

Thursday 8th November, 2018

Portfolio Stock Developments

Allegiance Coal - (ASX: AHQ, Share Price: \$0.055, Market Cap: \$28m, coverage initiated @ \$0.022 in June 2017 – *current gain of 150%*)



Key Catalyst

Itochu Corporation of Japan has agreed to invest in Telkwa Coal Limited, in order to underpin the funding and development of the Tenas Metallurgical Coal Project.

AHQ has performed solidly since our coverage initiation in June 2017, generating a current gain of 150%. The company has been a quiet - but very successful - achiever, focused on advancing its Tenas metallurgical coal project in northwest British Columbia. The project's major attraction is the potential for low-cost production and strong earnings, along with relatively modest start-up costs. The project has so far generated strong interest from Asian steel mills and is methodically being de-risked, with two Pre-feasibility Studies already completed, along with a revised resource estimate and geological model that should flow through favourably into a Definitive Feasibility Study (DFS) during Q1 2019. The project's attractive fundamentals has led to Itochu and AHQ completing and signed binding agreements to establish the Telkwa Met Coal Joint Venture, which will help fund the Tenas project into development.

Latest Activity

Itochu Invests in Tenas Project

Itochu Corporation of Japan has agreed to invest in Telkwa Coal Limited (TCL), which will underpin the funding and development of AHQ's Tenas Metallurgical Coal Project. AHQ and Itochu have completed and signed binding agreements to establish what will be known as the 'Telkwa Met Coal Joint Venture.'

TCL is AHQ's wholly-owned Canadian subsidiary that owns a 100% stake in the Telkwa Metallurgical Coal Project in British Columbia, Canada. The project comprises 126Mt of JORC metallurgical coal resources from the Tenas Project, together with the nearby Goathorn Creek and Telkwa North deposits.

Stage 1 of the Joint Venture investment comprises a C\$6.6M investment in TCL by Itochu by way of a subscription for TCL shares - representing 20% of TCL's issued share capital – as follows:

- C\$1.5M for a 5.3% interest in TCL following the issue of a section 10 order under the Environmental Assessment Act of British Columbia (which formally acknowledges the Tenas Project has been accepted for environmental review and permitting), expected mid-November 2018.
- C\$1.5M for a further 4.8% interest in TCL following completion of a positive Tenas DFS, targeted for completion in Q1 2019, subject to Itochu's approval at the time.
- C\$3.6M for a further 9.9% interest in TCL following lodgement of an application for an Environmental Assessment Certificate, targeted for Q3 2019, subject to Itochu's approval at the time.

Stage 2 of the Joint Venture investment comprises the right by Itochu to make a further investment in TCL following the granting of permits to mine the Tenas Project, up to a maximum of 50% of the issued share capital in TCL, and based on a 'post permits to mine' valuation. The quantum and size of that investment will be discussed following completion of the Tenas DFS and prior to the completion of permitting.

Technical Significance

Itochu's financial involvement with the Tenas project reflects not only the project's strong earnings potential and ability to supply a quality coal product, it also underlines Itochu's confidence in AHQ's ability to successfully secure mining permits and bring the Tenas Project into production.

The Itochu Stage 1 investment also provides a framework for what a base-case TCL valuation is worth, representing an enterprise value for TCL of C\$33M (approximately A\$35M). By comparison, AHQ's current market value is \$28M.

Itochu is an extremely high-quality project partner. Its origins date back to 1858 and today it is one of the largest commodity trading houses in the world, with assets worth A\$111 billion and annual revenue of A\$80 billion. Itochu will be the sole and exclusive sales agent for all Telkwa coal.

Next Steps

During the Stage 1 investment, Itochu will have the right to appoint two directors to the Board of TCL, one of whom will be the Marketing Director, while AHQ will have the right to appoint three directors. TCL will take responsibility for the operation of the Tenas mine, while Itochu will take responsibility for the marketing, sale and delivery of Tenas coal.

It is a condition of the Stage 1 investment by Itochu that TCL will, prior to Itochu's investment, hold C\$1.5M of cash at bank (which AHQ will fund from existing cash resources). Taking account of Itochu's Stage 1 investment, TCL will have available funding of C\$8.1M, which is currently expected to fully fund TCL through to the completion of Tenas Project permitting.

Other Recent Activity

Q3 2018 Project Activity

It has been a solid quarter of activity for AHQ, with the Tenas Metallurgical Coal Project DFS on schedule for completion during Q1 2019. Importantly, the Tenas DFS target metrics remain the same as previously announced, with some refinements following the detailed mine scheduling undertaken so far by SRK.

Tenas Project Key Metrics		
Total coal resource	Tonnes	36,500,000
Total mined coal	Tonnes	20,000,000
Total saleable coal	Tonnes	14,800,000
Annual saleable coal production	Tonnes per annum	750,000
Life of mine average strip ratio	BCM/ROMt	3.8:1
Life of mine yield	%	74
Mine life	Years	20

Environmental Baseline Studies

The environmental baseline studies that commenced almost two years ago will conclude during Q4 2018, with some residual work continuing into 2019. The studies are critical to the permitting process and establishing the environmental baselines prior to assessing environmental impacts from mining.

Formal Permitting Commenced

AHQ has lodged what is referred to as a "Project Description" with the Environmental Assessment Office of British Columbia (EAO) - the Government body responsible for managing the environmental assessment and permitting process. The Project Description is a legislated requirement that outlines the proposed project in significant detail, and provides the EAO with an indication of how 'ready' a proponent is for environmental assessment and permitting. Once accepted, the EAO will issue a 'section 10' order, formally accepting the project for review – which AHQ anticipates receiving in Q4 2018.

Tenas Project – EA Schedule	2018						2019						2020														
Task	7	8	9	10	11	12	1	2	3	4	5	6	7	8	9	10	11	12	1	2	3	4	5	6	7	8	9
Project Description				■																							
Section 10 Order				■																							
Section 11 Order					■																						
Valued Component (VC) draft				■																							
VC finalization				■																							
AIR ⁽¹⁾ draft					■																						
AIR finalization						■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
EA/Concurrent MAPA ⁽²⁾ - EMA PA ⁽³⁾																											
EA screening																											
EA acceptance																											
EA review																											
EA decision																											
Permit																											

Notes:
¹ AIR = Application Information Requirements or Terms of Reference
² MAPA = Mines Act Permit Application
³ EMA PA = Environmental Management Act Permit Application
⁴ BC Government EA Revitalization Process is in progress, with new legislation and regulation expected in the fall of 2019.

Metallurgical Coal Market Update

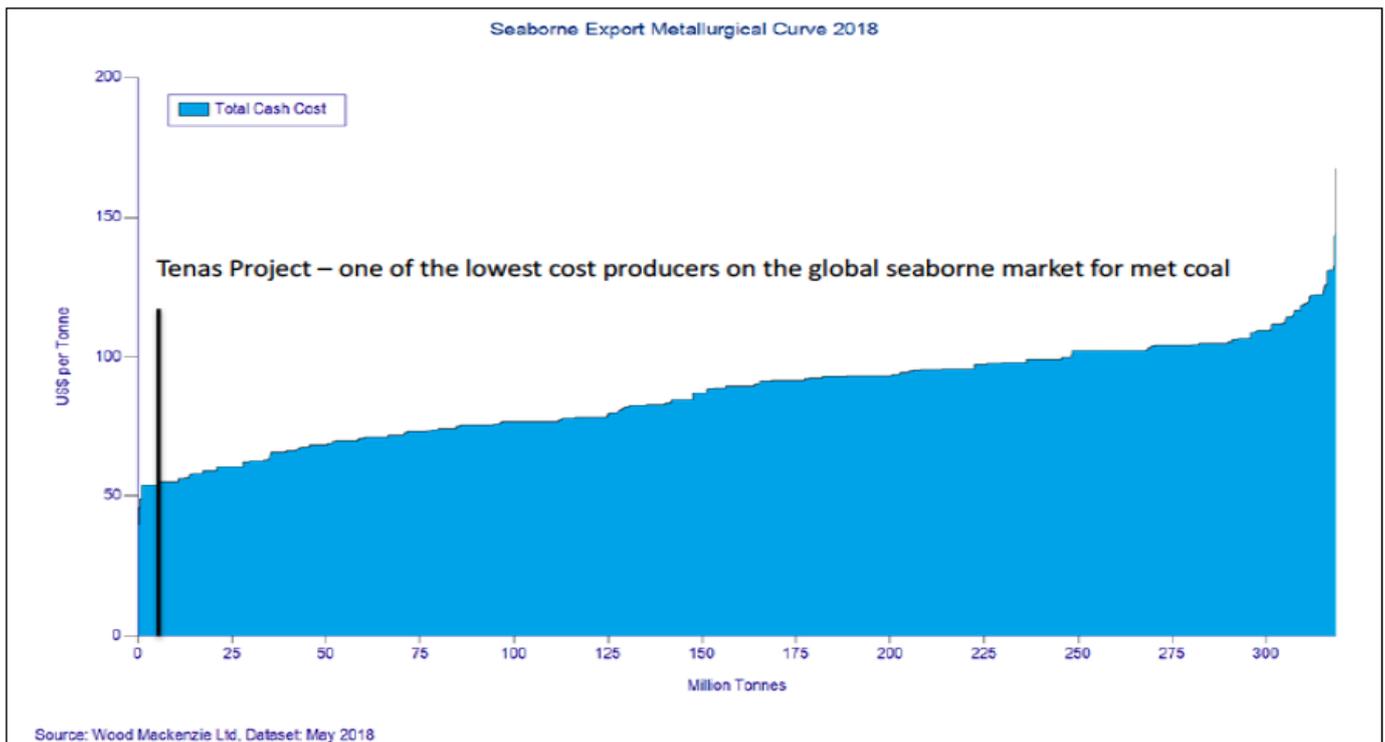
During Q3 2018, spot branded premium hard coking coal weakened early in the quarter to a low of US\$172/mt as a result of market nervousness around the implications of proposed US tariff increases on Chinese goods. However, the market subsequently rebounded on indications of increased Chinese steel demand in China as a result of positive housing and infrastructure data.

Hard coking coal prices rallied as steel inventories fell and hot rolled coil and rebar prices grew (with the steel rebar futures price reaching its highest level since February 2013). Prices surged to over US\$190/mt FOB by mid-September as the full extent of lower steel inventories became clear, combined with increased Chinese steel demand. The arrival of Cyclone Florence in the US, and the halting of production at Peabody’s North Goonyella Mine in Central Queensland following an underground fire, caused supply disruptions to the seaborne market, which took the hard coking coal price to US\$208/mt FOB.

The spot price for premium hard coking coal settled at US\$200/mt FOB for the quarter, while Nippon Sumitomo Steel Corporation settled Q3 2018 Semi Soft Coking Coal at US\$129/mt FOB, and LV PCI at US\$137/mt FOB.

Project Overview

The Tenas metallurgical coal project is located in British Columbia, Canada. The project includes three pit areas comprising 125.8Mt of JORC-compliant coal resources – with 102.3Mt in the Measured Category, 22.3Mt in the Indicated Category and 1.2Mt in the Inferred Category. During 2017 the company completed a Pre-Feasibility Study (PFS) declaring 42.5Mt of saleable coal reserves, positioning the project within the lowest five-percentile of the global seaborne metallurgical coal cost curve. AHQ is now undertaking a Definitive Feasibility Study of the Tenas Pit, which represents 21Mt of those saleable coal reserves.



Initial Capital

The estimated start-up capital expenditure is based on the start-up capital expenditure of the Large Mine PFS of US\$51M, with some additional start-up capital expenditure items brought forward which were anticipated to be delayed in the Large Mine PFS.

Initial Capital Expenditure	US\$M
Equipment	7.5
Pre-strip	1.3
Coal handling preparation plant and related Infrastructure	15.4
Mine infrastructure	18.3
Water management	13.3
Rail loop and loadout	6.0
Total Initial Capital	61.8

Coal Quality & Pricing

Tenas semi-soft coking coal (SSCC) is expected to be well received due to the limited availability of mid-volatile SSCC on the seaborne market, in contrast to the more readily available high-volatile SSCC coals. The market should react favourably to the introduction of a new mid-volatile SSCC, not only as diversification from Australia, but also due to the fact that current Canadian SSCC supplies are being reduced. Looking beyond strictly the Australian SSCC, not all SSCC on the seaborne market has similar favourable quality specifications. Kobie Koornhof & Associates (Koornhof), a respected British Columbia coal market specialist, has assessed the current market pricing for Tenas coal at US\$133.45/t.

Tenas SSCC Pricing v Q3 2018 Benchmark Pricing	US\$/t
Semi-soft coal	137.00
Sulphur penalty	5.30
Ash credit	1.75
Tenas current market price	133.45

Operating Costs

Operating costs have been estimated applying first principles and covering all aspects of the mining operation including waste removal, coal recovery, coal processing, haulage, road, maintenance, water management, reclamation and site administration. The Project has potential to be a very low cost producer, in fact one of the lowest cost producers, and is well positioned to be a reliable, long term supplier of metallurgical coal to Asian steel mills. Operating costs were estimated relying on unit costs derived from the Small Mine PFS and Large Mine PFS.

Operating Costs		US\$/saleable t
Site Costs		
Waste removal	Combination of load, haul and dozer push	16.8
Coal recovery	Load and haul	6.4
Coal processing	140tph modular and scalable wash-plant	5.0
Other site costs	Water management and reclamation	5.9
General and admin		3.0
Freight Costs		
Marketing		0.2
Haulage	Clean coal load and haul from CHPP to rail loop	2.6
Rail and port		13.1
Royalties	Payable to third parties	2.8
Total Operating Costs	Pre corporate tax & BC Govt. mineral tax	55.8

Permitting and Indicative Timeline

The Tenas Project producing 750ktpa of saleable coal triggers a review under the British Columbia Environmental Assessment Act. It does not however trigger a Canadian Federal Government review under the Canadian Environmental Assessment Act. AHQ intends to pursue 'concurrent permitting' whereby both the environmental assessment review and the application for permits to operate a mine, are processed in parallel.

Summary

AHQ's key attraction is its modest market capitalisation when compared with the development/corporate potential of its Tenas coal project. Many grassroots battery materials exploration plays have market values significantly larger than AHQ, with no defined JORC resources, let alone any sort of production potential or cornerstone partners of the quality of Itochu. The Tenas coal project is eminently 'do-able', a trait that isn't typical with respect to most bulk commodity projects at the appraisal stage. Tenas benefits from its access to railway and port infrastructure – a capex saving that can be measured in the hundreds of millions of dollars.

As potentially the lowest cost producer of metallurgical coal in British Columbia, and in the lowest five percentile of coal producers in the global seaborne metallurgical coal market, the project has capacity to weather the volatility of metallurgical coal prices. AHQ remains held within our coverage Portfolio.

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