8 March 2010

Aquila Resources (AQA)

Strategic value in steel making materials

Analyst
Fleur Grose 612 8224 2845

Authorisation
Peter Chapman 612 8224 2847

Recommendation

Accumulate

Price

$10.92

Target (12 months)

$11.90

AQA is an emerging producer of coking coal, iron ore and manganese, the key suite of steel making raw materials. It has the potential to become the 4th largest producer of this commodity mix behind Vale, BHP and Anglo. Baosteel has recognised the value of the portfolio with a 15% strategic stake. We continue to recommend accumulating stock due to the potential for positive surprises.

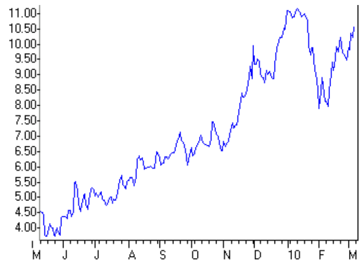
Expected Return

Capital growth	**9%**
Dividend yield	**0%**
Total expected return	**9%**

Company Data & Ratios

Enterprise value	**$3,218m**
Market cap	**$3,519m**
Issued capital	**322m**
Free float	**44.9%**
12 month price range	**$1.77-11.38**
GICS sector	**Materials**

Absolute Price



SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

The right commodities in the right places

AQA has a highly attractive portfolio of assets in world class provinces; coking coal in the Bowen Basin, iron ore in the Pilbara, and manganese in the Kalahari manganese field. In most cases these assets are adjacent to existing producers of high value scarce products. The highest priority projects could be sufficient to support equity production of up to 18.6Mtpa of iron ore, 5Mtpa of coking coal, and 0.74Mpta of manganese. Baosteel could assist with funding and off-take, and may invest further at the project level.

High risk / high reward

The broad portfolio brings optionality, through the ability to trade highly sought after assets, and the potential for further discoveries. However, with only one asset in production, significant earnings are at least 3 years away, and the growth projects are still subject to timing, execution and infrastructure risks. We have set an $11.90 price target, supported by our valuation, which accounts for all known resources, but allows a discount for infrastructure risks. Due to recent share price appreciation, we have downgraded to Accumulate (from Buy), but recognise the potential for positive surprise as asset negotiations and development decisions take place.

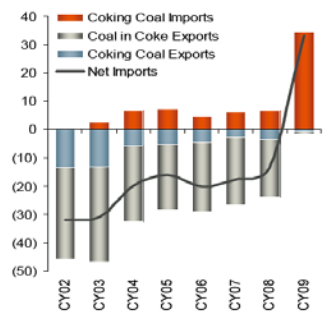
Earnings Forecast June

Year end	2010e	2011e	2012e	2013e
NPAT (reported) (A$m)	-4.6	30.1	56.5	264.1
NPAT (adjusted) (A$m)	-9.7	30.1	56.5	264.1
EPS (adjusted) (cps)	-1.4	8.9	16.7	77.3
EPS growth (%)	na	na	0.9	3.6
PER (x)	na	123.1	65.5	14.1
P/CFPS (x)	na	95.9	55.7	14.7
EV/EBITDA (x)	na	100.0	44.9	11.6
Dividend (¢ps)	0.0	0.0	0.0	0.0
Yield (%)	0.0	0.0	0.0	0.0
ROE (%)	-1.1	6.8	11.4	33.7

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Exposure to the right commodities

Figure 1: China swings to net importer



Source: BHP Billiton 2010

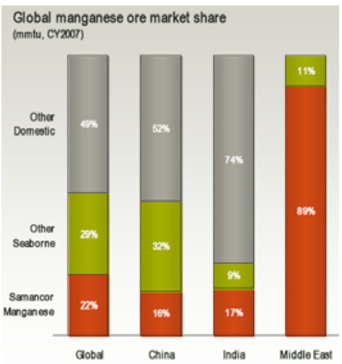
Coking coal – already scarce, and now China wants more

Demand for coking coal is expected to rise with increasing steel production. But what makes coking coal so attractive is the lack of supply. Thermal coal is relatively abundant, but premium hard coking is found in few basins globally. The market is so tight that when there is wet weather in Queensland, the world's largest supplier of seaborne coking coal, the price spikes, as just a few days delay in shipments impacts the market.

What has added to the positive outlook for coking coal is that China suddenly turned from net exporter to net importer in 2009. Unlike iron ore, China was self-sufficient in coking coal, so the traditional markets for seaborne trade have been Japan, Korea and Europe. Forced mine closures in China in 2009 due to safety concerns caused the initial swing to imports, but imports have been sustained at an average rate of 30-40Mpta for more than 12 months now. If this level persists, even new coking coal projects in Mongolia (up to 20Mtpa), and Mozambique (up to 16Mpta), still won't bring the market back into balance in the short term. At the same time Indian exports are declining due to an increasing domestic requirement which is further tightening the market.

BHP has settled some quarterly contracts at US$200/t up from US$127/t last year. We have a long term price assumption of US$150/t.

Figure 2: Manganese market share



Source: BHP Billiton 2008

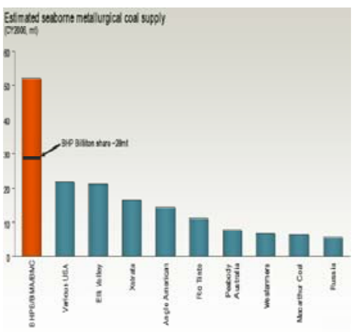
Iron Ore – supply slow to meet demand

Increasing Chinese demand should keep the iron ore markets in deficit for at least the next 3 years. There is no shortage of iron ore, but the exploration, capital and infrastructure required to increase production creates a lag between in meeting market demand. Supply should eventually catch up, and iron ore prices should retrace, but with our long term price expectation of 90c/dltu, low cost Australian producers should still make good margins.

Manganese – need more high grade deposits

Steel making also requires manganese, and the demand fundamentals for this commodity are similar to iron ore. The supply story is also similar, in that the grade of Chinese domestic production has been falling, and there is strong demand for high grade product. Low grade is considered <30%, medium grade 30-42%, and high grade >42%. We have a long term assumption of US$6.00/mtu for high grade product.

Figure 3: Coking coal market share



Source: BHP Billiton 2008

Customers want to diversify supply away from majors

Another important factor in all these markets is that they are tightly controlled by the majors. In iron ore the top 3 producers make-up c.70% of seaborne trade, in manganese the top 5 producers make-up c. 80% of seaborne trade, and in coking coal BHP Billiton Mitsubishi Alliance (BMA) dominates the market (Figure 3). Specifically, BHP is #1 in coking coal and manganese, and # 3 in iron ore.

Heavily concentrated supply, brings supply discipline and pricing power. In turn, that brings opportunities for independent producers which are welcomed for diversification and price tension by customers. The disadvantage however for new players is that the barriers to entry are high, through the need for expensive infrastructure, which is often not justifiable for one off projects.

A big footprint in elephant country

Aquila has projects in existing world class provinces, coking coal in the Bowen Basin, iron ore in the Pilbara, and manganese in the Kalahari Basin. In most cases deposits are close to those of existing producers and global majors, and in some cases they are right next door. The benefit of being in "elephant country" is that the chance of finding world class deposits is greater.

Coking Coal Elephant Country = the Bowen Basin

64% of the world's seaborne coking coal comes from the Bowen Basin (Figure 4). Here, AQA has accumulated tenements close to those of existing producers and global majors. AQA has projects next to BMA's Peak Downs and Goonyella Riverside, producers of the world's premium brands.

ISAAC PLAINS (AQA/VALE 50/50)

Isaac Plains is located to the east of Moranbah, right in the centre of the Bowen Basin coal mining district. The mine produces a mix of thermal, PCI, and semi-hard coking coal. This is not a premium mix, but as an opencut, was relatively easy to get into production, and is ramping up to full capacity (AQA 1.4Mtpa).

EAGLE DOWNS (AQA/VALE 50/50)

Eagle Downs is located immediately adjacent to and down dip of BMA's Peak Downs. Peak Downs is a large open pit operation producing high quality hard coking coal, one of BMA's premium brands. Eagle Downs would mine the same coal measures, but at costs marginally above those that can be achieved by BMA as Peak Downs also increases in depth.

BELVEDERE (VALE/AQA/AMCI 51/24.5/24.5)

Belvedere is located to the north of Moura in the Southern Bowen Basin immediately adjacent to and down dip of Anglo American Metallurgical Coal's Dawson Mine. Dawson is an open cut mine with potential to produce 12Mtpa of coking, soft coking and thermal coal. AQA/Vale would be mining the same coal measures, although by more expensive underground mining methods.

WASHPOOL (AQA 100%)

Washpool is located to the north west of Blackwater, and is close to Curragh (WES). Curragh produces low ash hard coking coal and PCI coal for export, and high ash thermal coal which is sold to a domestic power station. Washpool would produce a higher ash coking coal with good coking properties.

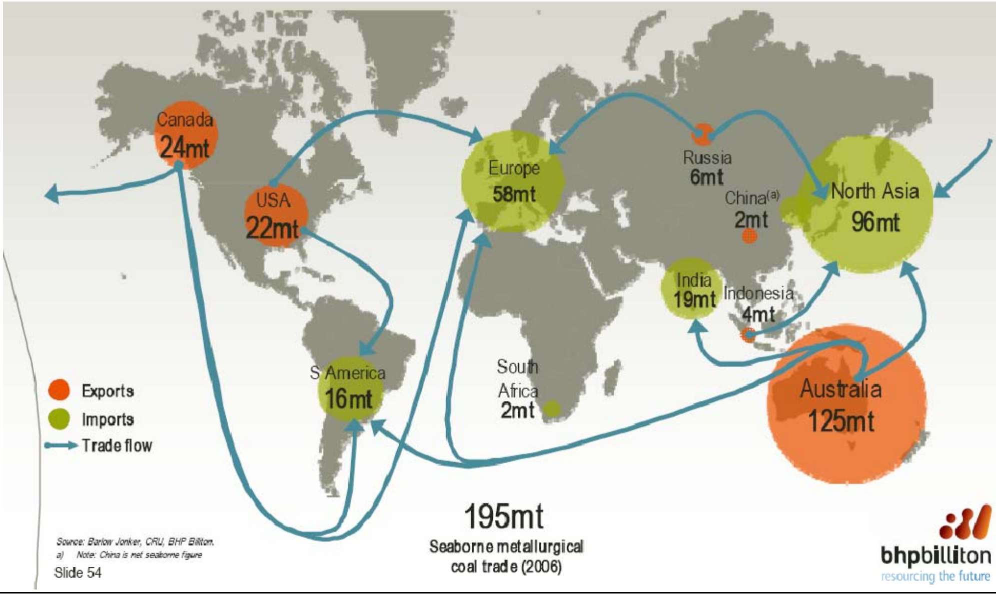
RED HILL (AQA 100%)

Red Hill is located to the north of Moranbah and is adjacent to Goonyella Riverside, operated by BMA. This is one of the largest open cut operations in Australia with a capacity of 15Mtpa and produces high quality coking coal, another of BMA's premium brands. Burton open-cut mine owned by Peabody Energy Australia Coal Pty Ltd is also close-by, and produces medium volatile hard and semi-hard coking and thermal coal.

NUMEROUS OTHER TENEMENTS (AQA 50% OR 100%)

AQA has many more tenements, but with priority being given to the projects above, there has been little exploration. These are shown in Figure 5. It is likely that some tenements considered to be non-core, could be sold to fund higher value projects.

Figure 4 – Bowen Basin – Home of coking coal



SOURCE: BHP BILLITON 2008

Figure 5 – AQA 100% tenements, in addition to 3 projects with Vale

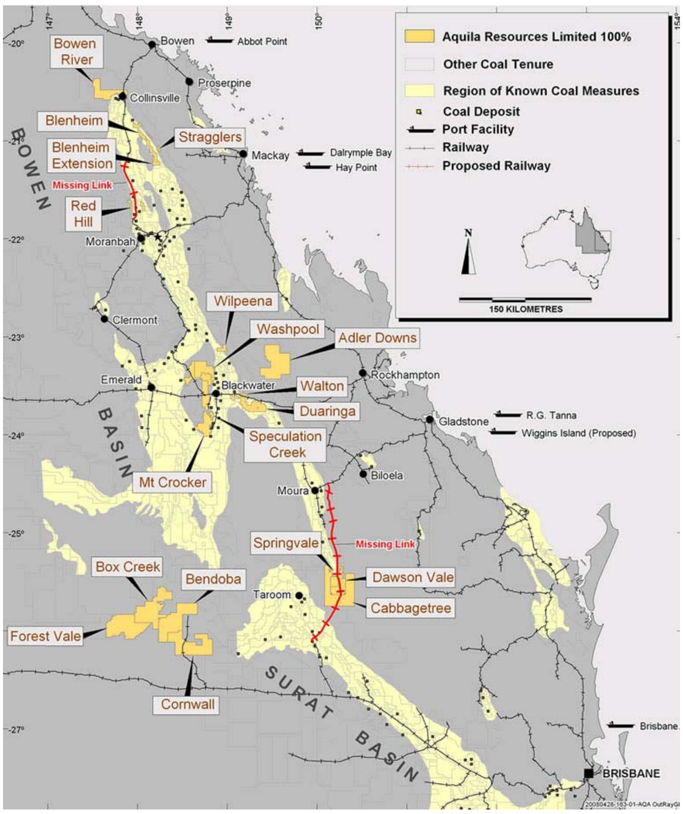
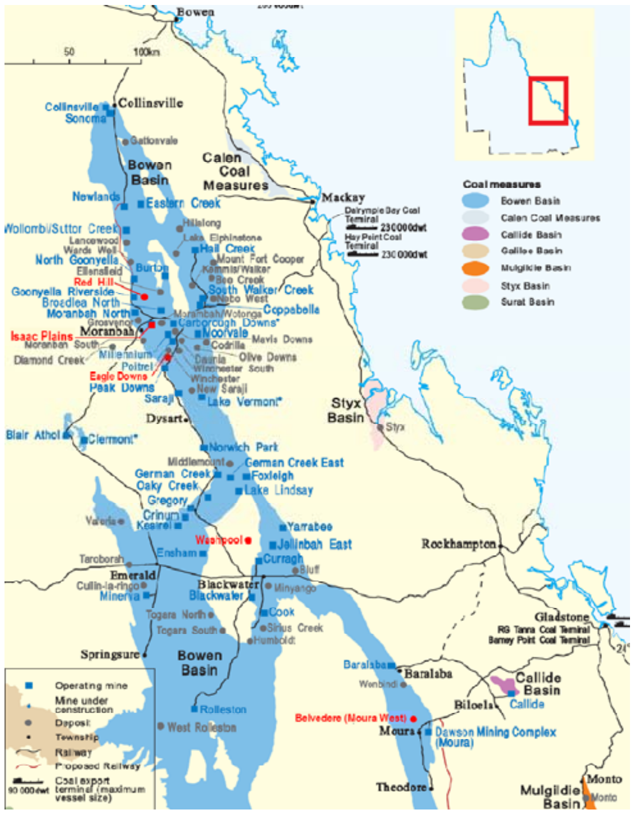


Figure 6 – AQA projects next to other Bowen Basin mines



SOURCE: COMPANY DATA

SOURCE: COMPANY DATA

Iron Ore Elephant country = The Pilbara

LARGE TENEMENT HOLDING VIA API (AQA 50%, AMCI 50%)

The Pilbara region of Western Australia is one of the premier iron ore provinces globally for both its vast metal endowment and location close to the Asian market. BHP, RIO, and FMG, three of the four largest iron ore producers, export from the Pilbara. AQA has a large tenement landholding in the province through the Australian Premium Iron JV (API), in which AQA has a 50% interest. The API holds approximately 9,350km^2.

API is currently developing Stage 1 (30Mtpa 100%) of the Project, which is based initially on pisolite (channel iron) ore deposits located 30 to 85 km south west of Pannawonica (Robe River, RIO).

The East Pilbara projects are located between Paraburdoo (Hamersley, RIO), Tom Price (RIO) and Newman (BHP) areas. The tenements and are believed to be prospective for Marra Mamba and Brockman Iron Formations. The Hardey deposit could support additional production of 10Mpta of BID (bedded iron).

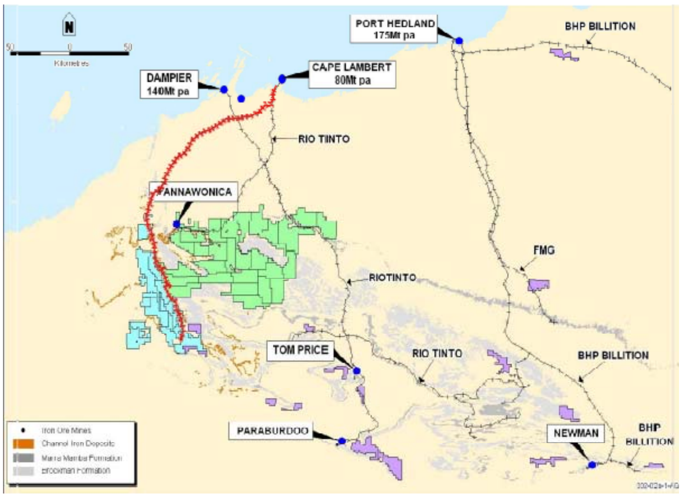
NEW PORT ANKETELL POINT PROPOSAL

API's WPIOP (West Pilbara Iron Ore Project) is proposing a fourth port for the Pilbara, in addition to Port Hedland (BHP, FMG + independents), Cape Lambert and Dampier (RIO). Whilst the port at Anketell Point has an initial design capacity for up to 40Mtpa to accommodate API's projects, provision has been made to allow for the progressive expansion of the facilities for other users, up to 350Mtpa of export capacity. FMG has expressed interest in using the port for any expansion beyond 155tpa, for its Eastern Pilbara tenements. China Metallurgical may use it for its 15 Mtpa Cape Lambert Project.

The port was approved by the WA government on March 5 2010, and the next step is for government approvals to be received in the middle of 2011, followed by two years of construction, with production expected late in 2013.

The benefit of this project is that it offers API the opportunity to manage its own infrastructure.

Figure 7 – Proposed port and rail



SOURCE: COMPANY

Figure 8 – Proposed port

SOURCE: COMPANY

Manganese elephant country = Kalahari Basin

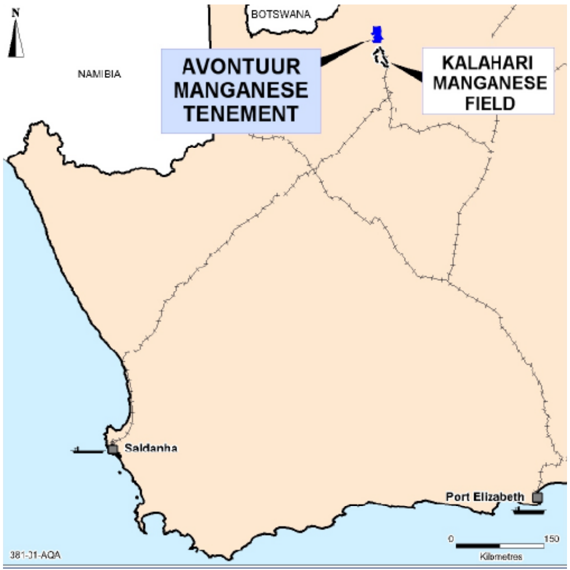
AQA's 74% owned Avontuur Manganese project is just north of the Kalahari Basin in South Africa. The majority of the world's high grade manganese comes from Australia, the Kalahari Basin, Gabon (Eramet) and Brazil (Vale).

The Avontuur resource is 34Mt @ 40% Mn which would be considered medium to high grade. There are two separate resources 25km apart, with one only 20km north of Samancor's Wessels mine. The larger of the two is the Gravenhage resource at 32.5Mt @ 39.9% Mn, which is relatively shallow, and suitable for a 1Mtpa operation with a mine life of 15 years.

There remains potential to increase the resource along strike and down dip along the existing 5km resource envelope, and along a further 10km strike extension. We are expecting a resource upgrade soon. The size, grade, and commercial potential of this resource are consistent with other producing mines in Australia and South Africa.

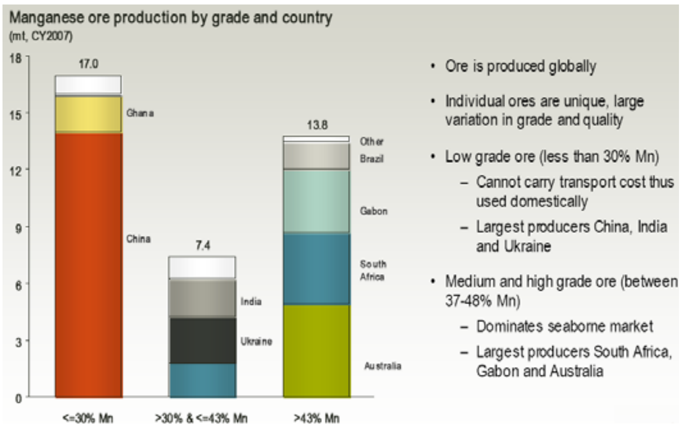
AQA is a member of a manganese producers group negotiating with Transnet for infrastructure upgrades. At this stage there a two options, using the port at Saldanha to the west or at Port Elizabeth to the east. The current plan is for studies are to commence shortly with access due in 2013, but given the typical delays associated with such work we are cautious about this timeline.

Figure 9 – Avontuur – near Kalahari Basin



SOURCE: COMPANY DATA

Figure 10 – Source of high grade manganese – Australia and S. Africa



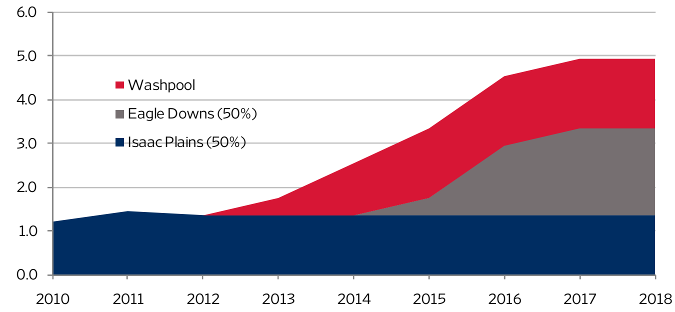
SOURCE: BHP BILLITON 2008

Potential for a major steel make producer

Potential for $8.7bn market cap by 2017

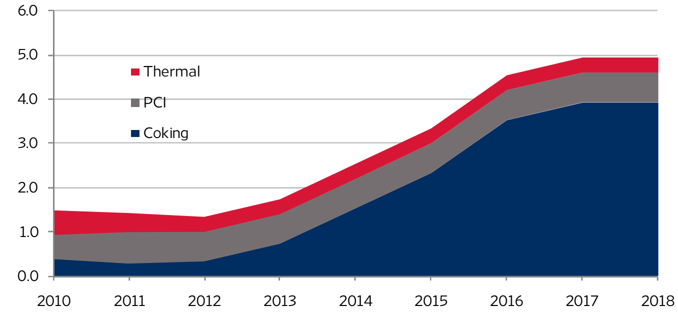
AQA has the potential to have attributable production of 5Mtpa of coal, with the majority coking coal, 18.6Mtpa of iron ore and 0.74Mtpa of manganese. This is roughly equivalent to an MCC (market cap $2.9bn), plus an OMH (market cap $800m), and 1/3 of an FMG (market cap x 0.33 = $5bn), for a total of $8.7bn, 2.6 times AQA's current market cap. We have calculated that this production level is 41Mt in iron ore equivalents using 2008 prices, number 4 behind Vale, BHP and Anglo. FMG is looking to expand to 155Mt of iron ore but does not have any coking coal or manganese. We do acknowledge that Fig 15 is based on 2007 production levels which have now greatly increased, but the exercise shows that AQA could become a sizable producer.

Figure 11 – Attributable coal production



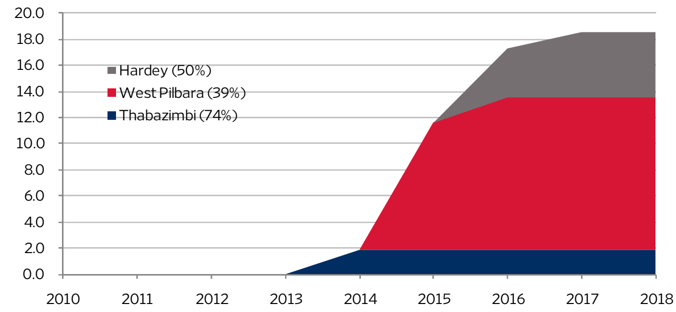
SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Figure 12 – Attributable coal production by type



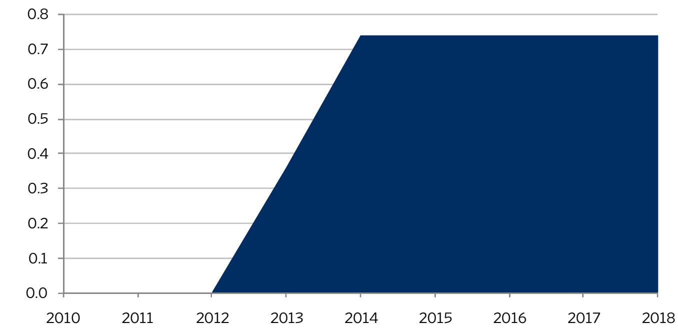
SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Figure 13 – Attributable iron ore production



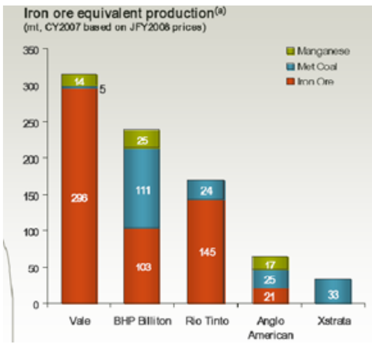
SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Figure 14 – Attributable manganese production



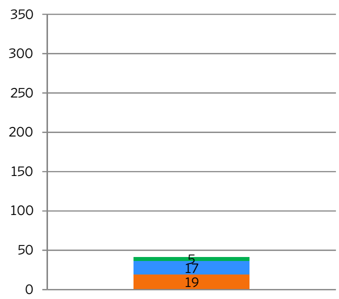
SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Figure 15 – Top steel make producers



SOURCE: BHP BILLITON ANALYSIS 2008 USING 2008 PRICES

Figure 16 – AQA production in iron ore equivalents – total 41Mt



SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES USING SAME ASSUMPTIONS AS FIGURE 15

Feeding the hungry elephants

Total capex at least $3bn

With many project opportunities comes a large capex requirement. Aquila estimates that its share of capex for its key projects should be A$3.1bn. This number is based largely on what could soon be out of date concept studies, and is most likely to rise with inflation, so we have been more conservative in our estimates.

We have developed a conceptual funding plan, which shows what funding may be required and at what time. The project cash flows are shown at the bottom and we have "filled in" the required cash from different sources at the top, sufficient to keep total cash positive.

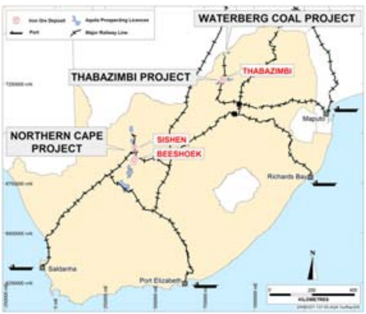
Funding options - project finance, asset sales and equity

Cash currently stands at $317m following the placement to Baosteel last year. The next source of cash is likely to come from the sale of the 24.5% stake in Belvedere to Vale. The period whereby Vale must elect to take up the option is open until June 2010.

Thereafter we expect AQA will look to use project finance. AQA's strategic alliance with Baosteel could assist in accessing low cost Chinese funding, similar to what Gindalbie has achieved through Ansteel.

Another option is to sell noncore assets, of which there are several. These may include the coal assets in Botswana and South Africa, the Northern Cape Iron Ore project, and other tenements in the Bowen Basin. It may also be possible to sell small stakes in projects to potential offtake partners.

Figure 17: Potential non-core assets



Source: COMPANY

Our conceptual model includes an example of all these options. We have also assumed that AQA raises a further $400m in equity to keep a gearing ratio of 30%. If AQA was to raise this amount today at $10/sh, the extra 40m shares would dilute our valuation to $12.27 or 2%.

We have assumed that the majority of funding is required in 2013/2014, as we have been conservative in the start-up time of projects. We have pushed back Eagle Downs, following the announcement last week that the Abbot Point port allocation had been lost. And we have the WPIOP starting in 2015 compared to the company's estimate of 2013. If AQA is successful in sticking to its timeline, the funding requirement may come sooner.

Other options that we have not considered are, a third party funding the port and rail for the WPIOP, or the sharing of port costs with FMG or MCC.

Figure 18 – Conceptual funding plan

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Starting Cash	317	317	798	851	166	225	98	908	1728
Divestments									
Belvedere - sell 24.5% to Vale		455							
Washpool - sell 50% to X			178						
Red Hill - sell 100%					50				
External funding									
Debt				500	900				
Equity					400				
Projects									
Corporate Costs	-30	-30	-30	-30	-30	-30	-30	-30	-30
Isaac Plains 50%	30	56	79	87	77	68	60	58	58
Eagle Downs 50%		0	0	0	-260	-233	109	137	137
Washpool 50%		0	-125	-58	38	43	43	43	43
Thabazimbi 74%	0	0	0	-100	47	36	30	25	25
Avontuur 74%	0	0	-50	116	116	116	62	62	124
West Pilbara 39%	0	0	0	-1200	-1280	372	404	362	362
Hardey 50%	0	0	0	0	0	-500	131	163	163
Ending Cash	317	798	851	166	225	98	908	1728	2610

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Opportunities and risks

We have updated our DCF valuation for all of the key projects, and our valuation is now $12.54. We have set a price target of $11.90 which accounts for infrastructure risk.

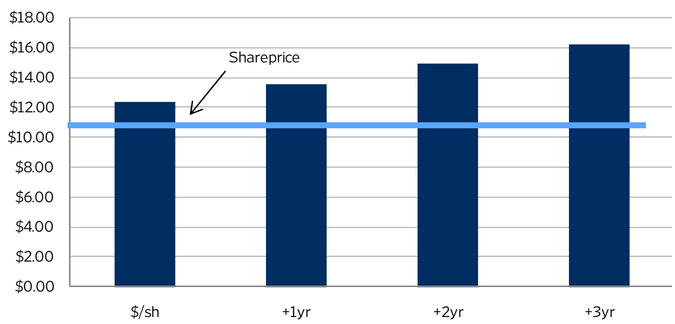
However, valuing AQA is difficult as there are many options, often fluid, and some of the development hurdles are yet to be resolved, so we discuss the opportunities and risks below.

Figure 19 - Valuation

	$M	$/sh	Weight	$/sh risked
Iron Ore				
West Pilbara 30Mt CID	4	0.01	100%	0.01
Hardey 10Mtpa BID	495	1.45	100%	1.45
Port sharing	428	1.25	100%	1.25
Infrastructure sale	184	0.54	75%	0.40
Thabazimbi	85	0.25	75%	0.19
Coal				
Isaac Plains	516	1.51	100%	1.51
Eagle Downs	984	2.88	100%	2.88
Belvedere	414	1.21	100%	1.21
Washpool	208	0.61	100%	0.61
Manganese				
Avontuur	585	1.71	75%	1.28
Other				
Corporate	-128	-0.38	100%	-0.38
Investments	30	0.09	100%	0.09
Options	31	0.09	100%	0.09
Cash	301	0.88	100%	0.88
Other assets	150	0.44	100%	0.44
Total	4287	12.54		11.91

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Figure 20 – Valuation curve



SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Opportunities

BROWNFIELD EXPANSIONS

The 30Mtpa WPIOP includes a major new infrastructure initiative, however the resources discovered to date are small relative to the size and cost of the port and rail, which results in a low return. The upside will come from finding new resources over time, and leveraging off the existing infrastructure. The 10Mtpa Hardey project which would be the next bolt-on, generates a much better return. There may be many more Hardeys discovered over time, but today those resources are yet to be discovered, and it is difficult to assign value to resources that don't exist. We have given the port and rail a residual value, assuming no more resources are economic and the infrastructure still has some value.

There is an opportunity to share port costs with other potential uses such as FMG and MCC. We have considered that synergy as potential benefit, but an issue is that while interested in the port option, FMG and MCC don't need the project as fast as API.

In summary, if you were to take the view the API will discover more resources over time, and the port is built in a timely and cost efficient manner, the iron ore division could be worth a lot more than we have indicated. Each Hardey for example could add $1.45 to the share price.

ORGANIC GROWTH

We have chosen only to model the projects which are the highest priority, but AQA has a much larger portfolio. We have assigned $150m to other assets, but this not just a nominal figure. This is backed up by several projects across the commodities and in some cases with resources.

M&A AND TRADING ASSETS

The benefit of a strong portfolio is that non-core assets can be traded, or stakes in major projects can be sold to fund development.

Given that the option period on Belvedere is open we look at coal transaction multiples. The average EV/t of resource multiple is $2.8/t, but across all types of coal. Some coking coal transactions are above $3/t. If we use an average multiple of $2.8/t AQA's coal portfolio would be worth $13.72. Belvedere alone would be worth $2.7bn, and even if we ignore the inferred resources, it would be worth $1bn. Doing a similar exercise for iron ore using an EV/t of resource multiple of $5/t, that portfolio would be worth $4.24. Again, using a $40/t value for manganese, Avontuur would be worth $3.00. In total this comes to $20.96, much greater than our DCF valuation of $12.54.

Figure 21 – Recent coal transaction multiples

Acquirer	Mine	Company	Coal	EV/Resource
Macarthur		Gloucester	Semi Hard Coking	3.2
Yanzhou		Felix	PCI/Thermal	2.6
Noble		Gloucester	Semi Hard Coking	2.9
Gloucester		Whitehaven	Thermal/Coking	0.9
Cockatoo	Baralba		PCI/Thermal	5.4
J Power	Narrabri		Thermal	3.8
EDF Trading	Narrabri		Thermal	3.9
Xinwen	Teresa		Coking	1.8
Shenhua	Watermark		Thermal	na
BHPB	New Saraji		Coking	3.6
Posco		Macarthur	PCI	3.7
Arcelor		Macarthur	PCI	3.7
Anglo	Foxleigh		PCI	3.6
Noble	Monto		Thermal	0.9
Macarthur	Middlemount		Coking/PCI	3.9
Cliffs	Somona		Coking/Thermal	2.9
Xstrata		Resource Pacific	Thermal	4.3
Xstrata		Austral Coal	Hard Coking	2.5
Xstrata	Anvil Hill		Thermal	0.9
CRC	Yarrabee		PCI	4.4
CVRD	Belvedere		Coking	0.1
Xstrata	Narama		Thermal	5.7
Sojitz	Minerva		Thermal	4.1
Koreans	Moorlaben		Thermal	1.9
Sojitz	Moorlaben		Thermal	1.9
Citic		Macarthur	PCI	1.2
Xstrata		Gloucester Coal	Semi Hard Coking	2.1
AMCI		Felix	PCI	1.2
CVRD		AMCI	Coking	2.9
Centennial		Powercoal	Thermal	
			Average	2.8
			Median	2.9

SOURCE: VARIOUS AND SOUTHERN CROSS EQUITIES ESTIMATES

HIGHER PRICES

We have long term price assumptions of 90US¢/dltu for iron ore, US$150/t for coking coal, $6/mtu for manganese, and 75¢ for currency. Spot prices are higher, but as the bulk of AQA's projects reach full capacity in 2016/27, near term prices are not so relevant. Higher A$ prices would increase our valuation.

PREMIUM RATINGS

Coking coal producers are trading at a premium. We believe this is because they are in production and benefiting from current rising prices, have infrastructure allocations, and are first in queue for the next infrastructure expansions. So we don't necessarily believe AQA deserves such a premium just yet.

Sources of risk

MULTIPLE EARLY STAGE PROJECTS

At this stage AQA has only one asset in production, and development projects due to commence at least 3 years away. There are many hurdles remaining before these projects become a reality. The association with Baosteel should reduce funding and offtake risk, but infrastructure remains the biggest issue.

Figure 22 – Early stage projects

	Coal	Iron Ore	Manganese
Production	Isaac Plains (50%)		
Feasibility	Eagle Downs (50%)	West Pilbara (39%)	
	Washpool (100%)		
Pre-Feasibility	Belvedere (24.5%)		Avontuur (74%)
Concept /	Red Hill (100%)	Thabazimbi (74%)	
Exploration	Asenjo Energy (50%)	Northern Cape (74%)	
	Bowen Basin (100%)		

SOURCE: COMPANY AND SOUTHERN CROSS EQUITIES ESTIMATES

INFRASTRUCTURE

Infrastructure is key to development in bulks. Prices for steelmaking materials and assets are high as the barriers to entry, mainly getting access to infrastructure are high, and AQA still has some barriers.

Last week's announcement that the JV partners AQA and Vale could not agree on the preferred infrastructure option for Eagle Downs, and the subsequent relinquishing of the Abbot Point allocation is an example of such a risk. To account for this we have assumed that the project is delayed 3 years and doesn't start until 2015. It may be possible to buy allocation in the meantime but that will be difficult in our view.

For the Thabazimbi and Avontuur projects in South Africa, solutions have been identified, but not yet finalised, and as these are dependent on other players it could take some time. For this reason we have applied a discount to these projects to develop our risked valuation.

Investment view

With a diverse portfolio of assets in the right commodities in the right places we expect AQA to continue to perform well. We have increased our price target to $11.90 (from $10.55), our risk weighted valuation. Following recent share price appreciation, the valuation gap has been closing fast and we have downgraded to Accumulate (from Buy) accordingly.

Our target price would be higher if:

- There were greater resources underpinning the iron ore project
- Other users signed up for Anketell Point
- Interim port allocation could be bought for Eagle Downs
- A definitive infrastructure solution was found for Avontuur and Thabazimbi

There will be a steady stream of news over the next 12 months, with the key ones being a potential sale price for Belvedere, which would give a see-through valuation to the rest of the coal portfolio, and a resource upgrade at Avontuur.

- Avontuur revised resource – Q1 2010
- Avontuur feasibility to commence – Q2 2010
- WPIOP feasibility study results – mid 2010
- Thabazimbi inaugural resource – Q2 2010
- Belvedere option period expires - June 2010
- Washpool feasibility study results – Q2 2010
- Eagle Downs BFS – mid 2011
- Avontuur feasibility study results – mid 2011
- Ongoing positive news on iron ore, coking coal and manganese pricing
- Any M&A in these sectors

Aquila Resources (AQA)

Company Description

AQA is an Australian based developer of bulk commodity projects (coal, iron ore, manganese). The Isaac Plains coal mine (AQA share 1.4Mtpa) is currently ramping up, and attributable coal production should grow to 5Mpta by 2017 through the development of the Eagle Downs and Washpool projects, all in the Bowen Basin, Queensland. AQA's 50/50 partner in Isaac Plains and Eagle Downs is Vale. AQA has a 50% interest in the API JV which is seeking to develop the West Pilbara Iron Ore Project (WPIOP), with initial production of 30Mtpa of CID product through Anketell Point near Cape Lambert. The Avontuur manganese project could produce 1Mtpa. The project pipeline enables a steep production curve to globally significant scale.

Investment Strategy

The portfolio of iron ore, coking coal and manganese is a powerful combination as the current supply base for these steelmaking raw materials is highly concentrated. This makes AQA's assets attractive to consumers looking for independent off-take agreements or acquisitions.

The large portfolio of tenements creates the flexibility to choose higher priority targets to fast track, and potentially divest lower priority assets as a source of funding.

AQA offers a strong growth profile, independent exposure to steelmaking raw materials, potential internal funding options through divestments, and M&A potential. The growth potential should be supported by strong news flow over the next 12 months. However with the majority of the current resource base already priced in, and several years before production is expected, we have downgraded to Accumulate.

Valuation

Our valuation is $12.54, however to account for development risk, we have risk weighted each project, and derived a price target of $11.90.

Risks

The majority of projects are at an early stage therefore we see the development risk as high. Isaac Plains is the only source of production and cash flow currently. Other projects are in the concept to feasibility stage and higher production and related cash flows are several years away. Risks include resource definition, securing off-take agreements, access to infrastructure, and financing.

The agreements with Baosteel have greatly reduced the financing and off-take risks, however other risks specific to each deposit, and access to shared infrastructure remain.

Aquila Resources
as at 8 March 2010

Recommendation	Accumulate
Price	$10.92
Target (12 months)	$11.90

Table 1 - Financial summary

Aquila (AQA)		Share price:	$ 10.92
As at	8/03/2010	Market Cap:	$ 3,734

PROFIT AND LOSS					
Y/e June 30	**2009a**	**2010f**	**2011f**	**2012f**	**2013f**
Sales revenue	92	149	201	221	457
EBITDA	-24	-20	34	79	415
Depreciation	-5	-5	-5	-15	-28
EBIT	-29	-25	29	64	387
Net Interest Expense	-6	7	14	17	-10
Pre-tax profit	-35	-18	43	81	377
Tax	9	8	-13	-24	-113
Net Profit	-26	-10	30	56	264
Adjustments	0	0	0	0	0
SCEQ adj profit	-26	-10	30	56	264
One-off items	0	5	0	0	0
Reported net profit	-26	-5	30	56	264

CASHFLOW					
Y/e June 30	**2009a**	**2010f**	**2011f**	**2012f**	**2013f**
Receipts from customers	94	156	201	221	457
Payments to suppliers	-74	-128	-164	-147	-80
Net interest	6	5	14	17	-10
Tax paid	-42	-1	-13	-24	-113
Other	0	0	0	0	0
Operating cashflow	-16	32	39	66	254
Capex	-17	-4	-7	-252	-1518
Investments	0	0	0	0	0
Asset sales	0	1	0	0	0
Other	-49	-38	0	0	0
Investing cashflow	-66	-41	-7	-252	-1518
Change in borrowings	-3	-5	0	0	1600
Equity raised	2	0	8	0	23
Dividends paid	0	0	0	0	0
Other	-1	285	0	0	0
Financing cashflow	-2	280	8	0	1623
Net change in cash	-85	271	39	-186	359
Cash at end of period	74	344	383	198	556

BALANCE SHEET					
Y/e June 30	**2009a**	**2010f**	**2011f**	**2012f**	**2013f**
Cash	74	344	383	198	556
Receivables	4	0	0	0	0
Inventories	15	12	16	18	37
Investments	0	0	0	0	0
Other	30	0	-4	-6	-25
Current assets	122	356	395	210	568
PPE	63	67	69	306	1796
Investments	0	0	0	0	0
Intangibles	0	0	0	0	0
Other	19	24	24	24	24
Non-current assets	88	98	100	337	1827
Total assets	211	454	495	546	2395
Payables	32	30	34	29	-10
Debt	21	16	16	16	1616
Provisions	2	6	6	6	6
Other	0	0	0	0	0
Total liabilities	56	52	56	51	1612
Shareholders' equity	155	402	439	495	781
Minorities	0	0	0	1	2
Total shareholders funds	155	402	439	496	783
Total funds employed	103	73	72	314	1843
W/A diluted shares on issue	249	322	339	339	340

VALUATION DATA					
Y/e June 30	**2009a**	**2010f**	**2011f**	**2012f**	**2013f**
Net profit adj ($m)	-26	-10	30	56	264
EPS (c)	na	-1	9	17	77
EPS growth (%)	na	na	na	88%	364%
P/E ratio (x)	na	na	123	66	14
CFPS (c)	-7	10	11	20	74
Price/CF (x)	-167	109	96	56	15
DPS (c)	0	0	0	0	0
Yield (%)	0	0	0	0	0
Franking (%)	0	0	0	0	0
EV/EBITDA	-151	-170	100	45	12
EBITDA margin (%)	-26	-13	17	36	91
Valuation per share:					12.54
A$ Target price (12 mth):					**11.90**
Total Return (including yield)					**9%**

PROFITABILITY RATIOS					
Y/e June 30	**2009a**	**2010f**	**2011f**	**2012f**	**2013f**
EBITDA/sales (%)	-26	-13	17	36	91
EBIT/sales (%)	-31	0	14	29	85
Return on assets (%)	-12	-1	6	10	11
Return on equity (%)	-17	-1	7	11	34
Return on funds empl'd (%)	-25	-6	42	18	14
Dividend cover (x)	0	0	0	0	0
Effective tax rate (%)	26	46	30	30	30

LIQUIDITY AND LEVERAGE RATIOS					
Y/e June 30	**2009a**	**2010f**	**2011f**	**2012f**	**2013f**
Net debt/(cash) ($m)	-52	-328	-367	-182	1060
Net debt/equity (%)	-34	-82	-84	-37	135
Net interest cover (x)	-4	4	-2	-4	40
Current ratio (x)	3	12	12	7	-61
Inventory turnover	0	0	10	8	1
Inventory/sales	0	5	8	8	4

VALUATION				
	$M	**$/sh**	**Weight**	**$/sh risked**
Iron Ore				
West Pilbara 30Mt CID	4	0.01	100%	0.01
Hardey 10Mtpa BID	495	1.45	100%	1.45
Port sharing	428	1.25	100%	1.25
Infrastructure sale	184	0.54	75%	0.40
Thabazimbi	85	0.25	75%	0.19
Coal				
Isaac Plains	516	1.51	100%	1.51
Eagle Downs	984	2.88	100%	2.88
Belvedere	414	1.21	100%	1.21
Washpool	208	0.61	100%	0.61
Manganese				
Avontuur	585	1.71	75%	1.28
Other				
Corporate	-128	-0.38	100%	-0.38
Investments	30	0.09	100%	0.09
Options	31	0.09	100%	0.09
Cash	301	0.88	100%	0.88
Other assets	150	0.44	100%	0.44
Total	**4287**	**12.54**		**11.91**

PRODUCTION					
Base Case Production	**2009a**	**2010f**	**2011f**	**2012f**	**2013f**
Iron Ore					
West Pilbara (Mt)	0.0	0.0	0.0	0.0	0.0
Thabazimbi (Mt) (74%)	0.0	0.0	0.0	0.0	0.0
Coal					
Isaac Plains (50%)	0.7	1.2	1.4	1.4	1.4
Eagle Downs (50%)	0.0	0.0	0.0	0.0	0.0

ASSUMPTIONS					
Y/e June 30	**2009a**	**2010f**	**2011f**	**2012f**	**2013f**
A$	0.75	0.91	0.93	0.83	0.75
Iron Ore Lump (US¢/%Fe)	179	123	161	164	159
Iron Ore Fine (US¢/%Fe)	133	106	131	131	127
HCC (US$/t)	257	144	195	198	185
PCI (US$/t)	199	103	143	144	139
Thermal (US$/t)	118	73	93	95	95

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Recommendation structure

Spec Buy: Expect >30% total return on a 12 month view but carries significantly higher risk than its sector

Buy: Expect >15% total return on a 12 month view

Accumulate: Expect total return between 0% and +15% on a 12 month view

Reduce: Expect -15% and 0% total return on a 12 month view

Sell: Expect <-15% total return on a 12 month view

Fleur Grose
Analyst Authorisation

Peter Chapman
Authorisation

Limited Incorporated ACN 071 935 441
Level 32, Aurora Place
88 Phillip Street, Sydney 2000
Telephone +61 2 8224 2811
Facsimile +61 2 9231 0588
Email general@sceq.com.au
www.sceq.com.au

Research Team

Sanjay Magotra
Head of Research
Senior Industrial Analyst
Infrastructure/Utilities
T 612 8224 2880
E smagotra@sceq.com.au

Daniel Blair
Industrial Analyst
Telco and Media
T 612 8224 2886
E dblair@sceq.com.au

Peter Chapman
Senior Resources Analyst
Oil/Gas/Gold
T 612 8224 2847
E pchapman@sceq.com.au

Fleur Grose
Resources Analyst
Iron Ore/Coal/Diversifieds
T 612 8224 2845
E fgrose@sceq.com.au

Johan Hedstrom
Senior Resources Analyst
Energy
T 612 8224 2859
E jhedstrom@sceq.com.au

Judith Kan
Associate Industrial Analyst
Infrastructure/Utilities
T 612 8224 2844
E jkan@sceq.com.au

TS Lim
Financials Analyst
Banks/Regionals
T 612 8224 2810
E tslim@sceq.com.au

Hamish Perks
Industrial Analyst
Emerging Growth
T 612 8224 2804
E hperks@sceq.com.au

Stuart Roberts
Senior Industrial Analyst
Healthcare/Biotech
T 612 8224 2871
E sroberts@sceq.com.au

Emma Sellen
Executive Assistant
T 612 8224 2853
E esellen@sceq.com.au

Jonathan Snape
Senior Industrial Analyst
Emerging Growth
T 613 9235 1601
E jsnape@sceq.com.au

Mathan Somasundaram
Quantitative Analyst
Head of Quant & Data Services
T 612 8224 2825
E mathan@sceq.com.au

Lafitani Sotiriou
Analyst
Financials/Industrials
T 612 8224 2813
E lsotiriou@sceq.com.au

Janice Tai
Quantitative and System Analyst
T 612 8224 2833
E jtai@sceq.com.au

Joel Weiss
Quantitative Analyst
T 612 8224 2895
E jweiss@sceq.com.au

Southern Cross Equities Ltd and its associates hold 2,750 shares in AQA as at the date of this report. This position is subject to change without notice.