

HALLGARTEN & COMPANY

Coverage Update

Christopher Ecclestone
ceccestone@hallgartenco.com

Ucore (UCU.v, UURAF:OTCQX) Strategy: Long

Key Metrics			FY12	FY13e	FY14e
Price (CAD)	\$ 0.345	Consensus EPS		n/a	n/a
12-Month Target Price (CAD)	\$ 0.90	Hallgarten EPS		\$ (0.02)	\$ (0.03)
Upside to Target	160.9%	Actual EPS	(\$0.04)		
12mth hi-low CAD	\$0.215 -\$0.64	P/E	n/a	n/a	n/a
Market Cap (CAD mn)	\$ 68.0				
Shares Outstanding (mns)	197.2	Dividend	0.00	0.00	0.00
Fully Diluted (mns)	236.7	Yield	0.0%	0.0%	0.0%

Ucore

Cashed Up and Ready to Go

- + After the recent exercise of warrants and a sizeable financing, Ucore has around \$10mn in cash in the bank making it one of the most cashed-up REE players
- + Politically the company has strong support in the form of both Federal Senators, and the US House Representative, who have played active roles as sponsors of legislation to reactivate the US Rare Earth industry
- + Strong bi-partisan support at the State legislature has delivered resounding support for legislation that effectively gives a State guarantee to debt financing of the infrastructure at the mine site to the tune of up to \$145mn
- + Having passed both the Alaskan Senate and House, all SB99 requires now is signing into law
- + Bokan is one of the most interesting Rare Earth properties in the space with a high ratio of Heavy Rare Earths (and in particular our favorite Yttrium)
- + The Bokan Mountain deposit has easy access to shipping, something very few alternative deposits have
- + Capex at slightly over \$200mn is at the low end of the spectrum in the REE space
- ✘ The Rare Earth space is not out of the woods yet and is only as fragile, or as strong, as the reactivation in the broader mining markets

Ucore – Political and Financial Ducks in a Row

Since our last coverage update on Ucore two key pieces have fallen into place. The stock price has had a wild ride soaring by 100% on the initial news of the progress of the Alaskan bill, easing off on fears of a financing and flat-lining once the financing was in place and closed. Now the company is cashed up (more so than virtually any other REE junior) and the Alaskan legislators have done their duty and unanimously got behind the funding guarantee. It is hard to see what more investors can want....

The Key Takeaways on Bokan

As the risk of boring investors with the attractions of Ucore's Bokan project we would reiterate the points made in our full coverage of the stock last month. Ucore is the ultimate in niche players in the REE space. It has parsed the "me-too" marketing of those with Heavy Rare Earths and further narrowed itself down to being an Yttrium/Terbium/Dysprosium- focused HREE story. Pursuing "boutique" REE mines is the way to go in our estimation.

Bokan Mountain possesses a range of features that augur in favour of near term development:

- Excellent infrastructure, with immediate deepwater access in close proximity to rail heads and shipping routes.
- Alaska is a mining friendly jurisdiction with a history of successful mine permitting. Alaska has several large mines, with a skilled local work force and mining related contractors (though these are not necessarily in close proximity to Ucore's property).
- An unusually high proportion of high value heavy rare earth oxides (HREO). This Mineral Resource estimate shows HREO/TREO consistently around 40%.
- A notably high proportion of Dysprosium, Terbium and Yttrium; rare earth elements in scarce supply and strong demand. The latter in particular has been singled out as needing to be stockpiled by the US.

Playing Politics – and Very Well

We are wary of calling the events of recent weeks the apogee of Ucore's strategy of cultivation the "powers that be" in advancing its Bokan property for things might get better yet. It would certainly be icing on an already toothsome cake if the Federal Government also weighed in with some sort of offtake for Ucore's Heavy Rare Earths. But that may be asking too much. In any case the developments at the state level do much to reassure investors and ourselves that Ucore is pulling ahead of the REE pack on the all-important issue of financing. This has been the stumbling block for all projects since the reversal in the REE market in 2012. At that point in time only Molycorp and Lynas had actually secured financing for production. All the rest of the players were doodling about raising funds for exploration and consultants' reports.

Alaska's politicians weighed in early in the REE "revival" despite the fact that the only prospect of note in the state was Ucore's Bokan deposit. In March, Rep. Mike Coffman, R-Colo., sponsored the so-called RESTART Act, which in its long form was actually the Rare Earths Supply-Chain Technology and Resources Transformation Act of 2010. This was later introduced to the Senate by Senator Murkowski of Alaska (born in Ketchikan, we might add). This Republican Senator lost out in a primary challenge in 2010 and then triumphed using a write-in campaign which eventually made her the winning candidate. This only served to further enhance her stature (and provide more leverage). The Act was sponsored by the US Metal Magnet Association, a trade group with, at that time, seemingly less than a handful of members (two magnet manufacturers, Lynas and Avalon). The Act was seen as being primarily aimed at helping Molycorp but in the long-term the publicity it created has done more for Ucore than Molycorp.

The other Alaska Senator is Mark Begich, a Democrat. He too has been vocal in support of Ucore's project.

On January 2013, Senators Murkowski and Begich introduced S.181, a bill that calls for building some 75 miles of road that connects Bokan Mountain and Heatherdale Resources' Niblack mine project to the roughly 2,500 miles of roads that connect most of the communities on Prince of Wales Island. Murkowski noted that the bill would permit development of a road that minimizes costs, while also minimizing the effects on surface resources, preventing unnecessary surface disturbances and complying with all environmental laws and regulations.

U.S. Rep. Don Young (R- AK) introduced a companion bill, HR 587, in the House.

The road application has more to it than meets the eye due to restrictions (the Roadless Area Conservation Rule), by the US forestry service to drilling and other exploration in “roadless areas”. This is somewhat ironic as Bokan has been mined in the past and while it has a road (from the landing point to the old mine) the road doesn’t connect to any other road system on the island. Begic, in particular, has been outspoken in his opposition to this arcane restriction. In July 2011, the forestry service permitted helicopter-supported exploration drilling on two mining claims in the Tongass National Forest: Ucore’s Bokan Mountain rare earth prospect on Southeast Prince of Wales Island and a locally-owned poly-metallic prospect on Woewodski Island, just north of Prince of Wales Island.

Getting the State Government On-board

Ucore had also been busily cultivating State politicians to enhance grass-roots support. In April of 2013, the State Legislature unanimously voted in favor of Senate Joint Resolution No. 8. All 39 representatives in attendance voted in favor of the Resolution, which states the Legislature's support for continued and increased exploration, extraction, processing and production of rare earth elements in the State.

Several Representatives spoke out in favor of SJR8, including Representatives Costello, Kreiss-Tomkins, Johnson, and Millett. Representative Craig Johnson noted, "I see a future for Alaska where we can become a state that processes these minerals....and this could be the future of Alaska." Representative Millett noted Alaska's potential to play a crucial role in the US Department of Defense's recent announcement to stockpile strategic rare earths such as dysprosium. She asked representatives to vote in favor of the Joint Resolution and to "...send a message to Congress that we are ready, willing, and able to serve their needs for rare earth elements". The Joint Resolution, introduced in the Alaska Senate by Senator Lesil McGuire with 15 co-sponsors, passed both the Senate (with all 20 Senators voting in favor) and the Legislature unanimously.

It should be noted that Alaska is one of those lesser-populated states where personality politics are key and where there is much more proximity between state politicians and the Federal representatives than would be the case in a state such as New York or California. Thus getting both levels of government on board is not as complex as in bigger population states but one level cannot be ignored or left uncultivated while pursuing another. Ucore has diligently cultivated all levels over the years.

Tapping the Alaskan Rainy-Day Fund

This strategy paid off in mid-February 2014 when Ucore rather stunned the market with its update on progress in negotiations with State legislators by revealing that an initiative introduced to the Alaskan legislature contemplated the financing of up to \$145 Million of the Bokan-Dotson Ridge project’s capex through the Alaska Industrial Development and Export Authority (AIDEA).

AIDEA is a public corporation of the State of Alaska and in reality a sort of “rainy-day” fund to prepare the state for the time when oil revenues no longer suffice. The Authority has been active in the financing of multiple capital project initiatives in the Alaskan mining sector since 1985, including the DeLong Mountain Transportation System which serves the Red Dog Mine, the Skagway Ore Terminal, the Seward Coal Terminal, mine facilities at Fort Knox, as well as multiple non-mining capital projects,

Monday, April 28, 2014

including the Federal Express Maintenance Facility in Anchorage, the Snettisham Hydroelectric Project in Juneau, and the Ketchikan Shipyard in Southeast Alaska. The goal of most of these projects is to create lasting jobs in the populated parts of the state.

On February 18, Senator Bert Stedman (AK-R) presented an Amendment to Alaska Senate Bill No. 99, originated by State Senator Lesil McGuire (AK-R) in 2013. The amended Bill would give AIDEA the authority to issue long term bonds to finance the infrastructure and construction costs of the Bokan-Dotson Ridge rare earth project up to a Principal Amount of \$145mn.

The Stedman Amendment was read at the first committee hearing on the 18th of February 2014. The market responded dramatically to the news when the trading suspension was lifted with the stock soaring 50% at the open. Well, it might because the issue these days is the financeability of projects, not the chemistry aspects.

On March 31, 2014 the company reported that Senate Bill 99 "AIDEA: Development Loans" had passed through the Alaska State Senate in a unanimous vote, with all 20 senators voting in favor of the Bill. On the 25th of April it passed the State House and has now been sent to the Governor for signing.

If the evolution of events in the legislature is anything to go by, Ucore may have by-passed the crocodile pit of the capital markets and gone straight to the most cashed-up source.

Funding the Capex

We have already discussed the State's fund that expedites the projects that get the official nod. The disconnect in outside thinking is that when one looks at the PEA all sorts of conventional financing thoughts come to mind when in reality the intervention of the State in the process makes the situation altogether more interesting.

The legislation currently going forward envisages in fact a form of leasing which has quite important implications for Ucore. In investors' minds they see the legislation as expediting some sort of loan guarantee. In fact it signals something altogether more interesting in the form of a lease that encompasses all the above ground work at the site (hence the legislation covering \$145mn and the total capex being \$221mn). Essentially the government agency will build the processing and above ground facilities to Ucore's specifications and then the company will rent the State-owned plant etc for the LOM paying a lease fee. At the end of the lease Ucore will acquire the assets from the State at a pre-agreed price.

The effect of this is to shift nearly two-thirds of the cost of the project off the books with a dramatic impact on the NPV of the project.

This is not an exceptional "Ucore-only" event as the build-to-lease model is regarded as traditional in AIDEA's modus operandi. A good example of this was the Red Dog mine where infrastructure in the form of roads was built by AIDEA and the mine operator was then charged a toll on the road as a means of generating a return for the fund.

Finances

The company had not done a financing of substance for quite some time and therefore was due to raise some more funds. Obviously the bigger expenditures would ideally occur when funds have been raised through the government backed financing facility. In the short term though the company still has work to do in refining its mine plan and having more millions in the bank is better than having less.

The price spike from the Alaskan progress resulted in a revival in warrant exercise by long-term holders. The table below shows the average exercise price for the warrants and options outstanding as at last September 30th. As can be noted, both categories are

	Number	Exercise Price	Lifespan*
Stock options under plans approved by shareholders	10,575,000	0.40	3.26
Warrants	21,077,594	0.34	2.45

*Average remaining weighted life as at 30 Sept 2013

Warrant exercise in the short-term has the potential to add around \$7mn to the coffers, something that the public expecting a more straightforward private placing may not have considered.

Just last week the company announced that it had closed the final tranche of a non-brokered private placement by issuing 2,050,000 units at \$0.38 per unit for gross proceeds of \$779,000, resulting in cumulative gross proceeds for the Private Placement of \$7,878,126. The issue had been increased on two previous occasions in the preceding weeks showing a very strong demand from investors for the paper. Each unit consists of one common share in the capital of Ucore and one common share purchase warrant (for one common share at a price of \$0.50 until April 17, 2017). The surprising thing is that this good news was greeted by a sell-off in the stock which is rather perverse considering that usually the removal of the threat of a financing makes a stock go up.

There was also a small flow through in December 2013 of 1,200,000 common shares issued on a flow through basis for gross proceeds of \$252,000.

Risks

Derisking a REE project involves more than just getting a solid Feasibility Study under the belt. The biggest challenge is the price scenario where the main driver is not supply and demand but the (seemingly) capricious policies of the Chinese. Of course, these actions are not random but all part of an on-going struggle to maintain dominance in the REE space. As we have said elsewhere, this dominance is now seriously threatened and the onset of production at Bokan will be yet one more straw towards breaking the camel's back of Chinese price and supply dominance.

This means the REE space though is passing through the eye of the storm with all the conflicting counter currents and head and tail winds that implies.

The potential pitfalls with this venture are few but merit mentioning:

- ✘ That the REE company space goes back into hibernation
- ✘ Price
- ✘ Environmental concerns raise their head

We are not sure that the fortunes of the rest of the REE explorers actually impact on Ucore anymore. The space akin to a mosh-pit at a heavy-metal concert and Ucore have managed to get themselves hoisted up by their political advocates and can now crowd-surf the *hoi polloi*. This means that a revival of the broader REE space is not all that important for Ucore itself, as the room divides into likely producers and terminal non-starters. If a company manages to make the first cut (and the Alaskan financing guarantee seems to signal that Ucore will) then it will be more subject to the moves in the price deck for REEs than the fate of the more amorphous players.

For now Ucore has put together a caucus of political supporters that seems solid but is also so large that one or more of them departing the scene would not damage its prospects. The main anchor is the seemingly unassailable Senator Murkowski.

Environmental concerns are probably the most persistent issue. Once again having a bi-partisan support amongst the political class in Alaska will certainly help keep the focus on sustainable jobs. Ucore thus far has gone out of its way to be enviro-friendly particularly as the paste-backfill policy was a major carrot as it reduces enormously the potential for lingering environmental problems.

Conclusion

The revival of interest in Rare Earths has come at just the right time for Ucore. It has spent the “long dark night” of the sector working away at a resource, PEA and getting its political ducks in a row. Now the tipping point has been reached with mining coming back (somewhat) into favour, REE coming back in (selectively) from the cold and the support of the state legislature in Alaska becoming tangible. Most of the survivors cannot even compare on the key differentiator of a plausible financing route. That is the key advantage Ucore has gained with the recent announcements.

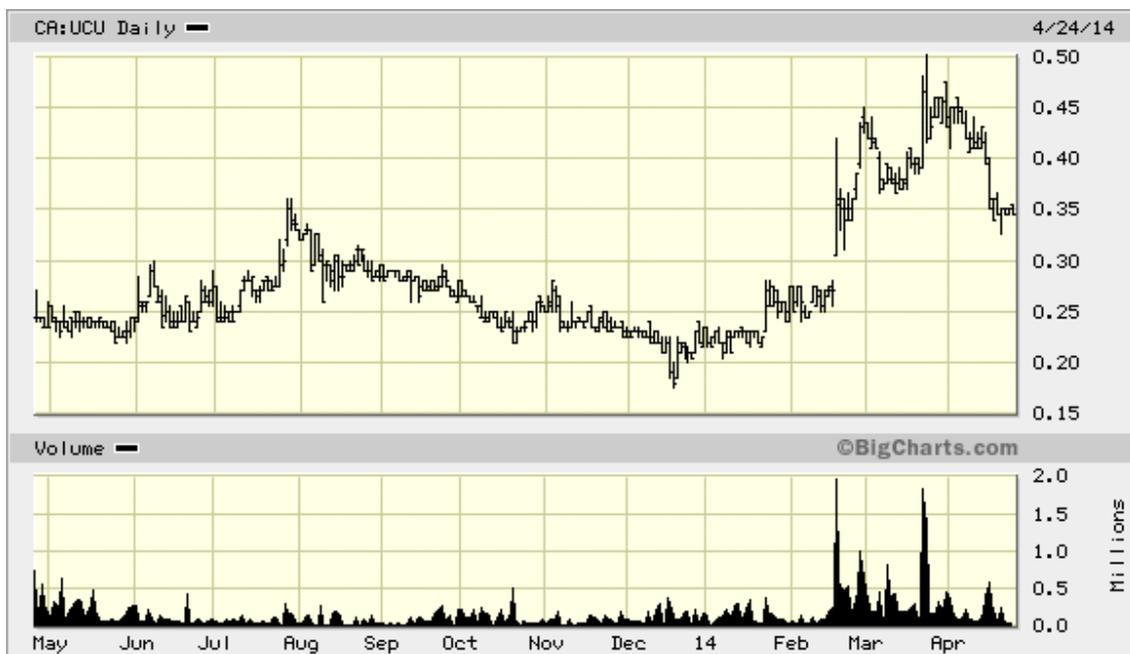
It is almost amusing to see that the REE world has divided into those promoting doable projects and those with more doubtful propositions trash-talking the former group. Generally those in the latter group have the weakest projects and the most dubious economics, not to mention challenging metallurgies. The process has reached its apogee in a Top Ten (well, top fifteen) list doing the rounds that not only goes to show that “comparisons are odious” but that one should always read the disclaimers...

Ucore is now cashed up for foreseeable short term needs and the backing of the State government has ensured it is well-positioned to raise the funds to get construction on the road. It also has a respectable starter resource with the possibility that this will expand. As it starts the march towards construction the more likely it is that UCU might succumb to blandishments of potential off-takers and maybe sell a minority stake to a Japanese trading house, for example.

Monday, April 28, 2014

It still remains a possibility that UCU will end up as a trophy in Molycorp's wall but that would require MCP getting its own house in order. Ucore has taken the correct course of not seeking to rely upon the "comfort of strangers" and it has already paid off. The chart below shows the curious path of the stock in the last month. The rally is understandable, as is the easing on the possibility of a financing. However the torpid reaction once the financing was out of the way and with the progress of the Alaskan legislation would seem to imply that investors are looking in the rear-view mirror rather than through the windscreen.

Our rating on Ucore remains as a **Long** call with a twelve-month target price at CAD\$0.90.



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