

Tuesday 19<sup>th</sup> June, 2018

### Portfolio Stock Developments

**Allegiance Coal** - (ASX: AHQ, Share Price: \$0.044, Market Cap: \$20m, coverage initiated @ \$0.022 in June 2017 – *current gain of 100%*)



### Key Catalyst

***Enhanced geological model for the Tenas Metallurgical Coal Project in Canada, with upgraded resource estimate, reduced waste rock and lower strip ratios.***

With all of the hype around battery materials companies, it's sometimes easy for investors to forget about fundamentals. AHQ is a relatively unusual beast because it's elected to focus on coal – a commodity that might not be at the forefront of most investors' thinking. Nevertheless, AHQ's share price has managed to double since we initiated coverage of the company a year ago. AHQ has been a quiet but very successful achiever, because it has focused on advancing its Telkwa metallurgical coal project in northwest British Columbia, Canada. The stock's major attraction is its potential for low-cost production and strong earnings. The company has had strong interest from Asian steel mills and is methodically de-risking the project, having already completed two Pre-feasibility Studies, along with a revised resource estimate and geological model that should flow through favourably into a Definitive Feasibility Study (DFS).

Latest Activity

**Updated Tenas Resources Statement**

AHQ has provided an updated resource statement with respect to the targeted coal seams for its Tenas Project feasibility study, which also highlights a significant improvement in the strip-ratio of waste rock to coal.

AHQ during 2017 completed two pre-feasibility studies, the results of which were announced during July 2017 and September respectively. In the first of those two studies, AHQ declared a coal resource across all three coal deposits of 148.1Mt. With respect to the 58.8Mt Tenas deposit, the resource statement included all of its 13 coal seams, with 30.9Mt of the resource hosted within three of the 13 seams (the remaining seams are relatively thin and high ash).

Nearly all of the raw coal in those three seams within the Tenas deposit was converted into ROM coal reserves, which amounted to 29.1Mt of ROM coal reserves in the 2017 PF Studies – and after washing was further converted into 21Mt of saleable coal reserves. In the updated coal resource statement for the Tenas deposit, all other coal seams have therefore been ignored.

The updated coal resource for the Tenas deposit is 36.5Mt, as summarized below:

Tenas Coal Resource	Measured Mt	Indicated Mt	Inferred Mt	Total Mt
C seam	4.5	1.5	-	6.0
1U seam	4.5	1.6	-	6.1
1 seam	18.1	6.3	-	24.3
<b>Total</b>	<b>27.1</b>	<b>9.4</b>	<b>-</b>	<b>36.5</b>

Technical Significance

Whilst there has been a 15% decrease in the overall resource for the Tenas deposit from 148.1Mt to 125.8Mt, there has importantly been a 20% increase in resources identified for the three targeted coal seams from 30.9Mt to 36.5Mt - thereby increasing the potential recoverable coal reserves.

Approximately 25% of the Tenas deposit has fallen into the Indicated category as a consequence of the fault-based geological model, however this will have little or no impact on the Tenas Project feasibility study.

**Strip Ratio Analysis of the Tenas Deposit**

As part of the first phase of mine planning for the Tenas Project feasibility study, SRK updated the pit optimisation model for the Tenas deposit, based on the new geological model. The effect of an increase in coal resources and a decrease in waste rock, illustrated by the Pit Models, is substantial. For example, based on the new Pit Models, if AHQ were to mine to the same strip ratio of 1.9:1 BCM/ROMt applied in the Small Mine PFS, it would recover 9.3Mt of saleable coal - more than double the 4.5Mt of estimated coal recoverable in the Small Mine PFS.

In addition, the two tables below compare selected pit shells used in assessing the production plans for the 2017 PF Studies, and selected pit shells of similar coal volumes, derived from the new Pit Models.

The new Pit Models have highlighted a material decrease in waste-rock to recover approximately the same amount of coal, which in turn has significantly reduced mining strip-ratios at comparable levels of production. When comparing previous pit-shell 24 to new pit-shell 19, the strip ratio is almost halved.

<b>Pre-feasibility Study: selected comparative pit shells</b>			
<b>Pit shell number</b>	<b>Waste Rock per BCM</b>	<b>Raw Coal per tonne</b>	<b>Strip ratio BCM/ROMt</b>
17	26,954,722	8,658,000	3.11:1
21	51,459,512	12,620,575	4.08:1
24	110,115,444	20,297,735	5.43:1
33	174,288,371	27,770,460	6.28:1
64	221,520,121	31,584,336	7.01:1

<b>Feasibility Study: selected comparative pit shells</b>			
<b>Pit shell number</b>	<b>Waste Rock per BCM</b>	<b>Raw Coal per tonne</b>	<b>Strip ratio BCM/ROMt</b>
2	11,372,213	8,651,206	1.31:1
9	20,496,234	11,736,387	1.75:1
19	56,676,843	20,055,707	2.83:1
29	102,084,965	27,678,534	3.69:1
37	142,595,896	33,028,879	4.32:1

### Technical Significance

Removal of waste-rock material in open-pit mining is typically the largest cost (by a significant margin). As a result, there is significant potential for improvements in terms of reducing operating costs in the Tenas Project feasibility study, compared to the existing very-low operating costs achieved in the 2017 PF Studies. Accordingly, this provides AHQ with confidence in its ability to improve Tenas project economics in the current feasibility study.

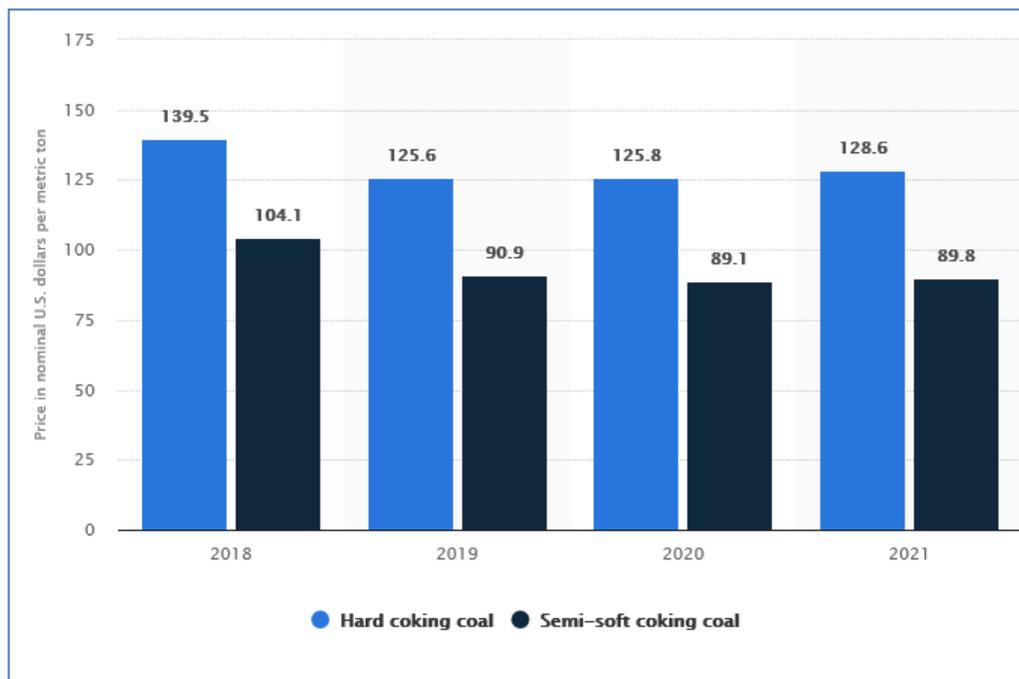
### **Recent Coal Price Commentary**

The Queensland government this month predicted prices for premium hard coking coal will remain above \$US130 a tonne until at least mid-2022, an advance on last year's prediction that it would gradually retreat towards \$US115 a tonne in the medium term. The state government predicts it will fetch \$US161 a tonne in fiscal 2019, dramatically higher than the \$US123 that was forecast for fiscal 2019 just six months ago.

Coking coal markets over recent years have been transformed by supply cuts and improved demand in China, which prompted the price to briefly rise beyond \$US300 a tonne in 2016, and it has averaged \$US193 since those forecasts were made in 2016.

Glencore's \$US1.7 billion acquisition of Rio Tinto's Hail Creek and Valeria coal assets in March implied a long-term coking coal price of \$US140 a tonne, while EMR Capital's purchase of Rio's Kestrel mine implied a long-term coking coal price of \$US170, according to UBS estimates.

Initial reactions to those deals saw Rio lauded for running an auction that extracted inflated prices, but in the months since, the market's attitude toward the prices paid by the acquirers has softened. JPMorgan raised its long-term price prediction by 28% in recent weeks on the back of the proceeds achieved in the Rio mine divestments, expectations for India to double coking coal imports by 2035, and estimates for the marginal cost of constructing new mines in Queensland.



"We believe metallurgical coal will enter an incentive price environment as Indian steel production and coal imports rise over the long term due to a lack of Indian coking coal resources," JPMorgan said in a note. The bank said a hypothetical new coking coal mine in Queensland, such as BHP's Wards Well project, would need prices above \$US130 a tonne to generate a 15% rate of return, and the bank now expects coking coal to average \$US140 long term, up from \$US110 a tonne.

"While our analysis shows that spot prices should be incentivising material volume growth, there has been a lack of recent project approvals. If the major miners continue to restrict new supply via 'value over volume' strategies, additional high-cost production will be needed. We therefore believe the balance of risks to our long-run analysis is skewed to the upside, which is a bullish scenario for existing producer margins," the bank said.

## Summary

***The key attraction of AHQ is its modest market capitalisation when compared with the development/corporate potential of its Telkwa coal project. Many grassroots exploration plays in the battery materials sector have market values significantly larger than AHQ. Furthermore the project is eminently 'do-able', a trait that isn't common in terms of most bulk commodity projects. The project has access to all requisite railway and port infrastructure – a capex saving that can be measured in the hundreds of millions of dollars.***

***AHQ anticipates that by the end of 2018, all environmental and socio-cultural baseline programs with respect to Telkwa will be complete in time for a regulatory submission during Q1 2019 - subject to both the completion of a feasibility study as well as a modest exploration program during 2018. Assuming submission of the joint Mines Act and Environmental Management Act permit applications during Q1 2019, approval is anticipated during H2 2019. AHQ will remain firmly held within our Portfolio.***

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