100%) hard coking coal projects; the 40Mtpa West Pilbara iron ore projects (50%), including Anketell Pt; and South African iron ore and manganese (74%). There is real risk that the high work load could result in delays but strategic partners Vale and Baosteel are an advantage, in our view.
- **Estimate revisions:** We have lowered our FY10 forecast profit from a A\$8m gain to a loss of A\$8m to account for higher exploration costs in 1H of A\$19m. In line with the Sep Q, we expense all exploration, resulting in the turnaround. Cash on hand at 31 Dec 09 was A\$316m (RBC: A\$321m).
- **News flow:** With so many projects in development, news flow is a defining feature of Aquila in the short term and a busy 2H FY10 lies ahead. Over the next 6 months we expect announcements on the Isaac Plains expansion, the PFS for Belvedere and outcome of Vale's sale option, feasibility results for Washpool, initial resource for South African iron ore (Thabazimbi) and upgrade to manganese (Avontuur).
- **Valuation:** Our target of A\$11.25 (A\$11.50) is based on 1.25x NAV of A\$8.98 (A\$9.11). 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. Most ASX coals have undergone a steep correction and Aquila is no exception. It now trades at a 10% discount to our valuation and implied return to our target is 42%. Aquila is a growth company and our preferred ASX exposure for hard coking coal.



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FY Jun	2008A	2009A	2010E	2011E
Adj EPS - FD	(0.12)	(0.14)	(0.03)	0.08
Prev.			0.03	
P/AEPS	NM	NM	NM	NM
Annual Div. - FD	0.00	0.00	0.00	0.00
EV/EBITDA	NMx	NMx	NMx	52.0x

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.

A Busy Schedule Ahead

Dec Q production at the 50%-owned Isaac Plains coal mine of 0.6Mt (100%) was in line with our forecast but sales were ~0.2Mt better than we expected at almost 0.8Mt. However, current production is only a small part of the Aquila story and the Q report highlighted just how busy the company has been in advancing multiple projects that cover the bulk of steel making inputs.

YTD coal sales (PCI, semi-hard and thermal) are 1.5Mt on a 100% basis and the Dec Q's 0.8Mt was a record. The mine is clearly able to exceed capacity of 2Mtpa ROM despite interruptions from wet weather and consolidation of the contracts for mining and coal preparation. Approvals for expansion to 3.6Mtpa ROM (2.8Mtpa saleable) are progressing well with the public review period complete and final hearings of objections to be conducted in the current Q. We are confident that the mine can quickly move to the new level of output and forecast increased sales at capacity from the Sept Q 2010.

We are also encouraged by progress at the Washpool hard coking coal project as granting of a Mineral Development Licence is "imminent" and a Mining Lease Application has also been lodged. Eagle Downs (AQA: 50%) and Belvedere (AQA: 24.5%) are potential Tier 1 assets aiming to produce 8Mtpa and 9Mtpa hard coking coal, respectively, from ~2014. Vale has an option to purchase Aquila's share of Belvedere, which expires mid-2010 and we value that share at A\$380m.

For iron ore, we envisage initial production from 2013 at the West Pilbara projects with ramp-up to 30Mtpa over 2 years and a similar timetable for Hardey, which potentially adds 10Mtpa. In South Africa too, Aquila is advancing steel raw materials business with an initial resource for Thabazimbi iron ore expected in April 2010 and an upgrade of Avontuur's 33Mt manganese resource in the same month. Aquila clearly has bitten off a lot but we are encouraged by progress on so many fronts. Outperform.

Exhibit 1: Highlights of the Dec Q 09 and Near-term Timetable for Project Milestones

Mine/Project	Dec Q 2009	March Q 2010	June Q 2010
Isaac Plains (coal)	<ul style="list-style-type: none"> Consolidation of mining (John Holland) & CHPP (Ascentis) Contract with PN rail to complete rail & port contracts for 2.8Mt 	<ul style="list-style-type: none"> Final hearing with Environmental Approval objectors for expansion to 3.6Mtpa ROM 	
Eagle Downs (coal)	<ul style="list-style-type: none"> Acquisition of 3D seismic survey Signed as "Foundation Customer" for QR & GAPE port/rail access 	<ul style="list-style-type: none"> Conclusion of drilling for resource upgrade, currently 884Mt (100%) LT take-or-pay agreements for 4Mtpa 	<ul style="list-style-type: none"> 3D seismic processing and results
Belvedere (coal)	<ul style="list-style-type: none"> Declared "Significant Project" by Queensland government Completion of geological model and mine layout for C & D seams Cultural Heritage Management Plan signed off 	<ul style="list-style-type: none"> PFS due for release 	<ul style="list-style-type: none"> End of 6-month First Option Period for Vale to purchase Aquila's 24.5% of Belvedere
Washpool (coal)	<ul style="list-style-type: none"> Lodgment of Mining Lease Application and initial environmental applications 	<ul style="list-style-type: none"> Completion & release of Feasibility Study 	
West Pilbara Iron Ore	<ul style="list-style-type: none"> Environmental Scoping Document submitted to EPA for approval Potential mining contractors visited site Phase 2 of sinter test work complete Test work & mine planning for Hardey project commenced and 50 RC holes completed Resource upgraded from 63Mt to 156Mt Infill RC drilling completed at Kens Bore, Catho Well & Robe Exit Channel deposits 	<ul style="list-style-type: none"> Submission of draft Public Environmental Review for Anketell Point port 	
Thabazimbi Iron Ore	<ul style="list-style-type: none"> 14 drill holes completed at Meletse. Up to 68% Fe intersected 		<ul style="list-style-type: none"> Initial resource statement due
Northern Cape Iron Ore	<ul style="list-style-type: none"> Blackridge Prospecting Right granted 	<ul style="list-style-type: none"> Ground geophysics to commence 	
Avontuur Manganese	<ul style="list-style-type: none"> 26 holes drilled for resource upgrade, currently 33Mt @ 40% Mn 	<ul style="list-style-type: none"> Scout drilling of deposit outside defined resource 	<ul style="list-style-type: none"> Upgraded resource due

Source: Company reports

Exhibit 2: Aquila Resources Financial & Production Summary

Aquila Resources					
ASX: AQA	Share Price: 7.91	Year end: Jun	Stock Rating: Outperform	Price Target: A\$11.25	
	Mkt Cap: (2,616	Issued shares (m) 330.7	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
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
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
Hamersley 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
Hamersley Lump (FY avg)	USc/mtu	127.4	179.3	117.6	134.4	131.0						

RATIO ANALYSIS		FY08	FY09	FY10e	FY11e	FY12e
Diluted share capital	MM	255.0	254.5	330.7	330.7	330.7
EPS (diluted and pre sig. items)	A¢	-11.7	-14.0	-2.5	8.0	10.0
P/E	x	nmf	nmf	nmf	98.5x	79.0x
CFPS	A¢	0.9	(6.4)	9.5	15.2	15.2
P/CF	x	nmf	nmf	83.6x	52.0x	52.1x
DPS	A¢	0.0	0.0	0.0	0.0	0.0
Dividend yield	%	0.0%	0.0%	0.0%	0.0%	0.0%
Franking Level	%	0%	0%	0%	0%	0%
Book value per share		0.79	0.61	1.22	1.30	1.40
P/Book value	x	10.0x	13.0x	6.5x	6.1x	5.6x
R.O.E. (pre sig items)	%	-12%	-22%	-2%	6%	7%
R.O.A. (pre sig items)	%	-12%	-19%	-3%	7%	8%
Interest Cover	x	8.3x	-6.3x	5.8x	-6.5x	-6.3x
EBITDA per share	A\$ps	-0.13	-0.14	-0.01	0.13	0.16
EV/EBITDA	x	nmf	nmf	nmf	52.4x	43.6x

EARNINGS		FY08	FY09	FY10e	FY11e	FY12e
Sales Revenue	A\$MM	47	92	159	177	183
Other Revenue	"	0	0	0	0	0
Total Revenue	"	47	92	159	177	183
Operating costs	"	(43)	(53)	(110)	(115)	(117)
Operational EBITDA	"	4	39	49	63	66
Exploration Expense/Write-offs	"	(23)	(64)	(43)	(10)	(5)
Corporate & Other Costs	"	(15)	(10)	(8)	(8)	(9)
EBITDA	"	(34)	(35)	(3)	44	52
D&A	"	(2)	(5)	(11)	(11)	(11)
EBIT	"	(36)	(41)	(14)	33	41
Net Interest	"	4	(6)	2	5	6
Profit Before Tax	"	(32)	(47)	(11)	38	47
Tax Expense	"	7	13	3	(11)	(14)
Minorities	"	0	0	0	0	0
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%)

Coal Production (equity)		FY08	FY09	FY10e	FY11e	FY12e
Isaac Plains (50%)	mt	0.5	0.6	1.3	1.4	1.4
Eagle Downs (50%)	mt	0.0	0.0	0.0	0.0	0.0
Belvedere (24.5%)	mt	0.0	0.0	0.0	0.0	0.0
Total coal production	mt	0.5	0.6	1.3	1.4	1.4
Coal Sales (equity)		FY08	FY09	FY10e	FY11e	FY12e
Coking	mt	0.1	0.1	0.4	0.4	0.4
PCI/Semi-soft	mt	0.3	0.2	0.4	0.7	0.7
Thermal	mt	0.2	0.3	0.5	0.4	0.4
Total coal sales	mt	0.5	0.6	1.3	1.4	1.4
Avg Cash Price Realised	US\$/t	78.9	114.3	105.4	109.1	108.8
Avg Cash Cost (incl royalties)	US\$/t	80.3	88.5	70.0	70.6	69.7
Cash Margin	US\$/t	-1.4	25.8	35.4	38.6	39.1

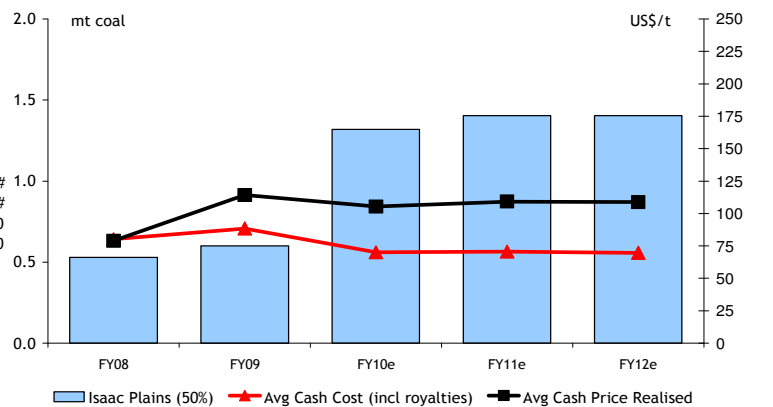
GROUP RESERVES AND RESOURCES		Proven	Probable	Total
Coal Reserves (ex AEL)				
Isaac Plains (50%)		26.0	39.5	65.5
Eagle Downs (50%)		97.9	59.6	157.5
Total reserves		123.9	99.1	223.0

Coal Resources (ex AEL)	M & I	Inferred	Total
Isaac Plains (50%)	95	46	140
Eagle Downs (50%)	450	434	884
Belvedere (24.5%)	1,526	2,340	3,866
Washpool (100%)	34	104	138
Total resources	2,104	2,924	5,028

West Pilbara Iron Resources	Tonnes (mt)	Fe %
Channel iron deposits (39%)	586	56.5%
Bedded iron deposits (100%)	156	61.5%
Total iron ore resources	742	57.5%

EPS SENSITIVITIES		FY10e	FY10e
Coal Prices (US\$/t)	+10%	Acps 8.0	% -315%
	-10%	2.1	-82%
A\$/US\$ (USc)	+10%	3.1	-120%
	-10%	7.5	-294%

ATTRIBUTABLE COAL PRODUCTION AND TRUE CASH COST PROFILE



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 (A\$11.50) is based on 1.25x NAV of A\$8.98 (A\$9.11). 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. Most ASX coals have undergone a steep correction and Aquila is no exception. It now trades at a 10% discount to our valuation and implied return to our target is 42%. Aquila is a growth company and our preferred ASX exposure for hard coking coal.

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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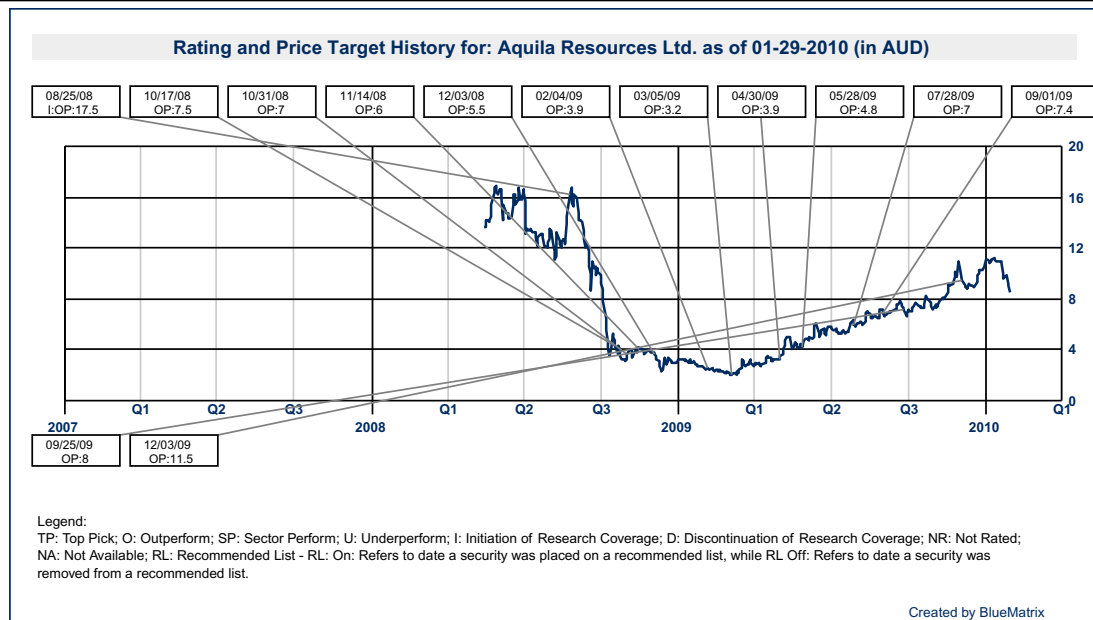
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	Count	Percent	Count	Percent
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HOLD[SP]	531	44.40	122	22.98
SELL[U]	71	5.90	6	8.45



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