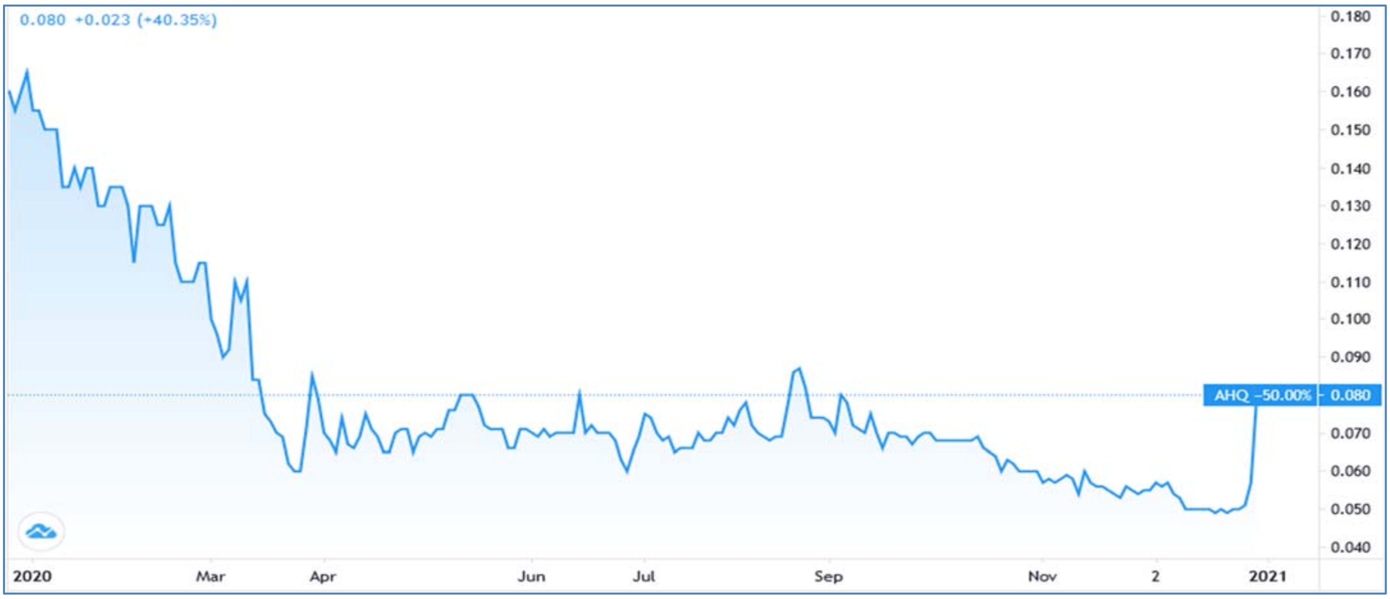
minelife

RESOURCE BULLETIN by Gavin Wendt

Saturday 2nd January, 2021

Portfolio Stock Developments

Allegiance Coal - (ASX: AHQ, Share Price: $0.08, Market Cap: $69m, coverage initiated @ $0.022 in June 2017 – *current gain of 263%)*



Key Catalyst

AHQ has announced a planned production start date for its New Elk coking coal mine in southeast Colorado, USA (subject to raising the start-up capital requirement) of June 2021.

AHQ has been something of a quiet achiever since our coverage initiation during June 2017, maintaining a relatively low market profile compared to many junior sector peers despite the tremendous advances made at its Tenas metallurgical coal project in northwest British Columbia. The project represents an enormously attractive development opportunity, with its primary attractions being the potential for low-cost production, strong operating margins and modest start-up costs. The project is being methodically de-risked, with the completion of two PFS and one DFS, and first production scheduled for H2 2022. The company has more recently benhanced its North American coal exposure with the acquisition of the New Elk Coal Mine in Colorado, USA. The mine is fully-constructed, permitted and production-ready, with a NI 43-101 hard coking coal resource of 656Mt, with production planned for 2021.

Latest Activity

New Elk Project Update

AHQ has provided an important update with respect to the commencement of mining at its New Elk metallurgical coal project, located in southeast Colorado, USA.

Overview

AHQ has now announced a planned production start date for its New Elk coking coal mine (subject to raising the start-up capital requirement) of June 2021.

The New Elk mine plan involves mining 22.2Mt of saleable coal reserves from the Blue seam, and is the same as that announced during April 2020 - all that has changed is rescheduling labour and equipment by a reduction in production units from four to two, resulting in the reserves being mined over 24 years rather than 15 years.

The loss in annual coal sales from a reduction in production units has been off-set by the acquisition of Pratt seam coal from Mays Mining. Therefore, the start-up capital requirement has been reduced to just US$13.5M from US$24M, which AHQ intends to fund with project debt.

AHQ has a debt term-sheet of US$25M from Nebari Natural Resources Credit Fund (subject to completion of due diligence), which AHQ is working to advance to documentation as the basis for funding the start-up capital requirement. Working capital is partly-funded by US$15M of off-take financing from M Resources Pty Ltd, New Elk's sales and marketing agent. AHQ is seeking a further US$10M of off-take financing to cover the balance of working capital requirements.

Details

The New Elk Final Start-up Mine Plan has not changed from the mine plan announced in April 2020 (the Slow Start-up Mine Plan), targeting the production of 22.2Mt of saleable Blue seam coal reserves, except for:

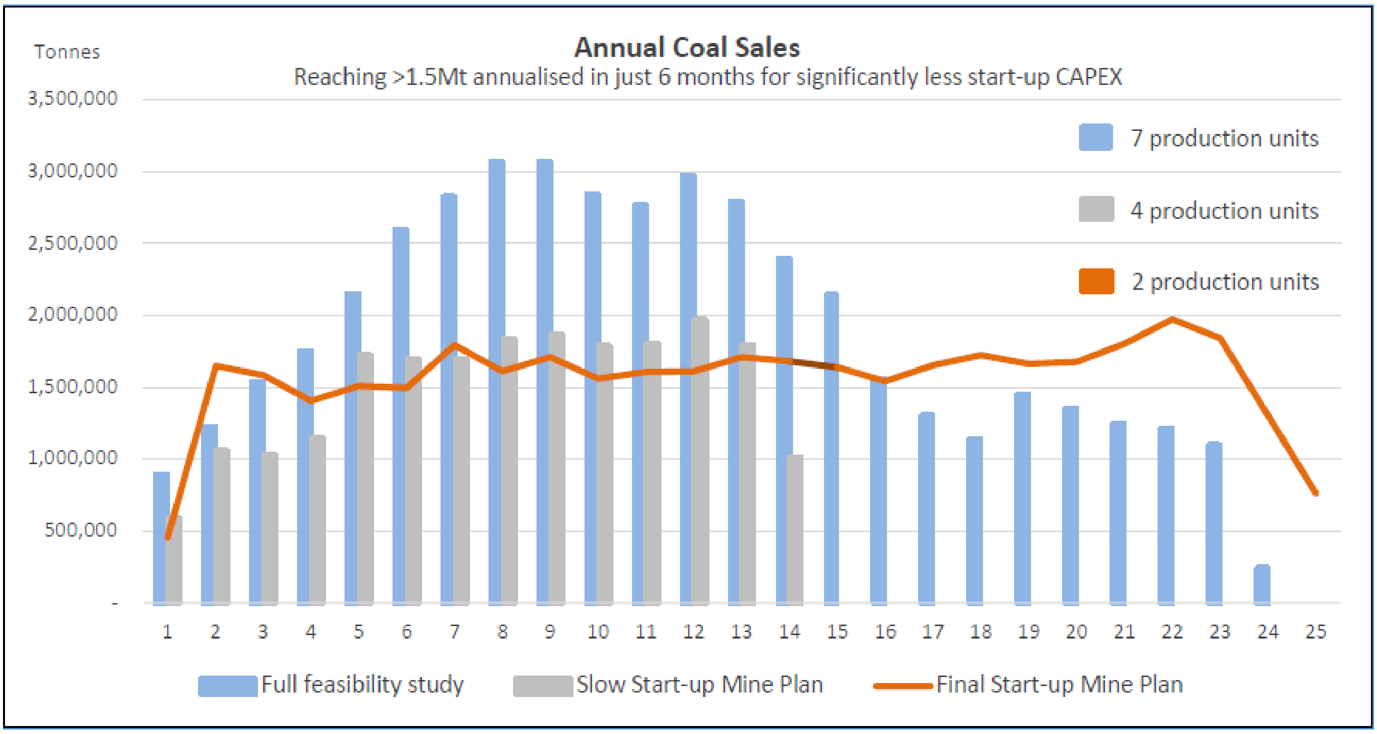
- A reduction in the number of production units from four to two
- A rescheduling of labour and the production units to mine the entire Blue seam reserve
- An extended Blue seam mine life from 15 to 24 years.

The loss in annual New Elk production from the Slow Start-up Mine Plan has been off-set by the purchase of a similar amount of coal from Mays Mining, thus maintaining a similar coal sales profile (for the first 15 years) to the Slow Start-up Mine Plan.

The key objective to arriving at the Final Start-up Mine Plan was to achieve maximum saleable coal sales, for minimal start-up capital, as quickly as possible. Purchasing Pratt seam coal has significantly reduced the capital demands on New Elk achieving average annual coal sales of around 1.6Mt.

The Blue seam has 22Mt of saleable coal reserves at a coal seam cut-off height of four feet. While the mine plan contemplates mining the entire Blue seam reserve with just two continuous miners over a period of 24 years, the intention is to either increase or replace Blue seam production (all or part) in year three from the Primero seam, which has the best coal quality in the New Elk Mine. On its own, the Primero seam coal is expected to command a premium price and if blended with the Pratt seam (or other Alabama high- vol A coking coals), will be very close to if not at benchmark high vol A coking coal.

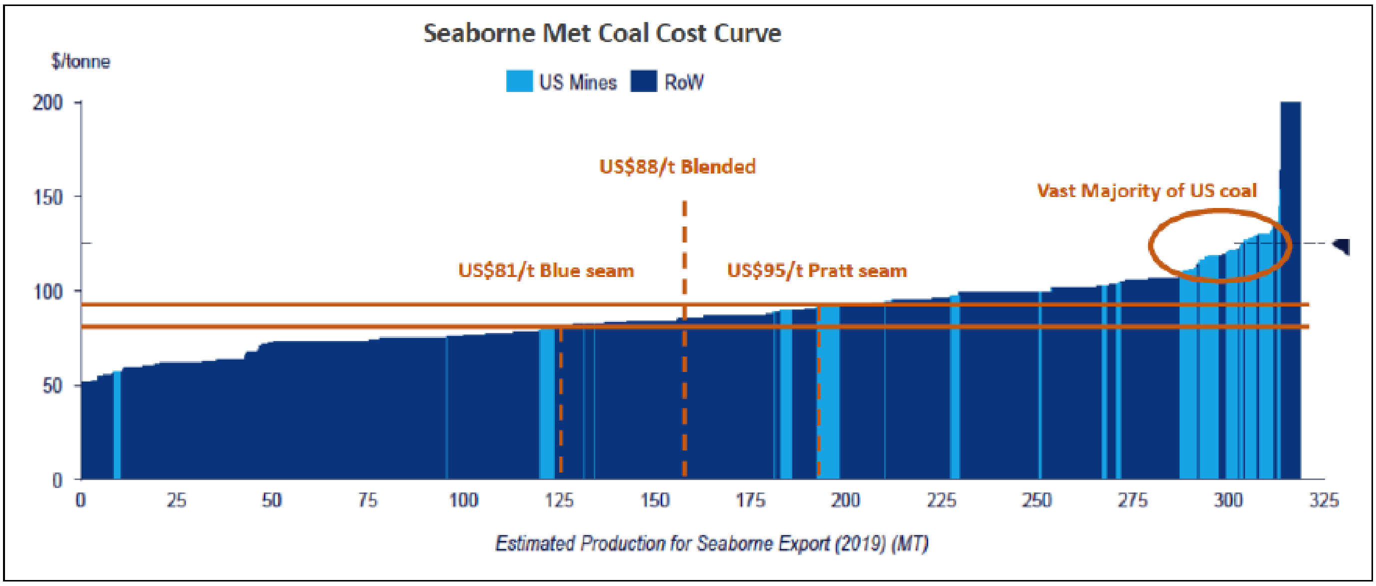
The graph below illustrates annual coal sales (noting the first period is just 7 months) from both New Elk Blue seam coal production and the purchase of Pratt seam coal from Mays Mining (Final Start-up Mine Plan), compared to the Full Feasibility Study Mine Plan announced in November 2019 and the Slow Start-up Mine Plan announced in April 2020.



The life of production Blue seam cash operating costs for New Elk (before royalties, interest and tax) have increased slightly (from $73.7/t to $81.3/t) as compared to the November 2019 feasibility study, due to a further rail haul to New Orleans versus Houston off-set in part by lower port costs. In addition, no provision had been made for the appointment of an external sales and marketing agent in the original feasibility study.

The life of mine cash cost for New Elk Blue seam coal places New Elk in the lower half of the seaborne metallurgical coal cost curve and amongst the lowest cost producers of US metallurgical coal. AHQ will purchase Pratt coal for a fixed price in addition to a bonus payment of 30% of the FOB port sales price that AHQ achieves over US$110/tonne.

The all-in cash cost for Pratt coal, which includes the fixed price payment (but not the bonus payment as it is variable to FOB price), barge and port costs, is around US$95/tonne. It is important to note that there is no sustaining capital or interest cost to purchasing Pratt coal. It is, therefore, except for the cash bonus payment, an all-in cash cost. The weighted average FOB port cash cost for Blue seam and Pratt seam coal is around US$87.5/tonne, placing this coal near the middle of the seaborne met coal cost curve, but still amongst the lowest for US coking coals.



Source: Wood Mackenzie

Project Overview

AHQ during July 2019, secured an exclusive 12-month option (later extended to 18 months), to acquire the permitted and fully-constructed New Elk coking coal mine located in southeast Colorado, USA. AHQ has since assessed the economic viability of the mine with an independent feasibility study and several optimisation studies, whilst also concluding critical rail, port and sales and marketing contracts.

The New Elk Mine is located in Las Animas County in southeast Colorado bordering northeast New Mexico, and sits within the Raton Basin (which according to U.S Geological Survey Paper 1625-A, has an estimated 15 billion metric tonnes of coal). The Raton Basin has had active coal mines for nearly 150 years, producing good-quality hard coking coals for domestic steel production. The Raton Basin hosts low sulphur, mid to high-volatile hard coking coals, typically with excellent plasticity which is an important element in the blending of coking coals in blast furnace steel production.

AHQ during April 2020, agreed commercial terms with Union Pacific Railroad for the rail transport of coal from New Elk to port, which includes ports both in the Gulf of Mexico and the west coast of the US and northern Mexico.

The company also during April 2020, appointed M Resources of Brisbane Australia as its sales and marketing agent and secured US$15 million of off-take financing. AHQ also acquired coal leases at the neighbouring Lorencito Property, which contains the same coal seams as New Elk. Of particular interest is the Primero seam, which has superior coking coal quality to the coal seams within New Elk - and is expected to enhance the value of New Elk.

During October 2020, AHQ completed the acquisition of 100% of New Elk, whilst in December 2020 AHQ entered into an agreement with Mays Mining to acquire high sulphur high vol 'A' coking coal to blend with New Elk's low sulphur high vol 'B' coking coal, and to sell and export a better quality product from New Orleans to the seaborne market.

Key performance indicators life of mine	Units	Value
LOM average coal price	US$/t	130.6
Annual average revenue	A$M	271.7
Annual average EBITDA	A$M	76.6
Exchange rate	AUD:USD	0.77
Net present value @ 8% pre interest and tax	A$M	566
Net present value @ 8% post tax	A$M	393
Internal rate of return pre tax	%	573
Internal rate of return post tax	%	301

Coal reserves and coal sales life of mine	Units	
Annual average ROM coal production	Mtonnes	1.2
Average product coal yield	%	71
Annual average saleable coal production	Ktonnes	849
Mine life	Years	24.3
Annual average coal acquired for blending	Ktonnes	752
Annual average coal sales	Mtonnes	1.6

Start-up capital		US$M
Wash-plant upgrade		5.0
Mine access and ventilation		0.2
Mine infrastructure mostly related to conveyor systems		4.0
Refurbishment of mining equipment and some purchases	Two production units	6.8
Other mining support equipment & rail investment		1.7
Total Start-up Capital (excludes contingency)		**17.7**

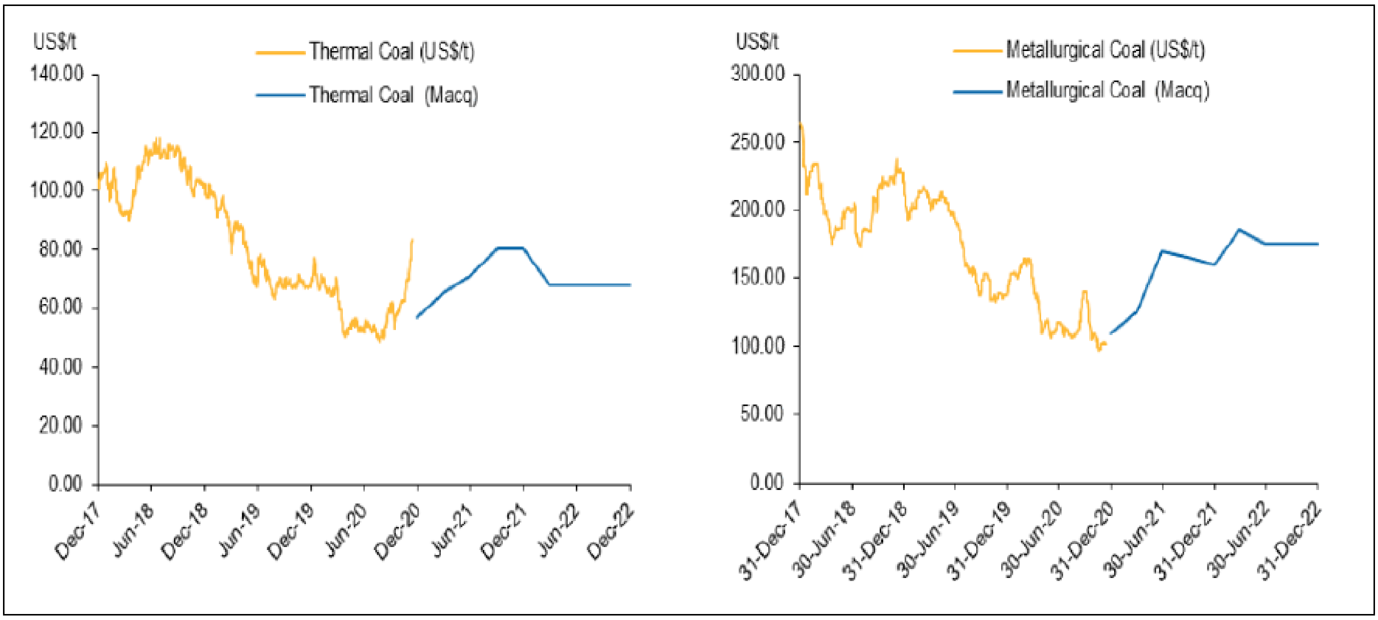
Operating costs life of mine		US$/Saleable t
Mining		28.7
Coal processing		4.4
General and administration		2.8
Marketing costs		2.4
Haulage		0.9
Rail to port and loaded		42.1
Total all-in cash cost FOB pre-interest and tax		**81.3**

Coal Price Outlook

The Chinese ban on Australian coal has created short-term opportunities for US coking coals leading into 2021, with Citi Research commenting in early December that it expects another US$20-US$30 per tonne for high-vol A on current spot levels of US116/t - and more recently AHQ was advised that a vessel of US coking sold for US$170/t (CFR China).

While the Chinese ban on Australian coal continues, China will likely continue to prioritise supply from Mongolia, Asia and Russia, as well as Canada and the US. The market is uncertain as to when the Chinese ban on Australian coal will be lifted, although Citi Research expects it to occur by mid-2021, noting that China does not produce enough domestic low vol hard coking coal to support its steel mills (in 2019 China produced 28Mt of low vol hard coking coal while importing 15Mt).

Macquarie forecast benchmark hard coking coal to return to pre-COVID levels of US$150/t by mid-2021 and to remain at or above that level to the end of 2022, providing a good benchmark price for New Elk's saleable coal over the next two years.



Source: Bloomberg, Macquarie Research, December 2020

<u>Summary</u>

ASX is focused on the development of two metallurgical coal projects in North America – its New Elk mine in Colorado, USA and its Tenas project in British Columbia, Canada.

First cab off the rank is the New Elk hard coking coal mine, a fully-permitted and constructed mine, where AHQ is targeting a return to production during 2021. AHQ is also developing the Tenas project in partnership with Itochu Corporation, where a DFS has been completed and the project is now in the permitting process, with production targeted for H2 2022.

AHQ remains firmly held within our coverage Portfolio.