

Tuesday 22<sup>nd</sup> August, 2017

### Telkwa PFS Review Almost Complete – Portfolio Stock (coverage initiated @ \$0.022 in June 2017)

**Allegiance Coal (ASX: AHQ, Share Price: \$0.038, Market Cap: \$8.5m)** is a recent addition to our Portfolio and only the second coal company that we've included in our coverage universe. Key catalysts include extremely modest market capitalization, advanced resource position, access to all necessary production infrastructure, low sovereign risk, strong management and achievable development timetable.

*After announcing positive initial Pre-Feasibility Study (PFS) results for its Telkwa metallurgical coal project in Canada during July, Allegiance has now advised that the results of a revised PFS focused on a staged production option (featuring significantly reduced capex), will be available to the market by 30 September.*



### Market Significance

Allegiance Coal stock has already risen by 72% since our coverage initiation just two months ago, driven by market anticipation surrounding the PFS results related to the Telkwa staged development option. With a market valuation of less than \$10m, Allegiance represents one of the least-expensive coal opportunities available to ASX investors. The Telkwa project is eminently 'do-able' as it offers access to all necessary bulk-commodity production and transport infrastructure, situated within a secure mining jurisdiction. The coking coal price environment remains sound, with prices demonstrating tremendous resilience.

## **Catalyst - Revised PFS Results Imminent**

Market anticipation is building after Allegiance Coal confirmed that the revised PFS results with respect to its Telkwa coal project in Canada will be made available by 30<sup>th</sup> September at the latest, following completion of the PFS review.

Perhaps the biggest feature of the review is confirmation that Stage 1 start-up capital has been reduced by almost 30% from US\$51 million in the original July study to a currently estimated US\$36 million. Full details will be released in the comprehensive PFS review.

The Stage 1 PFS effectively represents the actual commencement of project development, with the document forming the basis of formal processes with the Ministry of Energy & Mines, Sub-EA permit applications, First Nations negotiations and consultations with other key stakeholders.

## **Technical Significance**

As we indicated in our research coverage at the time, the initial PFS results were compelling enough - however Allegiance identified immediate opportunities for enhancements in overall project economics - mainly related to project capex costs.

Furthermore, Allegiance has elected to focus solely on a 250,000tpa saleable coal operational scenario, due to the fact that it would facilitate a much more rapid approvals process. Under British Columbia mining and environmental legislation, a coal mine producing less than 250,000tpa of saleable coal does not trigger a review under the British Columbia Environmental Assessment Act (Sub-EA).

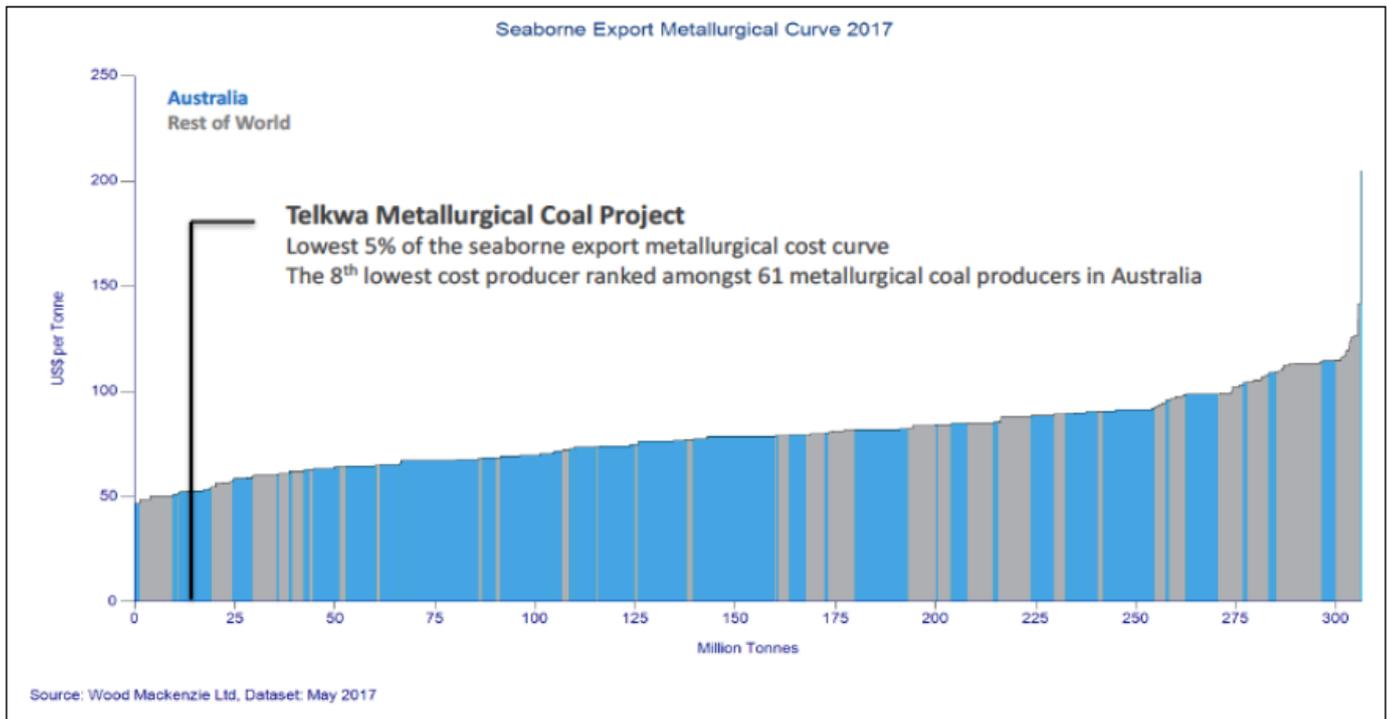
Furthermore, it does not trigger a Federal Government review under the Canadian Environmental Assessment Act. It thus provides potential for a much less complex and more rapid permitting process, resulting in a shorter timeline to production.

What's also significant is that Allegiance has significantly outperformed its own PFS review timeline - which had originally been Q1 2018 (now end-Q3 2017).

## **Telkwa Project Overview**

The most compelling aspect of Telkwa is the project's positioning within the lowest five-percentile on the seaborne metallurgical coal cost curve. This is enormously important, as it insulates the project from coal price downturns. This will allow Allegiance to maintain profitability during periods when competitors would be struggling with operating margins.

Furthermore, relative to Australian producers of metallurgical coal, the project would rank in FOB cost terms as the eighth-lowest amongst 61 producers, ranking in the lowest ten-percentile in Australian production terms. This is clearly evident in the graphic below.



**Figure 1:** Telkwa's position low on the industry cost curve

What was also significant in the original PFS was a sensitivity analysis in terms of variations in both coal pricing and costs (operating costs and capital expenditure). The initial PFS results demonstrate that Telkwa can withstand a 30% decrease in coal prices - resulting in a post-tax NPV<sub>10%</sub> of US\$3M and a post-tax IRR of 10%. The project would also sustain a positive return even with a 30% increase in costs - resulting in a positive post-tax NPV<sub>10%</sub> of US\$68M and a post-tax IRR of 15%.

Table 14: Sensitivity		Operating and Capital Costs (US\$M)						
NPV	US\$243	1,822	2,083	2,343	2,603	2,863	3,124	3,384
Price: US\$ per tonne of clean coal	77	179	121	62	3	-57	-120	-183
	88	259	201	142	84	25	-34	-94
	99	338	280	222	164	105	47	-12
	110	417	359	301	243	185	127	68
	121	496	438	380	322	264	206	148
	132	575	517	459	401	343	285	227
	143	654	596	538	480	422	364	306

Table 15: Sensitivity		Operating and Capital Costs (US\$M)						
IRR	30%	1,822	2,083	2,343	2,603	2,863	3,124	3,384
Price: US\$ per tonne of clean coal	77	31%	24%	17%	10%	0%	0%	0%
	88	38%	31%	24%	18%	13%	6%	0%
	99	44%	37%	30%	24%	19%	14%	9%
	110	50%	42%	35%	30%	24%	20%	15%
	121	56%	47%	40%	34%	29%	25%	20%
	132	61%	52%	45%	39%	34%	29%	25%
	143	66%	57%	50%	43%	38%	33%	29%

**Figure 2:** Telkwa price sensitivity analysis

## Strong Coking Coal Price Outlook

What's also driving interest in Allegiance and its Telkwa project is a very supportive environment for coking coal prices.

Coking coal futures prices on China's Dalian Commodity Exchange (DCE) have just their highest level this year, as prices firm on the back of both demand and supply factors.

On the supply side, mining accidents in Shanxi earlier this month have prompted the provincial government to close more than 50 coal mines as a safety precaution. A festival in Inner Mongolia this month also temporarily disrupted production and further tightened domestic supply.

On the demand side, sentiment remains bullish in China's steel sector, as expectations demand from the country's construction sector will remain resilient.



Domestic coking coal prices are also strong, with prices hinting US\$200/t FOB during August. For the purposes of the Staged Production PFS, independent consultants SRK have assumed a benchmark hard coking coal price range of between US\$170/t and US\$130/t.

## Difference between Coking Coal and Thermal Coal

Coking coal is worth more than thermal coal, as it has lower impurities (low ash, sulfur and phosphorus) and burns much cleaner and hotter than thermal coal. Coking is used to create coke, one of the key irreplaceable inputs in the steel-making process, whereas lower-grade thermal coal is used exclusively in the power-generation process.

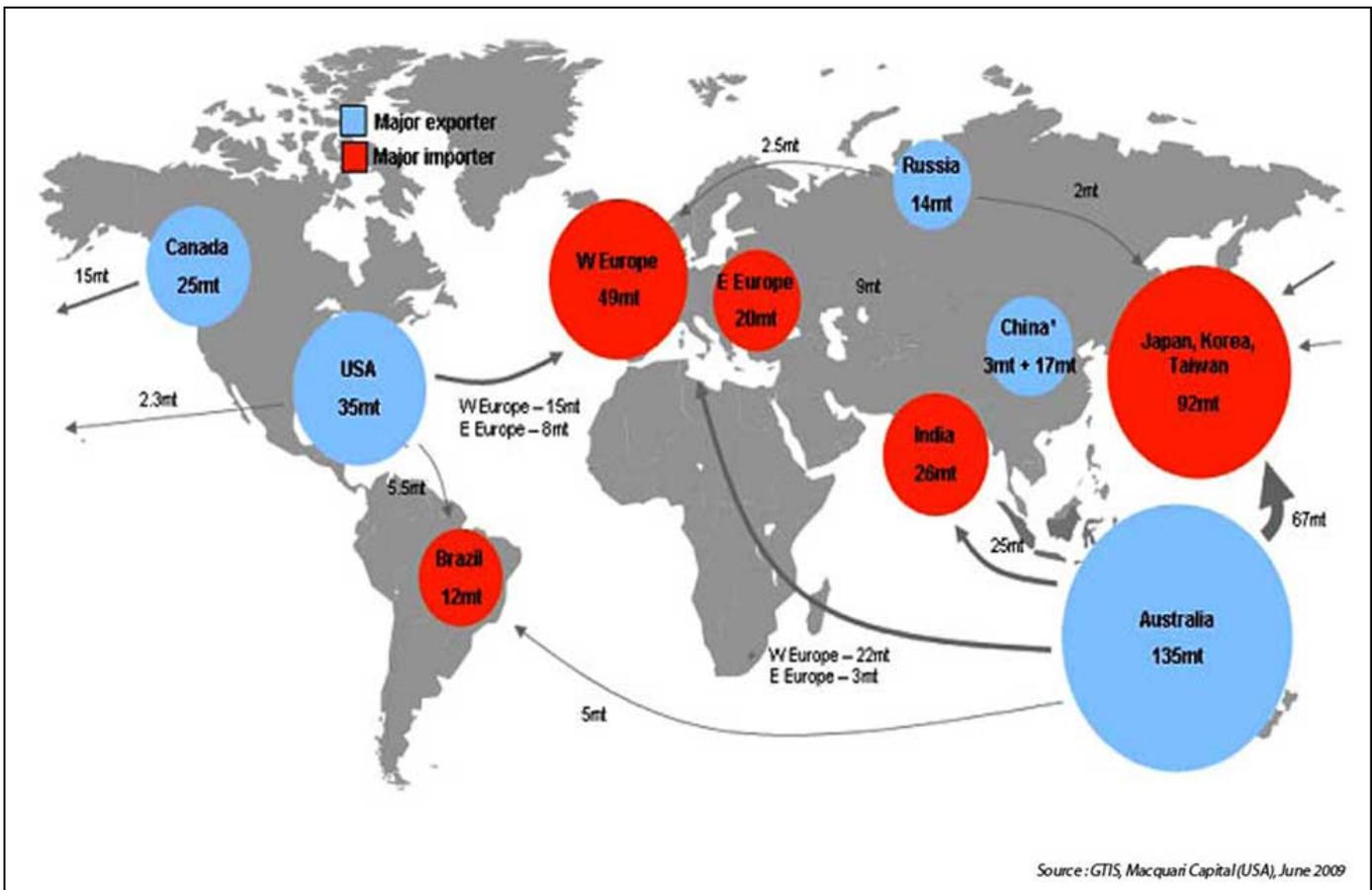


Figure 4: World Coking Coal Market

## Summary

We initiated coverage of Allegiance Coal at a price around \$0.022 during late June 2017 – representing a current gain of 72%.

The key attractions of the company are its modest market capitalisation of less than \$10 million (when compared with the inherent value/corporate appeal of its Telkwa coal project) and overall ‘do-ability’ of the project. It’s rare to find bulk commodity projects with modest capex requirements, access to all necessary infrastructure and a mining-friendly jurisdiction.

The enormous amount of project data already accumulated (including 91,000 metres of drilling) would alone be worth around \$40 million to Allegiance. Then we can factor in capex savings in terms of hundreds of millions of dollars from access to existing railway and port infrastructure.

Telkwa’s other big advantage is that it’s coking coal, which has enduring appeal as far as steel industry end-users are concerned. It is an entirely different story from the negative press and other headwinds associated with thermal coal developments.

Allegiance Coal remains firmly held within our Portfolio and we look forward to the release of enhanced PFS results during September.

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