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RESOURCE BULLETIN by Gavin Wendt

Monday 25th March, 2019

Portfolio Stock Developments

Allegiance Coal - (ASX: AHQ, Share Price: $0.064, Market Cap: $33m, coverage initiated @ $0.022 in June 2017 – *current gain of 191%)*

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 strongly since our coverage initiation during June 2017, having almost doubled in price. This is despite the fact that market interest has been overwhelmingly focused on battery materials companies. AHQ has been a quiet but very successful achiever, advancing its Tenas metallurgical coal project in northwest British Columbia. The project's primary attractions are the potential for low-cost production and strong earnings, together with 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 and the recent on-time release of a Definitive Feasibility Study (DFS). The project's attractive fundamentals have 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

Tenas Project DFS Results

AHQ has released the results of its Tenas Project Definitive Feasibility Study (DFS), which follows on from two pre-feasibility studies (PFS) undertaken by AHQ during 2017 – the first in relation to the entire Telkwa metallurgical coal complex and the second in relation to a stand-alone project at Tenas.

The Tenas Project DFS has as expected reinforced the potential of the Telkwa metallurgical coal complex, with excellent results highlighting an extremely robust project, representing a significant improvement on the two PFS undertaken during 2017.

Key Highlights:

- Annual production of 750,000 tonnes of saleable coal over a long 22-year mine life, representing just 15% of the entire Telkwa coal resource base.
- A modest strip-ratio of 3.6:1 BCM/ROMt.
- High 75% average yield for all metallurgical saleable coal.
- Extremely low US$49.7/tonne average all-in FOB cash cost (ex-port) before interest and tax.
- Strong average annual revenue of A$121.3M and A$63.7M average annual EBITDA, with a high ratio to revenue of 53%.
- Modest US$54.3M start-up capex, A$407.3M $NPV_{8\%}$ pre-tax and short 2.5-year capital payback.
- Strong pre-tax IRR of 56.9%.

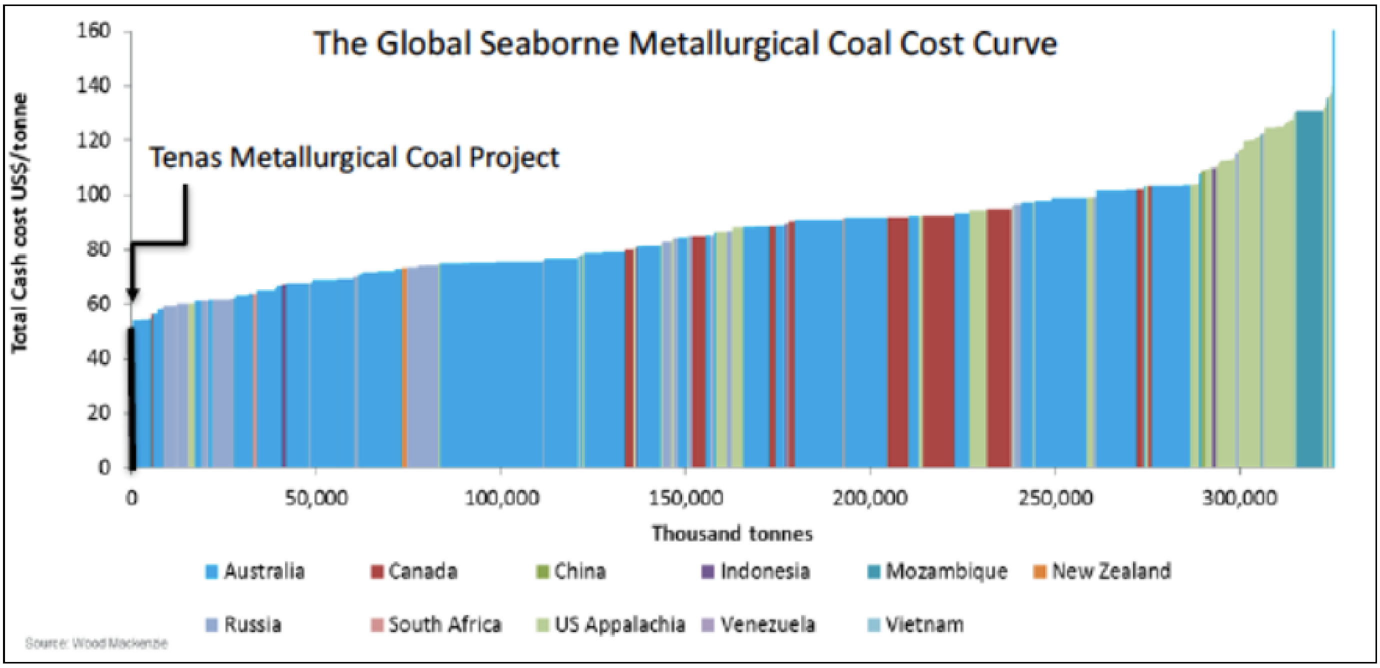
Technical Significance

The DFS results are extremely significant because they confirm the Tenas Project to be one of the lowest-cost producers of metallurgical coal on the global seaborne market – in fact likely the cheapest.

The Tenas Project enjoys exceptional location to rail and port - simple logistics is a key factor contributing to the project as a low-cost producer. Added to this is the fact that it is a shorter shipping distance to target markets, in particular the Japanese and South Korean steel mills, than from the main semi-soft coking coal competitor in the Hunter Valley of NSW via the port of Newcastle. It is 3,800 nautical miles from Ridley Terminals to Tokyo, whereas it is 4,300 nautical miles from Newcastle.

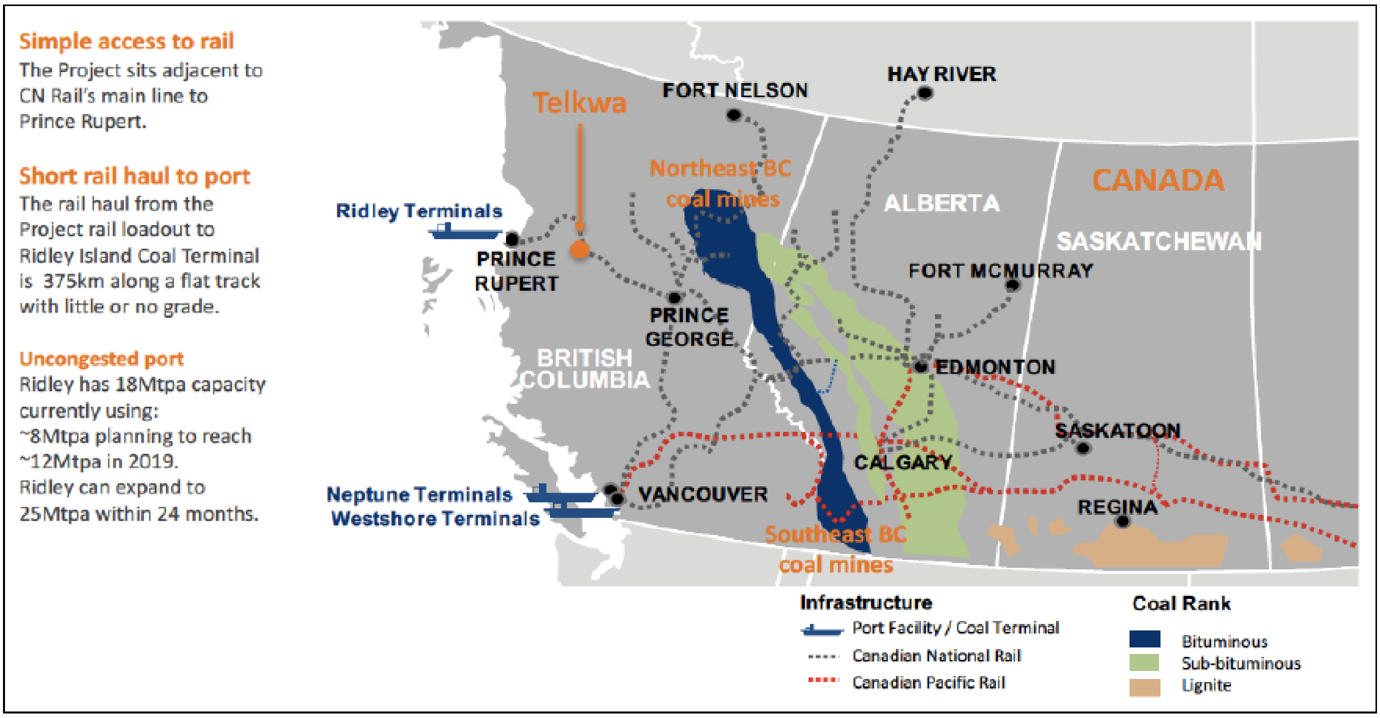
Equally importantly, there is no congestion at Ridley Terminals with no delays in ships berthing; unlike Newcastle (and Queensland), where ships often wait two to four weeks before they can berth. Mine owners incur expensive demurrage and steel mills suffer a delay in the supply of raw materials for their coke ovens and blast furnaces which disrupts steel production.

Multiple mining approaches can be deployed to take advantage of the unique geological and topographic setting of the Tenas deposit, which help reduce mining costs. Shallow-dipping coal strata and reasonably near-surface coal strata allow for a bottom-up mining approach. Mining commences with phase 1 in the shallowest area to the southwest, then moves progressively towards the syncline to the east, north and south.



Source: Wood Mackenzie seaborne metallurgical coal cost curve as at November 2018

The seaborne market comprises around 325 million tonnes of metallurgical coal per annum, with semi-coking coals accounting for around 60 million tonnes of that trade. The vast majority of semi-coking coals on the seaborne market come from the Hunter Valley coal mines in New South Wales from companies such as Glencore, Yancoal, and Whitehaven.



Coal Outlook

Kobie Koornhof & Associates Inc (Koornhof), a respected coal market specialist with particular expertise in North American coals, has provided a market outlook for metallurgical coal and a price guide for Telkwa coal as both a mid-volatile semi-soft coking coal and a mid-volatile PCI. The DFS has relied on Koornhof's pricing guidance for a Telkwa mid-volatile semi-soft coking coal.

According to Koornhof, demand for hard coking coal is continuing at robust levels as steel industry fundamentals remain a strong driver for seaborne coking coal imports. The current constraints to supply availability for high quality coking coals is likely to remain for the foreseeable future, since global coking coal supply is not coming on line at a pace that will upset the current supply/demand balance.

Koornhof has also noted in its report, that "Telkwa SSCC is expected to be well received due to limited availability of midvol SSCC on the seaborne market, in contrast to the more readily available high volatile SSCC coals from NSW. The market should react favourably to the introduction of a new midvol SSCC, not only as diversification from Australia, but also due to the fact that Canadian SSCC supplies have largely been eliminated with the closure of the Coal Mountain operation."

In terms of coal price estimation, Koornhof has provided a price range forecast for Telkwa coal of between US$114/t and US$137/t over the life of the project, but for the purposes of the DFS, AHQ has assumed the lowest price of US$120/t for coal sold in 2021 and 2022, and the lowest price of US$114/t for coal sold from 2023 onwards.

<u>Other Recent Activity</u>

Itochu Investment in Tenas Project

Back in late 2018, AHQ advised that Itochu Corporation of Japan had agreed to invest in Telkwa Coal Limited (TCL), which would underpin the funding and development of its Tenas Metallurgical Coal Project via 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.

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) – received in November 2018.
- C$1.5M for a further 4.8% interest in TCL following completion of a positive Tenas DFS, 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.

<u>Technical Significance</u>

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.

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.

<u>Next Steps</u>

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.

<u>Summary</u>

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 the world seaborne market, the project has capacity to weather the volatility of metallurgical coal prices. AHQ will now look forward to working closely with its joint venture partner, Itochu Corporation, in securing permits to mine over the next 18 months and bringing the Tenas Project into production. Accordingly, AHQ will remain firmly held within our coverage Portfolio.

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