

Allegiance Coal (ASX:AHQ)

September 2017

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Note: This report is based on information provided by the company as at September 2017

| Investment Profile | |
|---|-----------------|
| Share Price - 21 Sept. 2017 | A\$0.04 |
| Base case valuation | A\$0.37/share |
| Upside valuation | A\$0.82/share |
| Issued Capital: | |
| Ordinary Shares | 226.0m |
| Unlisted Options | 0.82m |
| Fully Diluted | 226.8m |
| Market Capitalisation | \$9.04m |
| 12 month L/H (adjusted for 5 for 1 consolidation, 10/11/2016) | \$0.019/\$0.175 |
| Cash and Liquid Investments | \$1.64 million |
| Debt | \$0.76 million |

| Board and Management | |
|---|--|
| Mr Malcolm Carson: Non-Executive Chairman | |
| Mr Mark Gray: Managing Director | |
| Mr David Fawcett: Non-Executive Director | |
| Mr Jonathan Reynolds: Finance Director | |
| Mr Dan Farmer: Chief Mining Engineer | |
| Mrs Angela Waterman: Environment & Government Relations | |

| Major Shareholders | |
|----------------------------------|--------|
| Telkwa Holdings Ltd | 13.23% |
| Salisbury Australia Holdings P/L | 12.15% |
| Bernard Laverty P/L | 7.06% |
| Franklin Civil P/L | 6.91% |
| Altius Minerals Corp. | 6.46% |
| Top 20 | 54.79% |
| Board and Management | 9.94% |



Senior Analyst – Mark Gordon

The investment opinion in this report is current as at the date of publication. Investors and advisers should be aware that over time the circumstances of the issuer and/or product may change which may affect our investment opinion.

LOW COST METALLURGICAL COAL

Allegiance Coal (“Allegiance” or “the Company”) is farming into the Telkwa Coal Project (“Telkwa” or “the Project”, located just 375km by rail from the under-utilised Ridley Island Coal Terminal (“RICT”) in northwestern British Columbia, Canada. Telkwa, which has Saleable Reserves of 42.5Mt of metallurgical coal, has the potential to produce at FOB costs in the lower 5% of the global sea-borne trade with resultant good returns from the Project. This is by virtue of the low strip ratio and access to infrastructure; the Project has ready access to power and transport, including being just 24km from the Canadian National Rail (“CNR”), which links directly to RICT.

To expedite development and bring forward cash flows (and value to shareholders), the Company is initially looking at a low cost “regional” mine start-up of <250,000tpa of clean coal which should result in a significantly shorter permitting time, possibly of around six months, than that required for a larger operation, and could potentially result in first production by late 2019. The strategy is to then upscale the operation, possibly to around 1,000,000tpa with the permitting for this to be carried out in parallel with the small scale operations.

KEY POINTS

Quality coal reserves: Telkwa hosts quality reserves over three deposits suitable for either pulverised coal injection (“PCI”) or semi soft coking coal (“SSCC”) metallurgical applications, with these sufficient to host a medium scale, 20+ year operation; the overall washing yields are 68%, with that for the Tenas deposit (which has Proven Reserves of 21Mt of saleable coal) on which planned operations are based, being 75%, which is equivalent to or better than peers.

Low strip ratio: The current Reserves have a low ROM strip ratio of 5.8:1, with this equating to a strip ratio of 8.5:1 for saleable coal with the Tenas deposit having a ROM strip ratio of 5.6:1, or 7.6:1 for saleable coal.

Infrastructure rich: Telkwa is well served by infrastructure, including electricity and transport, and when compared with Canadian peers, is close, at 375km by rail to the RICT. These factors contribute to the relatively low capital and operating costs.

Low cost: With our estimated FOB costs for the 250,000tpa operation of ~US\$54/tonne, Telkwa falls in the lowest 5% of the global sea-borne trade cost curve; these relatively low costs translate through to the higher strip ratio 1,000,000tpa scenario, with IIR’s analysis indicating that FOB costs will be in the order of US\$59/tonne. Low operating costs are backed by an estimated initial capital cost of US\$35 million, which should make the Project relatively easy to finance.

Forecast strong metallurgical coal markets: Demand, and hence prices for metallurgical coal are forecast to remain strong on the back of strong ongoing demand for steel.

Well regarded and stable jurisdiction: British Columbia is a well regarded and stable coal mining jurisdiction, and hence attractive to investors.

Strong management and technical team: The Company has management and technical personnel with extensive experience in the coal sector; in addition key personnel hold ~10% of the Company, thus aligning their interests with those of other shareholders.

VALUATION SUMMARY

We have a base case valuation of A\$0.37/share for Telkwa - this is based on the small scale operation, and we see significant upside to \$0.82/share in this with the ultimate, full-scale operation, and also upside with success on permitting and execution. We note that these figures are based on unfunded and pre-tax Telkwa Project modelling.

| Allegiance base case valuation summary | | | | | |
|--|----------------|-------------|-----------------|----------------|---------------|
| Asset | Total (A\$m) | Risk Factor | Riskd (A\$m) | Riskd/Share | Notes |
| Telkwa Stage 1 Ops | \$70.8 m | 50% | \$35.4 m | \$0.157 | NPV8, Pre-Tax |
| Other Telkwa Coal Reserves | \$465 m | 10% | \$46.5 m | \$0.206 | |
| Cash | \$1.64 m | 100% | \$1.64 m | \$0.007 | June 30, 2017 |
| Total | \$537 m | | \$83.5 m | \$0.370 | |

SWOT ANALYSIS

Strengths

- ◆ **High quality coal resource:** With excellent washing characteristics and a low strip ratio, Telkwa hosts a high quality coal resource with the potential to produce valuable metallurgical products.
- ◆ **Well regarded jurisdiction:** British Columbia is a well regarded and stable coal mining jurisdiction, and hence generally attractive to investors.
- ◆ **Close to infrastructure:** The proximity to transport and utility infrastructure is a key strength of Telkwa, with the planned Tenas pit being just 24km from the CNR at the town of Telkwa, and with Telkwa being just 375km on the CNR from the RICT - this compares with rail distances of ~1,300km for the northeast British Columbia coal operations, including those of Teck.
- ◆ **Close to markets:** RICT is closer to the target Asian markets than the main Australian export ports; also, given some recent disruptions in Australian supply customers are looking for supply diversity.
- ◆ **Potential for expedited permitting:** The potential to permit initial operations through the "regional" mine system has the capacity to significantly decrease permitting times and costs, and thus bring forward operational cash flows and deliver value to shareholders whilst the longer time-frame large scale mine permitting is underway.
- ◆ **Low cost:** At ~US\$55/tonne FOB, Telkwa has the potential to be a globally low cost producer, with the forecast strong economics also backed up by an expected low initial capex of US\$35 million; our analysis also indicates that the expansion capex will also be relatively low, and be able to be funded out of cash flow.
- ◆ **Experienced people with skin in the game:** Company personnel and consultants have significant experience in the coal game in Canada and also have significant holdings in Allegiance.

Weaknesses

- ◆ **Location:** Although the Project would appear to have support within the local community, the location, in an area that is attracting "tree changers" from cities such as Vancouver may be a factor in generating significant negative sentiment, which may affect the permitting process.
- ◆ **Cash position:** With A\$1.6 million in the bank as of June 30, 2017, and a cash burn of A\$1.3 million in the June quarter, Allegiance will need to go to the market to fund upcoming activities, including a planned six hole drilling programme; we would expect however that any raising will be reasonably modest, and given the recent increases in share price (up ~150% since June) and the interest in previous capital raisings that this should be successful.

Opportunities

- ◆ **Near term initial operations:** This is the key opportunity for Allegiance, with the potential to produce near term cash flow through the "regional" mine.
- ◆ **Expansion of operations:** This follows on from the above, with plans to expand operations to provide significant long term cash flow to Allegiance.
- ◆ **JV partners:** Allegiance will be looking to attract an offtake or JV partner to help fund the proposed operations.

Threats

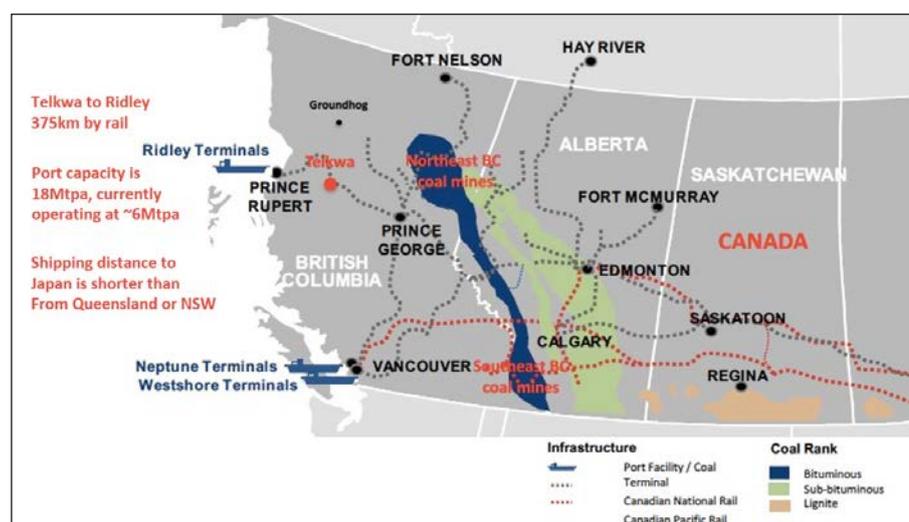
- ◆ **Permitting:** This is the key risk facing Allegiance - although the regulatory environment allows for the regional mine permitting there is the potential, through Ministerial discretion, for even regional scale mines to have to go through the longer, major mine permitting process. There is also the risk of any proposed operations not being permitted at all.
- ◆ **Metallurgical coal markets and exchange rates:** These are key threats facing any developer or producer - in the case of developers it will affect the ability to raise development capital, however, given the estimated low operating and capital costs, Allegiance is somewhat insulated from these factors.

OVERVIEW

STRATEGY AND PROJECT OVERVIEW

- ◆ Allegiance's focus is on Telkwa, located in central-western British Columbia, Canada (Figure 1), in which the Company has an option to earn up to 90% from Altius Resources Inc ("Altius") through its wholly owned subsidiary, Telkwa Coal Limited ("TCL").
- ◆ Telkwa has low strip ratio open pit Reserves and Resources of coal potentially suitable for SSCC and PCI blending metallurgical uses, and ideally located, close to infrastructure and markets, to be traded on the global sea-borne market.

Figure 1: Telkwa location map



Source: Allegiance

- ◆ The strategy is to initially develop what is termed a "regional" mine in British Columbia, which in the case of a coal operation has an output of less than 250,000tpa of clean coal.
- ◆ Unlike "major" mines, which require an environmental assessment ("EA") certificate following a review by the Provincial Environmental Assessment Office ("EAO"), permitting for regional mines is less complex and costly; this can potentially reduce the permitting time from up to four years in the case of a major mine to six months in the case of a regional mine.
- ◆ Dependent upon successful operation of the Stage 1 regional mine, Allegiance will look at a Stage 2 mine expansion to possibly around 1,000,000tpa of clean coal after ~four years (this being the expected major mine permitting time frame), with this permitting expected to be facilitated by using actual operational data from the Stage 1 operations.
- ◆ There is the possibility, under the relevant Acts and Regulations, that an expansion to over 250,000tpa, if it doesn't involve a 50% increase in footprint, may not be required to go through the EA process.
- ◆ Although coal at Telkwa is hosted in three deposits, Tenas, Telkwa North and Goathorn, the current strategy is to mine Tenas only; this has Proven Reserves of 29.1Mt of ROM coal, which will yield 21Mt of saleable coal - this is sufficient to cover a proposed +20 year, 1,000,000tpa operation.
- ◆ The Company has recently completed an updated PFS to this end, and is looking towards production in 2020 dependent upon successful financing and permitting - given the small proposed start-up size estimated capex is low at US\$35 million, with the upgrade to a 1,000,000tpa Stage 2 operation requiring only an estimated additional US\$10 million capex (we however have used US\$20 million in our modelling).
- ◆ Tenas also has advantages of a higher yielding coal, lower strip ratio and significantly less complex geometry than the other two deposits.

FINANCIAL POSITION

- ◆ As of June 30, 2017, the Company had cash of A\$1.637 million.
- ◆ The Company has debt of A\$0.759 million in the form of a legacy loan to a previous associate of the Company - this is unsecured, currently interest free and not due for repayment until August 2021.

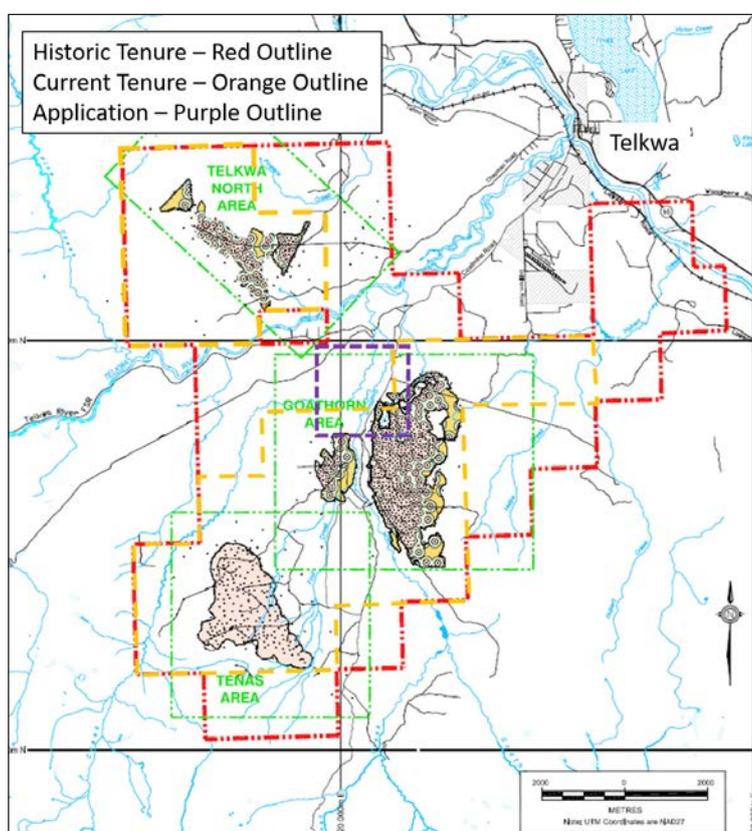
- ◆ Over the twelve months to June 30, 2017 the Company spent A\$1.366 million on exploration and evaluation and A\$0.952 million on administration and wages.
- ◆ Over the same period the Company raised \$4.044 million (before costs) in three raisings;
 - An interim placement of 26.4 million shares @ A\$0.005/share (pre-consolidation) in the September quarter, 2016,
 - A placement, post the 1 for 5 consolidation in November 2016 of 66.67 million shares @ A\$0.0375/share to raise A\$2.5 million, and,
 - A fully subscribed 1 for 3 rights issue in 2017 that raised \$1.412 million through the issue of 56.5 million shares @ A\$0.025/share.

TELKWA PROJECT - ALLEGIANCE EARNING 90%

Location and Tenure

- ◆ Telkwa is located some 15km southwest of the town of Telkwa in central-west British Columbia (Figure 2).

Figure 2: Telkwa Project, showing tenure, infrastructure and deposits



Source: Adapted from Allegiance

- ◆ The Project includes 21 British Columbia Crown Coal Licences for 5,310ha and 1,301ha of private lands held as Freehold titles by Carbon Development Corporation - the latter titles include both the subsurface and surface rights.
- ◆ The Crown licences are held under the names of Carbon Development Corporation (15 licences, 3,756ha) and Bulkley Valley Coal Ltd (6 licences, 1,554ha), both of which are subsidiaries of Altius.
- ◆ There is also one application in the name of Carbon Development Corporation for 675ha.
- ◆ All of the granted licences are in good standing, however have renewal dates of between December 24, 2017 and July 30, 2018, and thus are soon due for renewal.
- ◆ Fourteen non-critical licences totalling 3,518ha have been surrendered over the past 18 months, mainly to reduce holding costs which have reached up to ~C\$35/ha/year in the case of some of the licences.

Infrastructure

- ◆ The site is well served by infrastructure, with positive ramifications for both operating and capital costs of any future operation.

- ◆ Both the CNR and Yellowhead Highway 16 pass through Telkwa; other nearby towns and cities include Smithers (population ~5,500, 15km north of Telkwa), Houston (population ~3,600, 590km SSE), Terrace (population ~12,000, 220km west and Prince George (population ~74,000, ~350km ESE of Telkwa) - all are on Highway 16 and the nearest towns should be a ready source of resident labour.
- ◆ The RICT seaport is 375km by rail from Telkwa, which is the shipping port for Teck's coal operations in north-eastern British Columbia.
- ◆ The region is connected to the national electricity grid, and is also well supplied with water through natural drainage; accessible power lines include both 138KV and 25KV lines; importantly the 25KV line has sufficient spare capacity to supply at least up to a 500,000tpa operation at Telkwa, however the Company has indicated that there may be the capacity to operate up to 1,000,000tpa from this line, thus negating the need to build a sub-station that would be required if power had to be sourced from the 138KV line.

Farm-In and Acquisition Agreements

- ◆ As announced to the market on September 16, 2016, Allegiance has acquired the rights to farm-in to Telkwa through the acquisition of 100% of the issued share capital of TCL, a Company set-up by the Managing Director of Allegiance, Mr Mark Gray - Mr Gray was appointed to the Allegiance position subsequent to the acquisition.
- ◆ The consideration for the acquisition of TCL was 50 million shares in Allegiance (post consolidation), with a nominal issue price of A\$0.025/share.
- ◆ The acquisition was subject to the following conditions amongst others:
 - A 1 for 5 consolidation of Allegiance's shares, and,
 - The successful completion of a capital raising of at least A\$1 million, both of which were successfully completed.
- ◆ The consideration also included share based payments of 10,956,282 shares to Carbon Development Corporation for monies due and payable from TCL, and 1,260,000 shares to CoalSense Consulting Inc. for monies due and payable from TCL.
- ◆ TCL acquired the farm-in rights to the Project from a subsidiary of Altius Minerals Corporation ("Altius"), with Altius acquiring the Project as part of its broader acquisition of producing mines from Sherrit Corporation in April 2013.
- ◆ TCL has the right to earn up to 90% of the Project, with Altius retaining a 10% free carry in relation to a small mine only; Altius must contribute to costs of a major mine.
- ◆ The following gross sales royalties are also payable to Altius:
 - 3.0% where the benchmark coal price is less than US\$100/tonne,
 - 3.5% where the price is US\$100-US\$109.99/tonne,
 - 4.0% where the price is US\$110-US\$119.99/tonne, and,
 - 4.5% where the price is US\$120/tonne or greater.
- ◆ The other farm-in obligations and payments are summarised in Table 1.

Table 1: Telkwa farm-in obligations

| Table 1: Telkwa farm-in obligations | | | |
|-------------------------------------|---|--------------------|--|
| Milestone | Completion | Status, obligation | |
| 1 | Deliver NI 43-101 JORC compliant report | 20 Mar 2015 | Completed |
| | Complete internal scoping studies | 20 Mar 2016 | Completed |
| | Up-grade geo-model to a PFS standard | 20 Mar 2016 | Completed |
| | Incur C\$1M of expenditure | No time limit | Pay C\$200k for 20% project equity - Completed through issue of shares |
| 2 | Complete baseline studies | 10 Dec 2018 | |
| | Complete affected party agreements | 10 Dec 2018 | |
| | File small mine permit applications | 10 Dec 2018 | Pay C\$300k for a further 30% project equity |
| 3 | Grant of small mine permits | No time limit | Pay C\$500k for a further 40% project equity |
| 4 | Sale of 100k tonnes from a small mine | No time limit | Pay C\$2M |
| 5 | Grant of major mine permits | No time limit | Pay C\$2M |
| 6 | Sale of 500k tonnes from a major mine | No time limit | Pay C\$5M |

Source: Allegiance

Project History

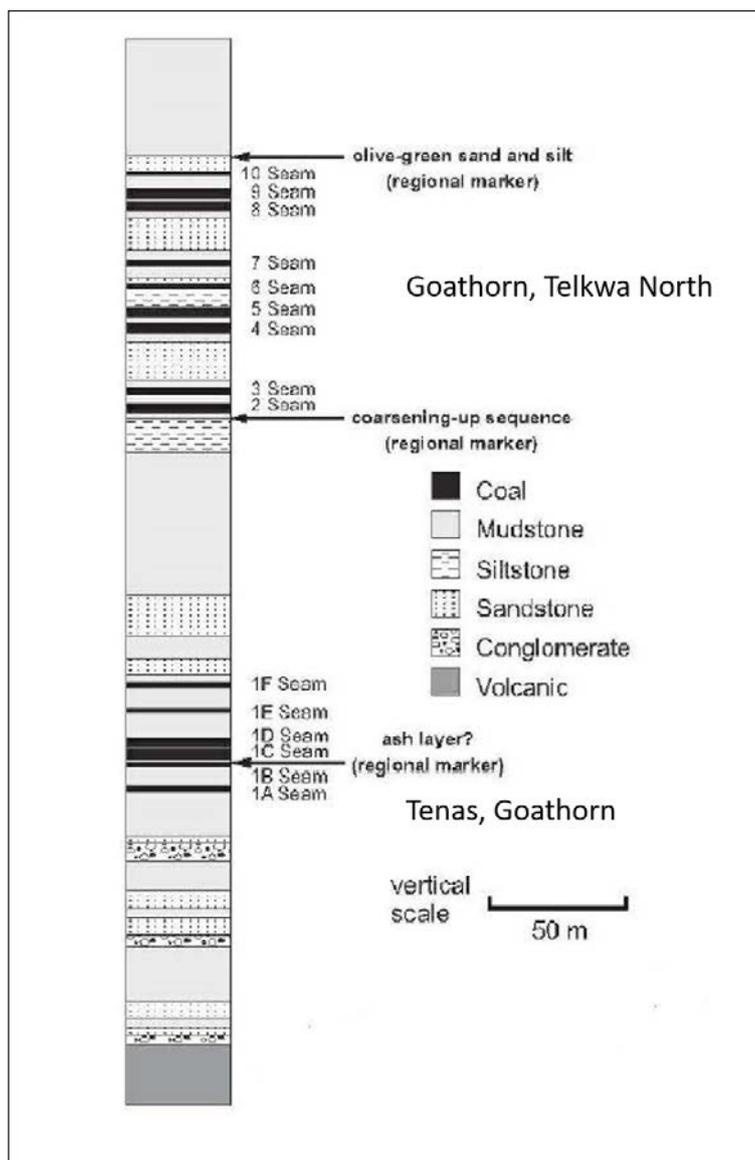
- ◆ Coal was initially discovered in the area in 1900, however production did not commence until 1918, with sporadic production from a number of operations, including the Aveling Mine and Telkwa Colliery until ~1945 - the coal was mainly for local consumption.
- ◆ The coalfield has been actively explored since 1950 by a variety of companies and Government agencies, with the Government of Canada conducting a regional geological survey which included the Telkwa licence area in 1951.
- ◆ An early major explorer included Shell Canada Resources Ltd, operating as Crowsnest Resources Ltd ("CNRL"), who carried out work, including several drilling programmes, from 1979 until the licences were acquired by Manalta Coal Ltd in 1992, with Manalta completing several work programmes until they were taken over by Luscar Ltd in 1998.
- ◆ Luscar, who themselves were subsequently acquired by Sherrit International, shelved plans to develop the property, with no work being carried out on the property between 1998 and the acquisition of the licences by Altius in 2013.
- ◆ The historic work however has resulted in the drilling of 91,000m in 828 holes, 321 of which are cored, with this being estimated to be worth ~A\$40 million to Allegiance.

Geology

- ◆ The Telkwa coal measures are located within the Lower Cretaceous sediments of the Skeena Group, with deposition into the Bowser Basin following uplift and erosion of the Skeena Arch.
- ◆ At Telkwa, the Skeena Group (which is represented by over 500m of coal-bearing strata, unconformably overlies the Jurassic Hazelton Volcanics.
- ◆ Separate episodes of transgression and regression formed four different lithostratigraphic units (Figure 3):
 - Unit I, deposited in a fluvial environment on Hazelton Volcanic Basement - this includes "Coal Zone 1," which are the seams at Tenas, and which also occur at Goathorn.
 - Unit II, which was deposited in a deltaic/shallow marine environment consists of up to 140m of largely sandstone and silty-mudstone; occasional coaly mudstone and peat beds are present, however these have no economic significance.
 - Unit III averages 85m thick and represents the second regressive cycle, and includes the main coal measures, as present at Goathorn and Telkwa North.
 - Unit IV overlies the coal measures, is >150m thick and represents the second transgressive cycle.
- ◆ Porphyritic Tertiary and Cretaceous intrusive sills and dykes have been recognised, as does a large Tertiary granodiorite plug on the northern licences - these disrupt the pre-existing stratigraphy.
- ◆ The Project, particularly the north, is covered by up to 25m of glacial till.
- ◆ The region has seen two major tectonic and intrusive events since Cretaceous times, resulting in significant faulting and folding; this along with disruption due to the intrusive activity has affected the northern part of the Project area more than the south - coal mineralisation at Goathorn and Telkwa North occurs in a series of fault blocks with various bedding orientations; that at Tenas forms a syncline with shallowly dipping limbs (Figure 4).
- ◆ The Unit I coal stratigraphy at Tenas includes up to 13 separate seams spread over a stratigraphic section of 45m; most are too thin to be of economic interest, however three, namely C, 1U and 1 are being targeted for extraction:
 - The uppermost seam, C, averages 1.49m in thickness, and is separated from the underlying 1U seam by approximately 13m of strata - the seam is well developed through most of the area, but exhibits some lateral variability,
 - The 1U Seam, which averages 1.77m in thickness is well developed, however has variable sulphur contents, and,
 - 1 Seam is the thickest seam at Tenas, with an average thickness of 4.12m, and is separated from the overlying 1U Seam by a siltstone parting that ranges between 0m and 2.5m in thickness.
- ◆ The Unit 1 stratigraphy is also seen at Goathorn, which also hosts, along with Telkwa North, the Unit III seams.

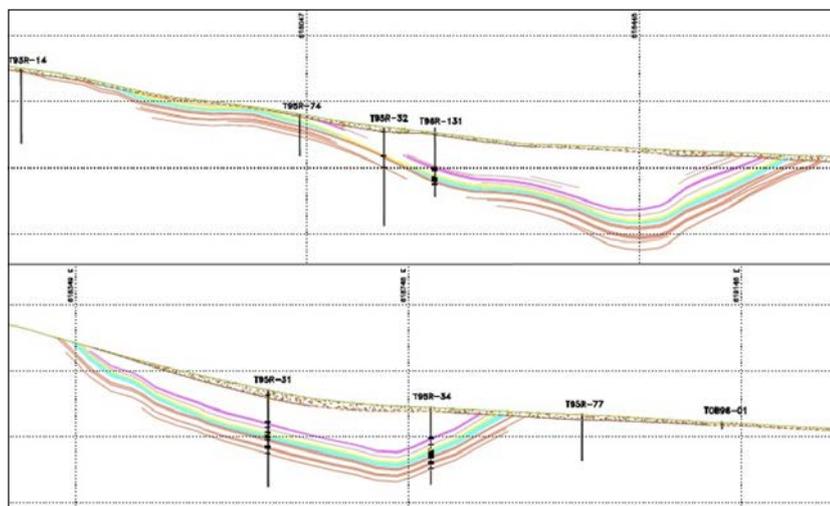
- ◆ These include up to 17 seams with an aggregate thickness of up to 20.5 within a stratigraphic package with an average thickness of 85m

Figure 3: Telkwa stratigraphy



Source: Norwest 205 NI43-101 Resource Estimation

Figure 4: Tenas cross-sections



Source: Allegiance

Resources, Reserves and Coal Quality

- ◆ The most recent JORC 2012 compliant Resources and Reserves were estimated by SRK as part of the 2017 PFS; these updated the Resources previously estimated by Norwest in 2015.
- ◆ Resources are shown in Table 2, Reserves in Table 3.

Table 2: Telkwa JORC 2012 compliant Coal Resources

| Table 2: Telkwa JORC 2012 compliant Coal Resources | | | | |
|--|-------------|--------------|--------------|-------------|
| Area | Measured Mt | Indicated Mt | M+I Mt | Inferred Mt |
| Tenas | 58.8 | | 58.8 | - |
| Goathorn | 59.5 | 9.2 | 64.7 | 0.2 |
| Telkwa North | 15.7 | 3.7 | 19.4 | 1 |
| Total | 134 | 12.9 | 146.9 | 1.2 |

Source: Allegiance

Table 3: Telkwa JORC 2012 compliant Coal Reserves

| Table 3: Telkwa JORC 2012 compliant Coal Reserves | | | |
|---|-------------|---------------|------------------|
| Reserves | ROM Coal Mt | Clean Coal Mt | Saleable Coal Mt |
| Tenas Proven | 29.1 | 20.6 | 21 |
| Tenas Probable | - | - | - |
| Tenas Total | 29.1 | 20.6 | 21 |
| Goathorn Proven | 22.1 | 12.6 | 18.8 |
| Goathorn Probable | 0.2 | 0.1 | 0.1 |
| Goathorn Total | 22.3 | 12.7 | 13.9 |
| Telkwa North Proven | 10.8 | 6.4 | 7 |
| Telkwa North Probable | 0.7 | 0.4 | 0.5 |
| Telkwa North Total | 11.5 | 6.8 | 7.5 |
| Grand Total | 62.9 | 40.1 | 42.5 |

Source: Allegiance

- ◆ What is apparent is the high confidence of the majority of the Resources and Reserves, including 100% of the Tenas Reserves being in the Proven category.
- ◆ All Tenas Reserves are from the 1, 1U and C seams, which are the three being targeted for production.
- ◆ The coal has been classified as a "High Volatile A Bituminous to Semi-anthracite", with properties considered suitable for use as a SSCC or PCI blending coal, with properties generally comparing favourably with similar export metallurgical coals from New South Wales and Queensland (Table 4).
- ◆ Reserves were predicated on the coal being sold as a PCI coal.

Table 4: Telkwa coal properties - washed at an SG of 1.6 for a yield of 75%

| Table 4: Telkwa coal properties - washed at an SG of 1.6 for a yield of 75% | | | | |
|---|---------|--------|----------|------------|
| Parameter | Units | Telkwa | NSW SSCC | NSW HV PCI |
| Total moisture | % | 7.8 | 6-10.5 | 6-10.5 |
| Volatile matter | % | 24.6 | 33-37 | 33-38 |
| Ash | % | 9.5 | 6.5-10.5 | 9-10.5 |
| Sulphur | % | 0.9 | 0.5-1.5 | 0.35-0.85 |
| Fixed carbon | % | 65.3 | 50-60 | 55 |
| Calorific value | Kcal/kg | 7,245 | N/A | 7250 |
| Free swell index | | 3-4 | 3-6 | N/A |
| HGI | | 64 | N/A | 40-50 |
| Reflectance | % | 0.84 | 0.8 | 0.65-0.85 |
| Max Fluidity | ddpm | 2-17 | 100-500 | N/A |
| CSR calculated | % | 37-43 | 25-30 | N/A |

Source: Allegiance

- ◆ Results of free swell index ("FSI") testwork indicates that Telkwa clean coal will be suitable for metallurgical purposes.

- ◆ The quality was confirmed and forecast prices benchmarked by an independent consultant against New South Wales and Queensland SSCC and PCI coals, with it being superior in some respects and of lower quality in others.
- ◆ At Tenas there is also variability between the various seams - Seam 1 is potentially more suitable as a PCI coal, whereas Seams 1U and C exhibit better coking properties and thus may potentially be marketable as SSCC products.

Pre-feasibility Study

Introduction

- ◆ The Company has completed and published the results of both an initial, staged PFS (July 3, 2017), and an update presenting the results of a regional mine scale, Stage 1 project (September 11, 2017), with the potential to upscale this at a later date.
- ◆ The studies were completed by SRK, with input from other experienced coal mining and infrastructure consultants.
- ◆ Figure 5 presents the conceptual mine layout for Stage 1, which utilises existing infrastructure as far as possible.

Figure 5: Conceptual site layout - Stage 1



Source: Allegiance

Parameters and Results

- ◆ Financial and operating results and parameters of the Stage 1 Project are presented in Tables 5 to 8 below; these also present where applicable the results of a 500,000tpa operation which will be feasible, subject to permitting, with only minimal additional capex (~US\$2 million) - the 100tph wash-plant as used in the 250,000tpa case has the capacity to produce 500,000tpa clean coal by just extending the hours of operation.
- ◆ In our view capital and operating costs look reasonable, and compare with published results for operations and studies for other development projects when economies of scale are considered.
- ◆ However it needs to be noted that these costs were largely calculated in CAD, and converted to USD at an exchange rate of 0.75 USD to 1 CAD; subsequent movements have led to an appreciation of the CAD to 0.80 USD to 1 CAD, therefore these costs may now understate USD denominated costs by ~5-7%.

Table 5: Telkwa Stage 1 operating parameters

| Table 6: Telkwa Stage 1 operating parameters | | |
|--|------------------|-----------|
| Parameter | Units | 250ktpa |
| LoM ROM coal production | Tonnes | 6,100,000 |
| LoM saeable coal production | Tonnes | 4,500,000 |
| Average ROM coal production | Tonnes per annum | 337,837 |
| Average product coal yield | % | 74 |
| Average saleable coal | Tonnes per annum | 250,000 |
| Average strip ratio | BCM/ROMt | 1.9:1 |
| Mine life (incl. pre-production) | Years | 19 |

Source: Allegiance

Table 6: Telkwa Stage 1 performance

| Table 6: Telkwa Stage 1 performance | | | |
|--|--------------|----------------|----------------|
| Key Performance Indicators @ 250ktpa | Units | 250ktpa | 500ktpa |
| Pre-tax NPV _{10%} | US\$M | 51 | 83 |
| Pre-tax IRR | % | 32 | 52 |
| Post-tax NPV _{10%} | US\$M | 29 | 49 |
| Post-tax IRR | % | 25 | 39 |
| Payback from commencement of production (real terms) | Years | 3.5 | 2.3 |
| LoM average EBITDA | A\$M | 18 | 38 |
| CAD:USD exchange rate | - | 0.75:1 | 0.75:1 |

Source: Allegiance

- ◆ Estimated capital expenditures for the 250,000tpa operation are presented in Table 7; as noted earlier this is based on a 100tph wash-plant working limited hours, with extending hours being sufficient to increase production to 500,000tpa.
- ◆ This table also compares the capex for Stage 1 as presented in the initial staged PFS with the revised numbers as presented in the 250,000tpa Stage 1 PFS.

Table 7: Telkwa Stage 1 estimated capital expenditure

| Table 7: Telkwa Stage 1 estimated capital expenditure | | | |
|--|--------------|-------------------|--------------------|
| Start-up Capital Expenditure | Units | Staged PFS | Stage 1 PFS |
| Equipment including primary production and ancillary | US\$M | 9.1 | 6.1 |
| Pre-strip | US\$M | 3 | 1 |
| Mine access | US\$M | 1.5 | 1.5 |
| Coal handling preparation plant and related Infrastructure | US\$M | 20.2 | 15.4 |
| Water management, power and other | US\$M | 15.2 | 9.1 |
| Rail siding and Loadout | US\$M | 2.3 | 1.9 |
| Total Initial Capital (includes >10% contingency) | US\$M | 51.2 | 35.1 |

Source: Allegiance

- ◆ Estimated operating costs (US\$/saleable tonne) are presented in Table 8, for both the initial staged PFS and the more recent Stage 1 PFS.
- ◆ This also includes what we have estimated (using cost curves and economies of scale calculations) for an expanded 1,000,000tpa clean coal production scenario as used in our valuation discussed later in this report - this production is the lower limit at which Federal environmental permitted will be required.

Table 8: Telkwa estimated operating costs

| Table 8: Telkwa estimated operating costs | | | | |
|--|------------------------|-------------------------------|----------------------------|-----------------------------|
| Key Performance Indicators | Units | Staged PFS to 1.75mtpa | Stage 1 PFS 250ktpa | IIR 1mtpa Tenas Case |
| Site Costs | | | | |
| Waste removal | US\$/saleable t | 23.8 | 11.2 | 23.2 |
| LoM Strip Ratio | BCM/ROMt | 5.8:1 | 1.90 :1 | 5.6 :1 |
| Waste removal/BCM | US\$/saleable t | 4.1 | 5.9 | 4.1 |
| Coal recovery | US\$/saleable t | 2.7 | 4.6 | 3.4 |
| Coal processing | US\$/saleable t | 3.6 | 8.5 | 4.9 |
| General and administration | US\$/saleable t | 4.0 | 2.3 | 3.9 |
| Other | US\$/saleable t | 2.5 | 4.6 | 3.7 |
| Transportation, Marketing & Royalties | | | | |
| Marketing costs | US\$/saleable t | 0.2 | 0.3 | 0.2 |
| Haulage (CHPP to Rail Siding) | US\$/saleable t | 2.6 | 3.6 | 3.0 |
| Rail to port and loaded | US\$/saleable t | 12.7 | 16.7 | 14 |
| Third party royalties | US\$/saleable t | 2.8 | 2.8 | 2.9 |
| Total all-in cash cost FOB pre-tax | US\$/saleable t | 54.8 | 54.5 | 59.3 |

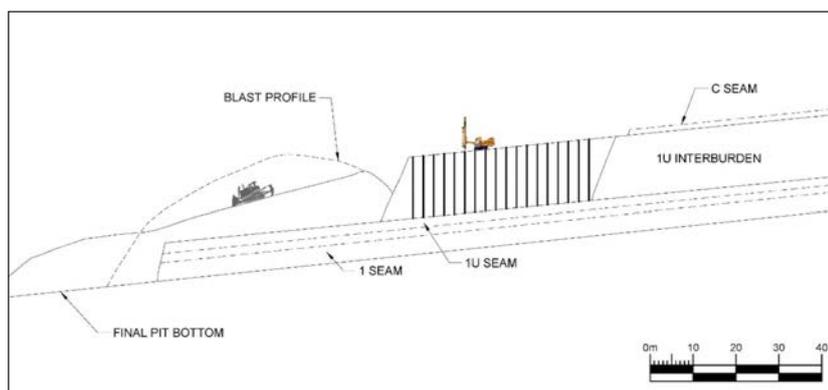
Source: Allegiance

- ◆ Such an operation would only require mining from the Tenas deposit, thus reducing the mine's foot-print; even at an ultimate production of 1,000,000tpa clean coal this would support a +20 year operation, including the 4-5 year 250,000tpa Stage 1 operation.
- ◆ The total estimated operating costs of US\$54.5/clean tonne places Telkwa in the lowest 5% of the sea-borne metallurgical coal cost curve - our expanded 1,000,000tpa case, with a higher cost of US\$59/tonne FOB still falls within the lower decile of the cost curve.
- ◆ Although FOB costs have been presented, the Company will look at mine gate sales (with the sales price being the FOB price less rail and port charges), with the royalty calculated accordingly.

Planned Operations

- ◆ Planned operations include a conventional drill and blast, dozer push (waste) and truck/shovel (coal and some waste) operation, with coal then being treated through a DMS CHPP, to produce a saleable product at an SG of 1.6 and with a yield of 75%.
- ◆ Given the dips of the Tenas seams, following an initial box-cut, plans are to dozer push ~50% of the waste to directly back fill the mined void - this has significant operating cost advantages over truck and shovel material movement (Figure 6).
- ◆ This also has environmental considerations, with all potentially acid generating ("PAG") material being pushed back into the void, with non-acid generating ("NAG") rock only being stacked on waste dumps.

Figure 6: Diagrammatic Tenas mining operations.



Source: Allegiance

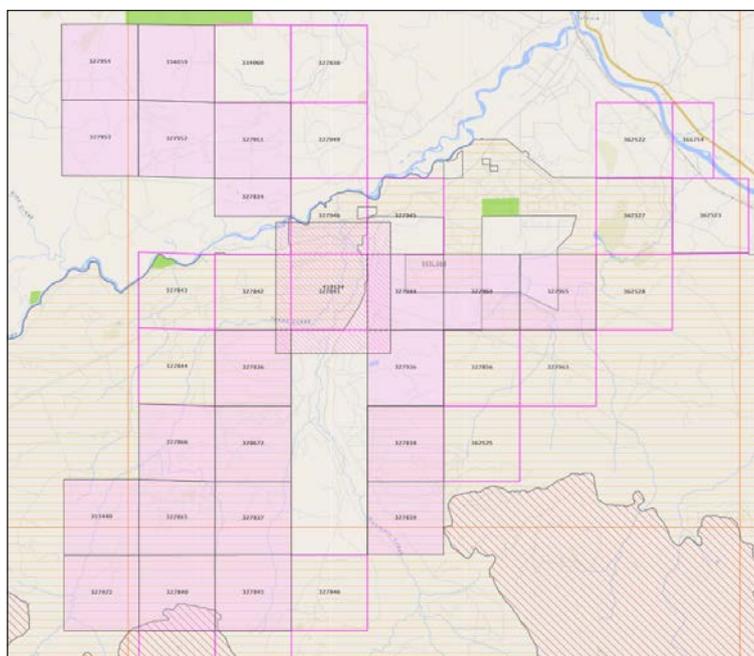
- ◆ Clean coal will be loaded onto trucks and hauled 23.4km along upgraded existing roads to a dedicated rail siding, where it will be loaded, using front-end loaders, onto rail for the 375km journey to RICT - RICT currently has the capacity to handle 18mtpa of coal, however currently handles only ~6mtpa, with the bulk coming from Teck's eastern BC operations.
- ◆ The CNR at Telkwa is the line that transports Teck's coal to the RICT.
- ◆ Tailings will be discharged into geotextile lined settling ponds, with plans to actively treat water possibly using lime during operations - waste water discharge is a potential issue given that the streams in the area feed into salmon spawning rivers - streams and rivers are sacrosanct in British Columbia.
- ◆ The PFS however has been based on post-closure rehabilitation and water treatment.

Permitting and Community Relations

- ◆ As mentioned the current strategy has been predicated around permitting thresholds, which include the upper 250,000tpa limit for a Provincial sub-EA regional mine (with the application to be lodged with the Department of Mines), and the 1,000,000tpa clean coal limit where Federal environmental agencies become involved.
- ◆ However there is the possibility that the regional mine status won't be approved, and that the 250,000tpa operation may have to go through the Provincial EA process - the relevant Ministers have discretion in this.
- ◆ On the basis that the sub-EA application is approved, the Company plans to lodge the application documents for the expanded operation on commencement of Stage 1 operations - they won't be accepted before this anyway, and also, actual operational data from Stage 1 will be invaluable in ongoing iterations and assessment of the expansion application, and should aid in approvals.

- ◆ The Company also plans to include the ultimate footprint of any expansions in the Stage 1 application - there is the possibility, under the act, that expansions can be approved without the Provincial EA should footprint increases be under a certain proportion of that of the original operation.
- ◆ In addition to the environmental approvals, a number of other permits are required (however approvals for these follow on from the environmental approvals); these include mining, dust and water amongst others.
- ◆ The Department of Mines has indicated that it should take around six months from the lodgement of the regional mine application to a decision; the Company is actively engaged in ongoing dialogue with the relevant agencies.
- ◆ This application requires significant environmental data, and the Company is currently undertaking baseline work that is expected to be completed in H1, 2018, and incorporated in the application to be lodged in H2, 2018, with a decision in H1, 2019.
- ◆ In addition to water, the second key environmental permitting consideration in British Columbia are caribou migration areas - there are designated areas immediately to the south of Tenas, however these are not expected to affect the permitting (Figure 7).
- ◆ Note that this figure does not show the freehold coal rights.

Figure 7: Telkwa Crown Coal Licences (shaded pink) and designated caribou areas (cross hatched red in south)



Source: BC Department of Mines Mineral Titles Online website, extracted September 18, 2017.

- ◆ The timeframe for activities, largely permitting, is shown in Figure 8, which also presents expected timeframes for other ongoing activities aiming towards a start-up in early 2020.

Figure 8: Telkwa timeline

| Calendar Year | 2017 | | | | 2018 | | | | 2019 | | | | 2020 | | | | 2021 | | | | | | |
|---------------------|---------------------------------|---|------------------------|---|---|---|------------------|---|---------------------------------|---|---|---|-------------------------|---|---|---|------|---|---|---|-----------------|------------------|----------------|
| Quarter | 1 | 2 | 3 | 4 | 1 | 2 | 3 | 4 | 1 | 2 | 3 | 4 | 1 | 2 | 3 | 4 | 1 | 2 | 3 | 4 | | | |
| First Nations | Signed first agreement | | Ongoing project review | | Socio-eco agreement | | | | Continual project participation | | | | | | | | | | | | | | |
| Project studies | Staged PFS complete | | Stage 1 PFS complete | | Stage 1 FS | | Stage 2 FS | | | | | | | | | | | | | | | | |
| Environmental | Baseline studies commenced | | | | Continual environmental monitoring for stages 1 & 2 | | | | | | | | | | | | | | | | | | |
| Stage 1 permitting | Constant ongoing Govt. dialogue | | | | Stage 1 filings | | Stage 1 decision | | | | | | | | | | | | | | | | |
| Marketing | Secure JV partner | | | | | | | | | | | | | | | | | | | | | | |
| Financing | Secure mine finance | | | | | | | | | | | | | | | | | | | | | | |
| Stage 1 development | | | | | | | | | Stage 1 construction | | | | | | | | | | | | | | |
| Stage 1 mine | | | | | | | | | | | | | Stage 1 coal production | | | | | | | | | | |
| Stage 2 permitting | | | | | | | | | | | | | | | | | | | | | Stage 2 filings | Stage 2 decision | Stage 2 mining |

Source: Allegiance

- ◆ These activities include the key First Nation engagement, with the initial Communications and Engagement Agreement being signed earlier this year.
- ◆ First Nation personnel are also actively involved in ongoing baseline studies, and the Company is using, as far as possible, local environmental consultants.
- ◆ Engagement with the other local communities has been limited to that with the Mayor of Telkwa to date, with the full community engagement process to commence in January, 2018.
- ◆ These activities are being coordinated and managed in British Columbia by Mrs Angela Waterman, the Environment & Government Relations Manager, who has previously permitted two coal mines, including a sub-EA operation.

Ongoing Activities

- ◆ As discussed previously, ongoing activities are largely related to environmental, permitting and community relations facets.
- ◆ The Company is also continuing on with JV partner negotiations, targeting Japanese customers and sourcing funding.
- ◆ In addition a six hole drilling programme is planned for January 2018 - this will include three groundwater wells and three others to collect other information, including metallurgical samples.

VALUATION

Summary

- ◆ We have completed a blended base case valuation for Allegiance, predicated on the Stage 1 operation, with this presented in Table 9; this also shows the significant upside potential with expansion to a 1,000,000tpa operation.
- ◆ The Telkwa valuations used in Table 9 are unfunded and pre-tax; Table 10 includes figures for funded, post-tax scenarios.

Table 9: Allegiance valuation summary

| Table 10: Allegiance valuation summary | | | | | |
|---|-----------------|-------------|-----------------|----------------|-----------------|
| Asset | Total (A\$m) | Risk Factor | Risked (A\$m) | Risked/Share | Notes |
| Base case, 250,000tpa, 18 year operation | | | | | |
| Telkwa Stage 1 Ops | \$70.8 m | 50% | \$35.4 m | \$0.157 | NPV8, Pre-Tax |
| Other Telkwa Coal Reserves | \$465 m | 10% | \$46.5 m | \$0.206 | See point below |
| Cash | \$1.64 m | 100% | \$1.64 m | \$0.007 | June 30, 2017 |
| Total | \$537 m | | \$83.5 m | \$0.370 | |
| Expanded operation, 250,000tpa for five years, 1,000,000tpa for 20 years | | | | | |
| Telkwa Stage 1 and 2 Ops | A\$312 m | 50% | \$156 m | \$0.691 | NPV8, Pre-Tax |
| Other Telkwa Coal Reserves | A\$274 m | 10% | \$27.4 m | \$0.121 | See point below |
| Cash | \$1.64 m | 100% | \$1.64 m | \$0.007 | June 30, 2017 |
| Total | A\$588 m | | \$185 m | \$0.820 | |

Source: Allegiance, IIR analysis

- ◆ The DCF valuations for the modelled operations are presented below - the base case NPV has been risked at 50% to reflect the inherent risks in the Project proceeding to production, even though technically the Project has been largely de-risked as evidenced by the Reserve confidence - we consider the key risk to be permitting.
- ◆ Figures presented are those attributable to Allegiance under the terms of the farm-in agreement as discussed earlier, and are not presented on a 100% basis unless noted otherwise.
- ◆ The "other coal" asset includes those reserves not included in the relevant modelled Tenas operations, with these valued at US\$6.60/tonne (A\$8.25/tonne), based on the NPV per ROM tonne resulting from the July 2017 PFS and initially risked for Reserve status (100% for Proven, 40% for Probable) - the 10% risk factor has then been applied to the reserve risked value to represent the uncertainty of them being mined, although in the case of the ~23Mt of ROM Reserves not used in the base case at Tenas, this is conservative.

Telkwa DCF

- ◆ We have completed two valuations for Telkwa - firstly the base case 250,000tpa operation as per the Company's Stage 1 PFS (and as used in our base case valuation), and secondly, an upside valuation based on a five year, 250,000tpa Stage 1, followed by an expansion to 1,000,000tpa for a further 20 years (which in our view is a viable scenario) - these are both presented as un-funded, pre-tax, and funded, post-tax cases.
- ◆ As the Company presented in the updated PFS, there is the case for an expansion to 500,000tpa which would provide an NPV between our two scenarios.
- ◆ Key financial parameters used in our modelling include a discount rate of 8%, a CAD(AUD) to USD exchange rate of 0.80 and a base case FOB coal price of US\$110/tonne FOB RICT.
- ◆ In the funded case, we have assumed a 60/40 debt equity mix for the Stage 1 capex, and assumed that capex for Stage 2 will be funded from cash-flow.
- ◆ A summary of key take-outs for both scenarios in AUD is presented in Table 10.
- ◆ The funded per share valuation assumes dilution through two capital raisings; pre-development raisings of A\$5 million at A\$0.05/share, and then initial capex equity funding of A\$17.5 million (US\$14 million) at A\$0.10/share - this results in a fully-diluted share capital of 501 million shares as used in our funded scenarios.
- ◆ These funding scenarios are those of IIR, and should be considered as indicative only - there are a number of different options that could be used to fund Telkwa, and which the Company is investigating.

Table 10: Telkwa project valuation summary

| Table 10: Telkwa project valuation summary | | |
|--|-----------|--------------------|
| Parameter | Base Case | Expansion to 1mtpa |
| Telkwa Un-Funded, Pre-Tax NPV8 | A\$71 m | A\$312 m |
| Telkwa Un-Funded, Pre-Tax IRR | 32.0% | 44.2% |
| Telkwa Funded, Post-Tax NPV8 | A\$72.0 m | A\$245 m |
| Peak Annual FCF - Funded | A\$10.1 m | A\$42.7 m |
| Peak Annual EBITDA | A\$11.1 m | A\$45.4 m |
| Implied 5x EBITDA Multiple | A\$55.7 m | A\$227 m |
| Un-Funded, Pre-Tax Value/Share | \$0.31 | \$1.38 |
| Funded, Post Tax Value per Share | \$0.14 | \$0.49 |

Source: IIR analysis

- ◆ Key inputs to our model are presented in Table 11 - costs for Stage 1 are based on those presented in the updated PFS, and those for Stage 2 have been estimated by IIR.
- ◆ Stage 1 costs will remain constant for both the 18 years, 250,000tpa scenario, and the initial five years of the two stage scenario.

Table 11: Key inputs - Telkwa

| Table 11: Key inputs, Telkwa | | | | |
|------------------------------|-----------------|-----------|------------|------------|
| Item | Units | Stage 1 | Stage 2 | LoM Ave |
| ROM Coal Mining Rate | tpa | 333,333 | 1,333,333 | 1,133,333 |
| Strip Ratio | Waste: Ore | 1.90:1 | 5.83:1 | 5.60:1 |
| Waste Moved | bcmpa | 633,333 | 7,775,000 | 6,346,667 |
| Washing Yield | % | 75% | 75% | 75% |
| Clean Coal Produced | tpa | 250,000 | 1,000,000 | 850,000 |
| Mine Life | Years | 5 | 20 | 25 |
| Total Clean Coal | t | 1,250,000 | 20,000,000 | 21,250,000 |
| Coal Mining Cost | US\$/saleable t | \$4.60 | \$3.30 | \$3.38 |
| Waste Mining Cost | US\$/saleable t | \$11.21 | \$23.91 | \$23.16 |
| Processing Cost | US\$/saleable t | \$8.50 | \$4.70 | \$4.92 |
| G & A | US\$/saleable t | \$2.30 | \$4.00 | \$3.90 |
| Other Site Costs | US\$/saleable t | \$4.60 | \$3.60 | \$3.66 |
| Total Site Costs | US\$/saleable t | \$31.21 | \$39.51 | \$39.02 |
| Marketing Costs | US\$/saleable t | \$0.30 | \$0.20 | \$0.21 |

| Item | Units | Stage 1 | Stage 2 | LoM Ave |
|------------------------|-----------------|----------|----------|----------|
| Haulage - CHPP to Rail | US\$/saleable t | \$3.60 | \$3.00 | \$3.04 |
| Rail and Port | US\$/saleable t | \$16.80 | \$14.00 | \$14.16 |
| Royalty | US\$/saleable t | \$2.80 | \$2.88 | \$2.88 |
| Total Costs | US\$/saleable t | \$54.71 | \$59.59 | \$59.30 |
| FOB Coal Sales Price | US\$/saleable t | \$110.00 | \$110.00 | \$110.00 |
| Mine Gate Sales Price | US\$/saleable t | \$93.20 | \$96.00 | \$95.84 |
| Operating Margin | US\$/saleable t | \$55.29 | \$50.41 | \$50.70 |
| Margin/Revenue | % | 50% | 46% | 46% |
| Capex | US\$ million | \$35.00 | \$20.00 | \$55.00 |
| Capex Intensity | US\$/tonne Coal | \$140 | N/A | \$65 |
| Sus capex Intensity | US\$/saleable t | \$4.00 | \$3.00 | \$3.06 |

Source: Allegiance, IIR analysis

- ◆ Note that we have estimated the expansion capex to be US\$20 million; this may actually be conservative with the Company indicating that this may only be in the order of US\$10 million (with the wash plant requiring only US\$3 million) - this has little effect on the overall NPV however with the Project not being very sensitive to capex.
- ◆ Table 12 presents key outputs for both scenarios in USD on an unfunded, pre-tax basis.

Table 12: Key outputs - Telkwa

| Item | Units | Scenario 1 | Scenario 2 |
|-------------------------|------------|------------|------------|
| Mine Life - Production | Years | 18 | 25 |
| Total Coal Mined | Tonnes | 6,000,000 | 28,333,333 |
| Clean Coal Produced | Tonnes | 4,500,000 | 21,300,000 |
| FOB Coal Sales Price | US\$/tonne | \$110 | \$110 |
| Pre-Tax NPV, Mid-Year | US\$m | \$57 m | \$250 m |
| Pre-Tax IRR | % | 32% | 44% |
| LoM Revenue AHQ | US\$m | \$446 m | \$2,104 m |
| LoM Opex AHQ | US\$m | -\$245 m | -\$1,141 m |
| LoM EBITDA AHQ | US\$m | \$201 m | \$963 m |
| LoM Capex (inc Sus) AHQ | US\$m | -\$50 m | -\$111 m |
| LoM FCF AHQ | US\$m | \$151 m | \$853 m |
| Peak annual FCF AHQ | US\$m | \$10 m | \$43 m |
| Peak Annual EBITDA AHQ | US\$m | \$11 m | \$45 m |
| Discount Rate | % | 8.00% | 8.00% |
| Exchange Rate | CAD:USD | 0.8 | 0.8 |
| Exchange Rate | AUD:CAD | 1 | 1 |

Source: Allegiance, IIR analysis

Sensitivity

- ◆ Our analysis indicates that the Project is most sensitive to operating costs and coal prices, with the base case sensitivity being presented in Table 13 (pre-tax NPV) and Table 14 (IRR).
- ◆ These show however, by virtue of the relatively low operating costs that even the low throughput operation is relatively robust; our view is also that these are the factors that have the main capacity for change.
- ◆ The sensitivity to coal price will also be affected by exchange rates.

Table 13: Telkwa base case pre-tax NPV sensitivity - AUD

| Table 13: Telkwa base case pre-tax NPV sensitivity - AUD | | | | | | |
|--|---------|--------|-------|-------|-------|-------|
| Change in Operating Costs | | | | | | |
| | | -20% | -10% | 0% | 10% | 20% |
| | \$67.02 | | | | | |
| FOB Coal Price US\$/t | US\$90 | \$52m | \$39m | \$25m | \$12m | -\$2m |
| | US\$95 | \$63m | \$50m | \$37m | \$23m | \$10m |
| | US\$100 | \$75m | \$61m | \$48m | \$35m | \$21m |
| | US\$105 | \$86m | \$73m | \$59m | \$46m | \$33m |
| | US\$110 | \$98m | \$84m | \$71m | \$57m | \$44m |
| | US\$115 | \$108m | \$96m | \$82m | \$69m | \$55m |

Source: IIR analysis

Table 14: Telkwa base case pre-tax IRR sensitivity

| Table 14: Telkwa base case pre-tax IRR sensitivity | | | | | | |
|--|---------|-------|-------|-------|-------|-------|
| Change in Operating Costs | | | | | | |
| | | -20% | -10% | 0% | 10% | 20% |
| | 30.81% | | | | | |
| FOB Coal Price US\$/t | US\$90 | 26.1% | 21.8% | 17.3% | 12.6% | 7.3% |
| | US\$95 | 29.7% | 25.5% | 21.1% | 16.6% | 11.8% |
| | US\$100 | 33.2% | 29.1% | 24.8% | 20.4% | 15.9% |
| | US\$105 | 36.8% | 32.6% | 28.4% | 24.2% | 19.8% |
| | US\$110 | 40.3% | 36.1% | 32.0% | 27.8% | 23.5% |
| | US\$115 | 43.4% | 39.7% | 35.5% | 31.3% | 27.1% |

Source: IIR analysis.

CAPITAL STRUCTURE

- ◆ Allegiance currently has 226 million ordinary shares on issue.
- ◆ The Company has 820,000 unlisted options on issue, with these having an expiry date of November 27, 2018 and an exercise price of A\$0.2475.
- ◆ The top 20 hold 78.70% of shares, with management holding 9.94%.
- ◆ The top holder is Telkwa Holdings with 13.23% - this is a company associated with the Managing Director, Mr Mark Gray.
- ◆ The Company has ~457 shareholders.

RISKS

- ◆ **Permitting:** We consider this to be they key risk for Allegiance at Telkwa, and could affect Telkwa in a number of ways:
 - Permitting under the regional mine system may take longer than expected,
 - There is the possibility that Telkwa could be pushed into the EA permitting route, with the resulting time and budget implications, or,
 - Applications will not be approved.
- ◆ **Coal prices and exchange rates:** These are factors that no resources companies have direct control over (except through hedging or offtake agreements), and provide downside risk with adverse movements, however on the upside, company values are generally well leveraged to positive moves in these parameters. Given the forecast low cost operations and robustness of the planned project, this risk is somewhat mitigated in the case of Allegiance.
- ◆ **Costs:** Unlike prices, companies have some control over costs, with company value again leveraged to changes in costs. Given the robust nature of proposed operations, the risk presented by higher costs is somewhat mitigated in the case of Allegiance.
- ◆ **Funding and markets:** Being a junior and in our view with the need to raise capital, Allegiance is at the mercy of the markets - although sentiment in the junior resources markets is reasonable at the moment, with companies being able to raise cash on the back of quality projects, this can change very quickly.

- ◆ **Offtake and coal quality:** The Company will ideally need to find an offtake partner to get Telkwa developed; although all indications are that the clean coal will be fit for purpose, this will not be confirmed until potential customers test the coal.

PEERS

- ◆ Table 15 presents a list of ASX-listed companies with coal projects in North America - these include thermal, metallurgical and anthracite producers.
- ◆ This highlights the low EV when compared with peers, as well as the relatively low EV/Resource tonne and EV/Reserve tonne for its high confidence coal inventory.
- ◆ Although the EV/tonne number is indicative only and needs to be used with care as changes can be due to any number of factors, it can give an insight into relative valuations.
- ◆ Although the initial capex is low, the capex intensity is relatively high at US\$140/annual tonne given the low throughput, however this significantly improves to US\$55/annual tonne for the expanded 1mtpa scenario.

Table 15: Allegiance peers

| Table 15: Allegiance peers | | | | | |
|----------------------------|------------------------|---------------|--------------------------------|-----------------|-----------------------|
| | Paringa Resources | Atrum Coal | Jameson Resources | Allegiance Coal | Pacific American Coal |
| Code | PNL | ATU | JAL | AHQ | PAK |
| Last | A\$0.385 | A\$0.19 | A\$0.10 | A\$0.04 | A\$0.03 |
| Shares On Issue | 317 m | 232 m | 251 m | 226 m | 165 m |
| Undiluted MC | \$122 m | \$44 m | \$25 m | \$9 m | \$5 m |
| EV | \$77 m | \$40 m | \$21 m | \$7.4 m | \$2.7 m |
| Project | Poplar Grove, Illinois | Groundhog, BC | Crown Mountain, Elk Valley, BC | Telkwa, BC | Elko, BC |
| Product | Thermal | Anthracite | HCC/PCI | SSCC/PCI | HCC |
| Stage | Construction | Revised PFS | Permitting/Design | Completed PFS | Undertaking studied |
| RoM Resources | 333 Mt | 1570 Mt | 90 Mt | 148 Mt | 258 Mt |
| RoM Reserves | 135.7 Mt | N/A | 56.0 Mt | 62.9 Mt | N/A |
| EV/ Resource tonne | \$0.23 | \$0.03 | \$0.23 | \$0.05 | \$0.01 |
| EV/Reserve Tonne | \$0.57 | N/A | \$0.37 | \$0.12 | N/A |
| Initial ROM Throughput | 3.70 mtpa | 1.40 mtpa | 3.20 mtpa | 0.34 mtpa | No Data |
| Yield | 76% | 63% | 52.60% | 74% | No Data |
| Clean Coal | 2.80 mtpa | 0.88 mtpa | 1.70 mtpa | 0.25 mtpa | No Data |
| Initial Capex | \$45 m | \$142 m | \$309 m | \$35 m | No Data |
| Capex Intensity | \$29/t | \$161/t | \$182/t | \$140/t | No Data |
| FOB Opex | \$29/t | \$96/t | \$75/t | \$56/t | No Data |

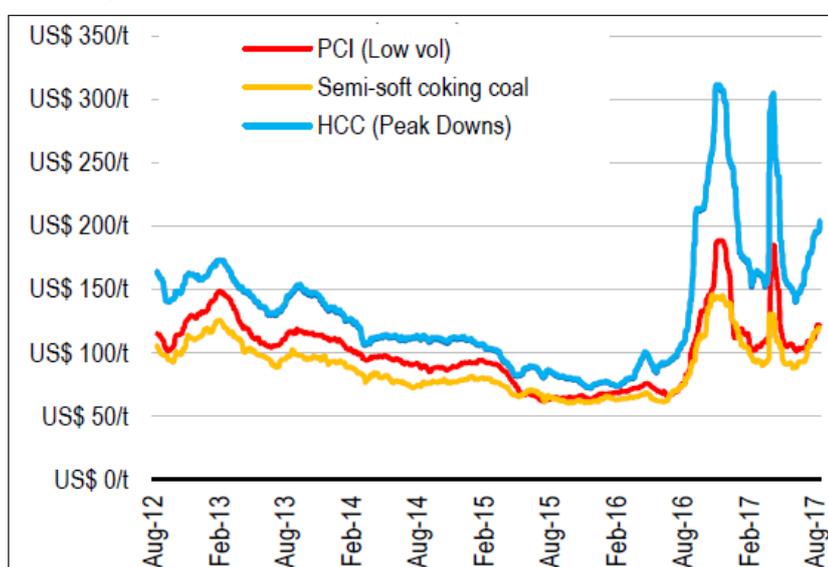
Source: IRESS, Company Reports, IIR analysis. *The Paringa capex does not include leased equipment, however the capex intensity number does.

SEA-BORNE METALLURGICAL COAL MARKETS

- ◆ Telkwa plans to sell metallurgical coal into the global sea-borne market, targeting Asian customers.
- ◆ In 2016, the sea-borne trade was ~315Mt, and is forecast to remain relatively stable or grow at ~1-2% per annum over coming years.
- ◆ The largest exporter is Australia, which in 2016 exported 189.3Mt, or 60% of sea-borne demand, with Australia being followed by the US (37Mt, 11.7%), Canada (34Mt, 10.7% and Russia (22Mt, 7%).
- ◆ Due to the potential for supply disruptions out of Australia (see below), Asian steel makers, particularly those in Japan and Korea, ideally like to have diversity of supply; this is not so critical in China which can make up shortfalls from domestic supply.

- ◆ China is the largest consumer of metallurgical coal, using some 61% of global production, and is followed by India (10%), Russia (6%), Japan (5%) and South Korea (4%); in 2016 China was the largest importer (~60Mt), followed by India (~50Mt), however with the balance expected to swing in favour of India over the next few years.
- ◆ The concentration of supply from Australia, particularly from Queensland, has led in the past to supply shocks resulting largely from tropical cyclones - Cyclone Debbie, which disrupted supply in March 2013 led to a short term price spike to over US\$300/tonne for HCC from the then prevailing price of ~US\$150/tonne; prices subsequently retraced to around US\$150/tonne, however more recently spot prices again reached over US\$200/tonne based on a number of factors, including strong steel demand.
- ◆ The above prices are for HCC, with PCI coal generally trading at ~70-75% of that for HCC and SSCC trading at 65-70%, although these discounts were exacerbated during the recent price spikes - comparative prices are shown in Figure 10.
- ◆ Due to their higher quality, metallurgical coals trade at a significant premium to thermal coals, with this variable, currently being at ~100%, however historically ranging between 50% and 100% - this is naturally exacerbated by spikes in the metallurgical coal prices.

Figure 10: Spot sea-borne metallurgical coal prices



Source: UBS Global Research

Price Forecasts

- ◆ Price forecasts, as usual for commodities, are varied; with long term research and broker FOB Queensland forecasts compiled by KPMG in July 2017 ranging between US\$104/tonne and US\$130/tonne for HCC, US\$78.4/tonne to US\$108/tonne for PCI and US\$69.6/tonne to US\$90/tonne for SSCC.
- ◆ We note that these are considerably lower than the forecasts for HCC of US\$140-US\$170/tonne used in the Company's PFS, however we would consider these to be relatively conservative, with all having prices in backwardation.

BOARD AND MANAGEMENT

- ◆ **Mr Malcolm Carson – Non-Executive Chairman:** Mr. Carson is a geologist and currently the Executive Chairman of Dampier Gold Ltd (ASX:DAU), and has been an executive and non-executive director of many ASX and TSX companies. He is a 40 year veteran in exploration and mining across a variety of minerals, in multiple jurisdictions, with many organisations including BHP, Kumba Resources, Iscor, Sons of Gwalia, Bankers Trust, and Rothschilds. Mr. Carson also spent five years working for the Government of Western Australia as a Senior Project Officer responsible for managing mining and industrial projects.
- ◆ **Mr Mark Gray – Managing Director:** Mr. Gray founded Telkwa Coal Limited (a wholly owned subsidiary of Allegiance) and secured the farm-in rights to the Telkwa metallurgical coal project in September 2014. He is a corporate lawyer with 30 years transactional experience gained as a lawyer with Herbert Smith in London, a partner with Bell Gully in New Zealand, and as a director of the investment bank Barclays de

Zoette Wedd, also in London. For the last 12 years Mr. Gray has been an advisor to and company executive of mining companies and operations including underground coal in Australia, and open pit mining in Africa, as well as exploration and development projects in several minerals including coal.

- ◆ **Mr David Fawcett – Non-Executive Director:** Mr. Fawcett is a mining engineer with over 40 years experience in the coal industry, primarily in Western Canada. During his career he has had a broad range of responsibilities from early stage geology and exploration, through feasibility and regulatory processes, to operations, management and executive positions for major, intermediate and start-up companies. He was a co-founder and president of Western Canadian Coal Corp. from 1997 to 2003 which company was subsequently taken over by US based Walter Energy Inc. for C\$3.5 billion. He was chief operating officer of NEMI Northern Energy & Mining Inc. from 2003 to 2004 and senior vice president of Hillsborough Resources Limited from 2005 to 2009. Mr Fawcett has been the recipient of several coal industry awards including the Coal Association of Canada's Award of Distinction in 2015.
- ◆ **Mr Jonathan Reynolds – Finance Director:** Mr. Reynolds is a chartered accountant with more than 25 years experience across many sectors spent mostly in financial management roles. Most recently, he has been finance director of a resource investment house, managing investments across a range of commodities, including coal. Prior to that he held the position of chief financial officer with a number of listed entities and before that was a senior manager with an international firm of chartered accountants. He is a member of Chartered Accountants Australia and New Zealand, a fellow of Financial Services Institute of Australia.
- ◆ **Mr Dan Farmer - Chief Mining Engineer:** Mr. Farmer is a mining engineer with over 20 years continuous experience in coal in British Columbia. He commenced his career with Luscar Coal in the 1990s when it was Canada's largest coal producer, and with Teck Resources following its acquisition of Luscar. Mr Farmer moved on to work for Anglo American Coal rising to the position of Operations Manager responsible for both Anglo's mine operations and technical services in British Columbia.
- ◆ **Mrs Angela Waterman - Environmental & Government Relations:** Mrs. Waterman is a mining industry professional with over 20 years of diverse experience covering commercial, technical, project development as well as operational aspects. She has an in-depth knowledge of the regulatory regime and extensive advocacy experience with governments, First Nations, and stakeholders. Mrs Waterman has worked within industry for Itochu, Northern Energy & Mining and Anglo American Coal, primarily in the area of regulatory and community affairs managing all aspects of environmental assessment, management and mine permitting. More recently, Angela has worked with mining association bodies in the same area representing and advocating industry concerns and initiatives to British Columbia government departments

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