Speculative

See key risks on page 8-9.
Speculative securities may not be suitable for Retail clients

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Allegiance Coal Ltd (AHQ)

Revised mine option & potential acquisition

Recommendation
Buy (unchanged)
Price
$0.125
Valuation
$0.21 (previously $0.15)
Risk
Speculative

GICS Sector

Energy

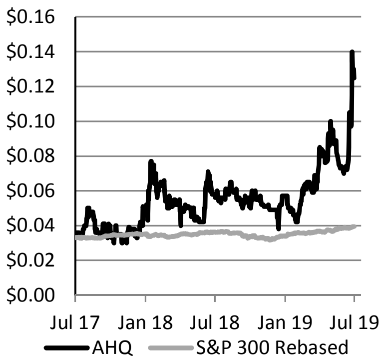
Expected Return	
Capital growth	**68%**
Dividend yield	**0%**
Total expected return	**68%**

Company Data & Ratios	
Enterprise value	**$67m**
Market cap	**$68m**
Issued capital	**546m**
Free float	**85%**
Avg. daily val. (52wk)	**$22,207**
12 month price range	**$0.04-$0.15**

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	0.07	0.07	0.06
Absolute (%)	71.23	92.31	115.52
Rel market (%)	68.12	85.00	105.94

Absolute Price



SOURCE: IRESS

Project enhancements & near-term cash flow potential

AHQ has recently made two material announcements:

1. A "revised mine plan option" for the Tenas metallurgical coal project with higher levels of production from year 5 and therefore improved project economics; and
2. That it has entered a binding and conditional terms sheet to acquire a mothballed hard coking coal mine located in southeast Colorado, USA.

Updated Tenas mine plan option brings forward cash flows

Following a review of the Tenas definitive feasibility study, AHQ and its consultants have identified the opportunity to utilise latent mining equipment capacity from year 6 of the project to potentially grow coal production from 750ktpa to 1.35Mtpa. The net result is that project cash flows are brought forward, increasing the project's NPV. However, this is only an option and AHQ will initially seek to permit the 750ktpa operation. Any increase in production would be subject to a new application and only once Tenas is operating at a steady state of 750ktpa.

Impact: Increase our unrisked project NPV by 40% and AHQ risked and diluted valuation to $0.21/sh (previously $0.15/sh)

Met coal acquisition could generate near-term cash flow

AHQ has the exclusive option to acquire the New Elk Coal hard coking coal mine currently on care and maintenance and located in southeast Colorado. The deal is subject to a number of conditions including AHQ's satisfactory due diligence and completion of the purchase prior to 14 July 2020. New Elk Coal is an underground mine with a non-JORC coal Resource of 656Mt and we estimate it has the potential to produce up to 3Mtpa coking coal and be in production within 18 months. Acquisition consideration involves AHQ assuming C$55m debt with repayments consisting of: US$3m in cash; US$3m in AHQ shares; US$5m in reclamation bonds; and the balance paid through an agreed percentage of the mine's operating cash flow.

Impact: No change to estimates until further feasibility study information is forthcoming.

Investment thesis: Speculative Buy, Valuation $0.21/sh

Our Speculative Buy recommendation is supported by our positive outlook for metallurgical coal prices and the relative simplicity of AHQ's Tenas Project. The New Elk Coal project has the potential commence operations and cash flow in FY21, prior to the Tenas Project ramping up from FY22.

As a result of the revised mine plan option for Tenas, we have increased our risked and diluted AHQ valuation to $0.21/sh (previously $0.15/sh). AHQ is trading at a significant discount to this value, which we expect to unwind as the Tenas project is permitted. The New Elk Coal deal represents further potential upside to our valuation.

AHQ is a mine development company with prospective operations and cash flows only. Our Speculative risk rating recognises this higher level of risk and volatility of returns.

Changes to AHQ valuation

Revised Tenas mine plan option: Valuation lifted to $0.21/sh

Our AHQ valuation is now $0.21/sh (previously $0.15/sh), with key changes being:

- Factoring in a less dilutive capital raising given the recent strength in AHQ's share price (adding $0.03/sh); and
- Factoring in half of the upside (i.e. a "risked case") to the revised mine plan option compared with the DFS case (adding $0.03/sh).

(1) Less dilutive capital raising factored in, adding $0.03/sh to our valuation

The net effect of a less dilutive equity raising on our risked and diluted AHQ valuation is a $0.03/sh increase to $0.18/sh.

- We had previously assumed that AHQ would complete a pre-development equity raising of A$39m at $0.07/sh (issuing 528m shares).
- With the recent appreciation in AHQ's share price, we now assume a pre-development equity raising of A$39m at $0.125/sh (issuing 311m news shares).

(2) Revised mine plan option adds another $0.03/sh (risked) to our valuation

The revised mine plan option adds another $0.03/sh (risked) to our valuation:

- It lifts our unrisked 100% Tenas project valuation by 40% to A$216m;
- After taking into account project risking (25% discount for permitting and development risks), AHQ's equity share (80%, with Itochu at 20%) and the equity raising dilution (point 2. above), it increases our valuation by $0.06/sh; then
- We are factoring half of this upside into our valuation, or $0.03/sh.

Key enhancements of the Tenas mine plan option compared with the definitive feasibility study (DFS) include:

- 16.55Mt saleable coal produced across 14.4 years (DFS 22 years);
- All-in FOB cash cost before interest and tax of US$45.0/t (DFS US$49.7/t);
- Life of mine EBITDA average (using AHQ's price assumptions) of A$105m (DFS A$64m); and
- Start-up capital expenditure of US$55.8m (DFS US$54.3m).

New Elk Coal deal: No immediate impact to AHQ valuation

Until potential project parameters are announced to the market and further due diligence conditions are met, we have elected not to attribute any value to the New Elk Coal deal.

Given publically available information on the project (see Sedar filings for Cline Mining Corporation), and the significant in-place infrastructure and work to date completed, we have a positive view on the value of the New Elk Coal deal. However, we also recognise that AHQ will likely be required to raise equity capital to complete the transaction.

The following is a broad timeline of the key dates of the New Elk Coal deal:

- Before 14 September 2019
    - Undertake legal and financial due diligence
- Before 14 April 2019
    - Undertake a feasibility study to develop a mine by;

- Before 14 June 2020
  - Raise sufficient capital to meet cash components of the acquisition (US$3m cash consideration plus US$5m government bonding)
  - Raise sufficient working capital to bring the mine back into production
  - Obtain AHQ shareholder approval
  - Execute on definitive transaction documentation

Valuation summary

The following table outlines the key calculations arriving to our AHQ valuation.

Table 1 - Bell Potter Securities AHQ fully diluted valuation

Current AHQ market data				
AHQ price $/sh	0.125			
Diluted shares on issue m	561			
Market capitalisation A$m	70			
AHQ equity valuation (UNDILUTED)		**A$m**	**A$/sh**	**Notes**
AHQ net cash (est. 30 June 2019) & options		2	0.00	
Tenas Project (100%) (unrisked)	154			100% project valuation, unrisked
Tenas Project (AHQ 80%) (unrisked)	123			AHQ equity share
Tenas Project (AHQ 80%) (risk discount of 25%)	92	92	0.16	Recognising permitting & development risks
Other AHQ assets net of corporate costs (Telkwa excl. Tenas) A$m		20	0.04	Recognising non-Tenas Project coal Resources & Reserves
AHQ equity valuation (UNDILUTED)		**114**	**0.20**	Before financing equity raisings
Tenas Project capital requirements	**US$m**	**A$m**		
Tenas capital cost	54	79		
Contingency (5%)	3	4		
Working capital	10	14		
Total funding requirement (TCL)	**67**	**97**		
Debt / equity financing assumed				
Debt finance (50%)	34	49		
Equity component (50%)	34	49		
AHQ equity share (80%)				
Debt finance (50%)	27	39		
Equity component (50%)	27	39		
Total required by AHQ	**54**	**78**		
Dilution: Project capex equity raise				
Equity raised A$m		39		
Capital raise (discount)/premium %		0%		
Raising price A$/sh		0.13		
New shares issued m		311		
Diluted shares on issue m		872		
AHQ equity valuation (DILUTED)		**A$m**	**A$/sh**	
AHQ cash (after equity raising & debt drawing)	80			
AHQ debt drawn	39			
AHQ net cash (post project capex equity raise)		41	0.05	
Tenas Project (AHQ 80%) (risk discount of 25%)		92	0.11	
Other AHQ assets net of corporate costs (Telkwa excl. Tenas) A$m		20	0.03	
A: AHQ equity valuation (DILUTED)		**153**	**0.18**	860m shares on issue after project capital raise
Upside - valuation to current share price %			44%	Buy recommendation, Speculative risk
B: Upside case - Revised Tenas mine plan option			**0.23**	
AHQ equity valuation (midpoint A & B)			**0.21**	

SOURCE: BELL POTTER SECURITIES ESTIMATES

Short term capital requirements

At 30 June 2019, AHQ had a cash balance of A$2.6m and loan facilities totalling A$1.7m.

Of the loan facilities:

(1) A$659k may be satisfied through the allotment of AHQ shares at a price of $0.025/sh, and is charged a rate of BBSW + 4%; and

(2) A$1.0m relates to unsecured promissory notes, repayable on 31 March 2020, bearing an implied interest rate of 12% pa.

Since the end of June 2019, AHQ's Tenas joint venture partner Itochu Corporation confirmed the results of the Tenas Project DFS and invested a further C$1.5m (A$1.6m, Tranche 2) in Telkwa Coal Limited (TCL). This investment takes Itochu's interest in TCL to 10.1%, with AHQ at 89.9%.

Under the terms of joint venture agreement, Itochu can increase its interest in TCL (and the Tenas Project) to 20% through a C$3.6m investment following the lodgement of an application for an Environmental Assessment Certificate (targeted for the September 2019 quarter). We expect Itochu to make this investment and thereby provide a further cash buffer for the project.

Table 2 - AHQ recent quarterly cash flows

Cash flow summary A$'000	**Sep-16**	**Dec-16**	**Mar-17**	**Jun-17**	**Sep-17**	**Dec-17**	**Mar-18**	**Jun-18**	**Sep-18**	**Dec-18**	**Mar-19**	**Jun-19**
Exploration & evaluation	-3	-70	-304	-989	-599	-490	-1,799	-1,084	-1,306	-1,182	-1,412	-1,241
Staff, admininstration & corporate	-153	-262	-253	-284	-347	-371	-315	-536	-503	-726	-681	-458
Other operating	4	33	3	2	2	-6	3	4	2	2	2	1
Total operating cash flows	**-152**	**-299**	**-554**	**-1,271**	**-944**	**-867**	**-2,111**	**-1,616**	**-1,807**	**-1,906**	**-2,091**	**-1,698**
Total investing cash flows	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Proceeds from shares net of costs	123	2,335	0	1,361	-10	3,302	766	2,878	2,194	57	0	2,393
Net proceeds from/(repayment of) borrowings net of costs	-1,282	-43	0	0	0	-100	0	0	0	0	0	943
Other financing cash flows	0	0	0	0	0	0	0	0	0	0	1,576	0
Total financing cash flows	**-1,159**	**2,292**	**0**	**1,361**	**-10**	**3,202**	**766**	**2,878**	**2,194**	**57**	**1,576**	**3,336**
Beginning cash balance	**1,418**	**108**	**2,101**	**1,547**	**1,637**	**683**	**3,018**	**1,673**	**2,935**	**3,322**	**1,473**	**958**
Total change in cash	-1,311	1,993	-554	90	-954	2,335	-1,345	1,262	387	-1,849	-515	1,638
Ending cash balance	**107**	**2,101**	**1,547**	**1,637**	**683**	**3,018**	**1,673**	**2,935**	**3,322**	**1,473**	**958**	**2,596**

SOURCE: AHQ QUARTERLY CASH FLOW STATEMENTS
NOTE: FIGURES MAY NOT ADD DUE TO ROUNDING

Revised Tenas mine plan option

Key points of the Tenas Project "Revised Mine Plan Option"

- AHQ has announced a revised mine plan option for the Tenas metallurgical coal project which represents an "Upside Case" to the March 2019 definitive feasibility study (DFS) "Base Case".
- The revised plan is the result of a DFS review undertaken by SRK Consulting Canada.
- In the Upside Case, when the Project's water management infrastructure is completed in year 6, the mining equipment and labour allocated to this task will be redeployed to pit mining operations.
- The result of redeploying this mining equipment and labour is that saleable coal production could ramp-up from initial production levels of 750ktpa to over 1Mtpa in years 5 to 6 of the project and then 1.35Mtpa over years 7 to 15.
- There would be no material change to the Tenas Project start-up capital expenditure and an additional US$5.3m incurred in year 4.
- Life-of-mine operating costs would be expected to fall from US$50/t (DFS) to US$45/t (Upside Case).
- AHQ is maintaining that the upside case represents a value accretive option for the Project. AHQ is only seeking to permit, initially, the Tenas Project with production of 750ktpa saleable tonnes. Any implementation of the revised mine plan option would be subject to consultation with key Project stakeholders and be the subject of a new regulatory application once the Tenas Mine is operating at a steady state.

Tenas Project DFS parameters

The following is an outline of the key Tenas Project DFS parameters. For further information see our AHQ initiation report dated 27 June 2019.

Table 3 - Tenas Metallurgical Coal Project

From March 2019 DFS release	
Coal quality	Semi-soft coking coal
Annual saleable coal production	0.75 Mtpa
Initial project life	22 years
Capital cost (to startup) – excludes leased mobile equipment	US$54.3m
Leased equipment	US$36.2m
Strip ratio BCM/ROM t (LOM average)	3.6 BCM/ROMt
Wash yield (LOM average)	75%
FOB cash cost (LOM average, excluding royalities & taxes)	US$49.70/t
AHQ DFS estimates	
Average annual revenue	A$121.3m
Average annual EBITDA	A$63.7m
Pre-tax NPV	A$407.3m
IRR pre-tax	56.90%
Payback period	2.5 years
Prices assumed (semi-soft, long term)	US$114/t

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

New Elk Coal deal – Hard Coking Coal

12 months exclusivity, deferred terms, low up-front capital

AHQ has entered into a binding and conditional terms sheet to acquire the holding entity of the New Elk Coal hard coking coal mine. Key terms include:

- AHQ has a 12-month exclusivity period where it will pay US$150k per month to maintain the asset's care and maintenance;
- AHQ will acquire New Elk Coal's equity for US$1 and will assume C$55m in debt to the operation's former shareholder;
- The C$55m will be repaid through: US$3m cash and US$3m AHQ shares on completion of the acquisition; AHQ replacing a US$5m Colorado State Mine remediation bond on completion; and the balance (approximately US$30m) to be repaid through an agreed percentage of mine operating cash flow;
- AHQ will undertake legal and financial due diligence by 14 September 2019 and review the geological model to mine by 14 October 2019;
- AHQ will undertake a feasibility study to develop a mine plan for production by 14 April 2020;
- AHQ will raise sufficient cash to replace Colorado state bonds, meet required cash payments and working capital requirements prior to 14 June 2020; and
- AHQ will obtain shareholder approval, enter into transaction documentation and complete the acquisition no later than 14 June 2020.

The New Elk Coal: Hard coking coal on care & maintenance

The New Elk Coal hard coking coal mine has been on care and maintenance since late 2012 following the fall in coking coal prices and the subsequent bankruptcy of the asset's major shareholder, Cline Mining Corporation. The asset has a non-JORC hard coking coal Resource of 656Mt, is fully permitted and fully constructed.

The AHQ New Elk Coal feasibility study will target the Blue, Allen and Green, seams which have a combined non-JORC coal Resource of over 230Mt. AHQ expect the target seams to produce mostly High Vol B hard coking coal with upside from some High Vol A hard coking coal production.

Project location: Raton Basin, southeast Colorado

The New Elk Coal mine is located in the Raton Basin which covers southern Colorado and northern New Mexico. The Basin has a long history of coal mining delivering to domestic and seaborne coal customers. Coals from this basin are typically low sulphur, mid to high volatile hard coking coals valuable for blending in blast furnace steel production.

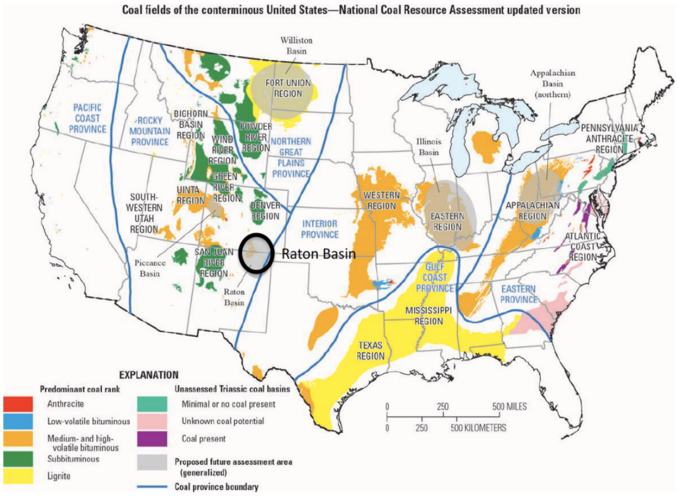
Previous New Elk Coal infrastructure investments by Cline

Cline acquired the mine in 2008 for C$17m and reopened operations having upgraded mine and supporting infrastructure. The estimated total cost of the Cline investment was C$150m. In 2011, production recommenced. However, the mine was forced to close in July 2012 on the weakness in coal prices. Cline invested US$63m in surface and underground equipment, including a US$8.5m upgrade of the coal wash plant. Much of the underground equipment, including Joy continuous miners and shuttle cars, remains on site and is capable of refurbishment.

July 2012 NI 43-101 Technical Report commissioned by Cline

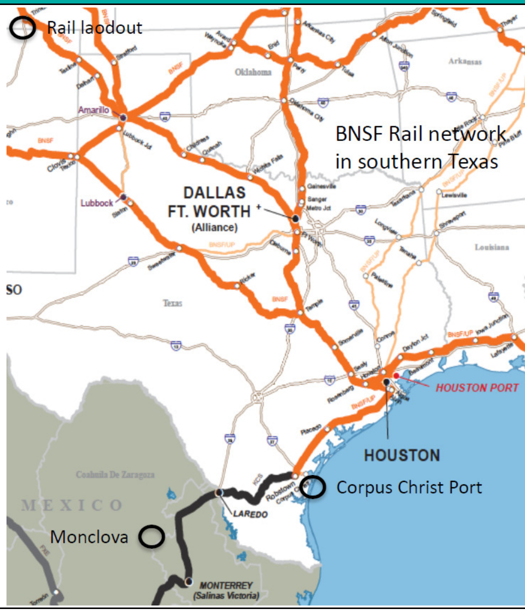
In July 2012, Cline announced to the TSX platforms a Technical Report (NI 43-101) which include details of a Preliminary Economic Assessment (PEA) of the New Elk Coal project. The preliminary mine plans indicated that there was adequate resource to support a 20 year mine life producing 3Mtpa (short) saleable coal. The technical report stated that “no fatal flaws to the project were identified in the PEA”.

Figure 1 - New Elk Coal location



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 2 - Logistics chain



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Transport: Within 21 miles of BNSF Railway operations

New Elk Coal is 21 miles (34km) from a main railway operated by BNSF Railway and the mine has leased access to a rail siding. A dedicated rail spur was removed in 1996. However, there is potential for this rail to be reconstructed for future use.

The rail loadout is 950 miles (1,530km) on BNSF to Houston Port. Kinder Morgan Coal Terminal has capacity to handle 5.25Mtpa coal and can receive 60,000t panamax vessels. This is a significant rail distance. However, the Wood Mackenzie pricing series quoted in the Technical Report point to US$37-41/t as an appropriate rail charge to calculate free-on-rail net-back prices from free-on-board benchmark pricing. New Elk Coal also has the potential to deliver coal by rail to East Coast U.S. and Mexico based steelmaking customers.

Management appointments in place

AHQ has subsequently announced the appointment of an experienced team to manage the New Elk Coal acquisition and potential recommissioning. The team includes Mr Larry Cook, a coal mining engineer with significant experience in US underground coal. Mr Cook has been appointed to the AHQ Board of Directors. Mr Amon Mahon (coal mining engineer) and Mr Bernie Mason (geologist) have been appointed as Joint Project Managers.

Mr Mahon and Mr Mason were originators and consultants to the deal and have each also been issued with 5m performance rights subject to various milestones.

Allegiance Coal Ltd (AHQ) summary

Company description

AHQ is an ASX-listed company in the process of permitting and developing the Tenas Metallurgical Coal Project in British Columbia, Canada. Tanas is a 21Mt semi-soft coking coal Reserve within a broader 42Mt Telkwa Reserve footprint. The project is to produce on average 750ktpa semi-soft coking coal over a mine life of 22 years at an average FOB cash cost of less than US$50/t (excluding royalties). The Telkwa Reserve provides potential for an expansion of the project beyond these parameters.

Investment thesis: Speculative Buy, Valuation $0.21/sh

Our Speculative Buy recommendation is supported by our positive outlook for metallurgical coal prices and the relative simplicity of AHQ's Tenas Project. The New Elk Coal deal has the potential establish the company's cash flow in FY21, prior to the Tenas Project ramping up from FY22.

As a result of the revised mine plan option for Tenas, we have increased our risked and diluted AHQ valuation to $0.21/sh (previously $0.15/sh). AHQ is trading at a significant discount to this value, which we expect unwind as the Tenas project is permitted. The New Elk Coal deal represents further potential upside to our valuation.

AHQ is a mine development company with prospective operations and cash flows only. Our Speculative risk rating recognises this higher level of risk and volatility of returns.

Valuation: $0.21/sh based on diluted Tenas Project

Key AHQ valuation parameters include:

- Modelling the Tenas Project using operational and cost assumptions consistent with the AHQ March 2019 DFS, however, with our more conservative semi-soft coking coal price assumptions.
- Apply a risk discount to this valuation to account for uncertainties with respect to permitting, financing and development.
- Assuming that AHQ raises equity to finance its share of the project after debt financing has been secured.

Risks

Risks to an investment in AHQ include, but are not limited to:

- **Commodity price and exchange rate fluctuations**. The future earnings and valuations of exploration, development and operating resources companies are subject to fluctuations in underlying commodity prices and foreign currency exchange rates.
- **Infrastructure access.** Bulk commodity producers are particularly reliant upon access to transport infrastructure. Access to infrastructure is often subject to contractual agreements, permits, and capacity allocations. Agreements are typically long-term in nature (+10 years). Infrastructure can be subject to outages as a result of weather events or the actions of third party providers.
- **Operating and capital cost fluctuations.** Markets for exploration, development and mining inputs can fluctuate widely and cause significant differences between planned

and actual operating and capital costs. Key operating costs are linked to energy and labour markets.

- **Resource growth and mine life extensions.** Future earnings forecasts and valuations may rely upon resource and reserve growth to extend mine lives.
- **Sovereign risks.** Mining companies' assets can be located in countries other than Australia and are subject to the sovereign risks of that country.
- **Regulatory changes risks.** Changes to the regulation of infrastructure and taxation (among other things) can impact the earnings and valuation of mining companies.
- **Environmental risks.** Resources companies are exposed to risks associated with environmental degradation as a result of their exploration and mining processes. Fossil fuel producers (coal) may be particularly exposed to the environmental risks of end markets including the electricity generation and steel production industries.
- **Operating and development risks.** Mining companies' assets are subject to risks associated with their operation and development. Risks for each company can be heightened depending on method of operation (e.g. underground versus open pit mining) or whether it is a single operation company. Development assets can be subject to approvals timelines or weather events, causing delays to commissioning and commercial production.
- **Occupational health and safety risks.** Mining companies are particularly exposed to OH&S risks given the physical nature and human resource intensity of operating assets.
- **Funding and capital management risks.** Funding and capital management risks can include access to debt and equity finance, maintaining covenants on debt finance, managing dividend payments, and managing debt repayments.
- **Merger/acquisition risks.** Risks associated with value transferred during merger and acquisition activity.

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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Disclosure: Bell Potter Securities acted as Lead Manager for a $2.7m capital raising in June 2019 and received fees for that service.

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