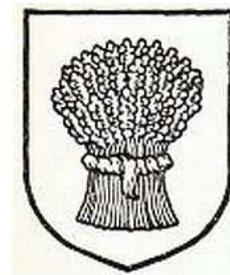


Monday, April 8, 2019



# HALLGARTEN & COMPANY

## Coverage Update

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## Telson Mining

(TSX-V: TSN, FSE: TSGN, OTCBB: SOHFF)

Strategy: Long

Key Metrics				
Price (CAD)	\$0.37			
12-Month Target Price (CAD)	\$1.10			
Upside to Target	197%			
12 mth high-low	\$0.35 - \$0.91			
Market Cap (CAD mn)	\$51.62			
Shares Outstanding (millions)	139.5			
Fully Diluted (millions)	154.7			
	<b>FY17</b>	<b>FY18e</b>	<b>FY19e</b>	<b>FY20e</b>
Consensus EPS		n/a	n/a	n/a
Hallgarten EPS (CAD)		(\$0.069)	\$0.086	\$0.447
Actual EPS (CAD)	-0.03			
P/E	n/a	n/a	4.3	0.8

# Telson Mining

## Hitting Its Stride as Zinc Rebounds

- + Telson is one of the few companies to have entered the Zinc mining space with not one but two mines, both located in Mexico
- + Production ramp-up is gaining pace with excellent volumes in 2018 and Q1 2019 and a significant reduction in operating costs from those projected in past studies and realized by past operators
- + Campo Morado with existing resources could feed the mill at 2500 tons per day for over 12 years and at Tahuehueto current reserves should provide for a 12-year mine life at 1,000 tonnes per day
- + There are another three and a half million tons of resources that could extend the life by two times should Telson be able to convert the resources to reserves
- + Strong exploration potential that could add new resources and reserves to allow production expansion and further add to mine life
- + Prices for Zinc look undaunted, we expect the price of the metal to move closer to \$2 per lb over the next 18 months
- × The company will need to pay \$5.5mn (the balance of Campo Morado purchase price) by the end of October 2019
- × The payables on the concentrates sold to Trafigura are quite low: for metal contained in the Zinc concentrate the NSR received is around 55% and from the Pb concentrate around 70% to 80%

### **Rising Production in a Rising Zinc Price Scenario**

The fluctuations of the Zinc market make for a rough ride for those companies that choose that path to fame and fortune. This is particularly because no-one has made much of a fortune from Zinc over the period since 2007. Picking up the pieces of the “fallen” like Nyrstar has been a profitable activity for some. The beneficiaries of its shrinkage program have been Ascendant Resources, Great Panther and Telson Mining, all of which sifted through the asset to pick up Zinc mines at bargain prices.

Telson had long been cultivating the Tahuehueto project and was in advanced development but the addition of Nyrstar’s Campo Morado vaulted that shuttered mine into the pole position and resulted in a swift return to production for the mine. Both are now in production with Campo Morado having declared commercial production, and this should also occur in 2020 at Tahuehueto. Telson’s operations look set to become substantial cash generating engines by 2020.

Technically the move to production has not been too problematical but the slump in Zinc prices in 2018

made production only marginally profitable and two months of cumulative mill down time as a result of a series of faulty SAG mill liners plus a major theft of concentrate further damaged margins. All these problems are now behind the company.

In this coverage update we shall look at how the company's two operations have been performing and how the fluctuations in the Zinc price have impacted.

### **Campo Morado**

The Campo Morado project hosts several polymetallic massive sulphide deposits containing zinc, copper, silver, gold and lead mineralization. Five deposits have been extensively drilled: G9, El Largo, Reforma, Naranjo and El Rey. The project is comprised of an underground multi-metal mine with infrastructure, installations and equipment. The project is currently producing between approximately 1,850 - 2,000 tonnes per day and is planning to increase production toward 2,500 during 2019.

The transaction by which Telson acquired the Campo Morado mine consisted of US\$20mn. Nyrstar could potentially receive a variable purchase price (VPP) royalty on future Zinc production on the first 10 million tons of ore processed by Telson when the price of zinc is at or above US\$2,100 per tonne. Telson could potentially repurchase 100% of the Zinc Royalty at any time for US\$4mn. There is also a 3% royalty payable to SGM on the NSR value of concentrate sales (before transport costs).

### **Offtake Agreement**

In mid-September of 2017 Telson announced to the markets that it had come to an agreement with Trafigura the main features of which were:

- + an executed loan facility of US\$5mn for working capital
- + An offtake agreements for 100% of the production of zinc and lead concentrates with a minimum fixed tonnage, starting delivery in October 2017 and ongoing until December 2021

This funding enabled the restart of mining and mineral processing at Campo Morado mine. Three-year term with a six-month grace period followed with 30 repayment installments. The loan facility matures in September 2020 and bears interest at a rate equal to 3-month LIBOR+5%. There are no hedging conditions and no equity-based payments

Under the offtake agreements Telson is selling 100% of the Lead and Zinc concentrate produced at the Campo Morado Mine from the commencement of commercial production until December 2021. The offtake has a 51-month term ending December 2021 for Campo Morado Pb/Zn concentrate production with a fixed minimum tonnage to be dispatched during the offtake term. While pricing was not disclosed the company reassured investors that the deal has "very competitive industry payable metal terms at LME and LBMA Spot prices".

## Initial Production

Telson restarted mining operations in September 2017 under a preproduction plan and on a trial basis at 1,400 tonnes per day. Production of zinc concentrates recommenced in October 2017 and Telson announced commercial production on May 15<sup>th</sup>, 2018 at 1,800 tonnes per day and intends to progress towards full capacity of approximately 2,500 tonnes per day during 2019.

Pre-production test milling operations started on October 14, 2017.

In early February of 2019, Telson published a snapshot of Campo Morado's 2018 pre-production and commercial production metrics. These included:

- Mill processed 585,601 tonnes of mineralized resources during 2018, (231,757 tonnes of pre-production to May 15, 2018 and 353,844 of commercial production since May 16, 2018)
- Average head grade of 4.26% Zinc, 0.37% Copper, 1.10% Lead, 1.02 g/t Gold, 118 g/t Silver
- Sold on a combined basis an estimated total of 39,333 tonnes of Zinc concentrate with estimated average grades of 41.82% Zn, 363 g/t Ag and 1.27 g/t Au for estimated total gross proceeds of US \$35.17 million. \*
- Sold on a combined basis an estimated total of 7,666 tonnes of lead concentrate with estimated average grades of 23.93% Pb, 662 g/t Ag, 5.15 g/t, Au and 2.21% Cu for estimated gross proceeds of US \$5.58 million. \*
- Combined estimated total all in operating costs, including mining, milling, freight, royalties, smelter costs, etc. were US \$32.46 million, resulting on an estimated cost per ton of US \$55/tonne.
- Combined estimated total metal sold – 36.26 million lbs (16,449 tonnes) zinc, 4.03 million lbs (1,834 tonnes) lead, 373,333 lbs (169 tonnes) copper, 2,870 oz gold and 622,309 oz silver.
- Mill throughput processing rate increased from 1,500 tonnes/day in January to an average of 1,800+ tonnes per day by year end, achieving maximum daily rates of over 2,200 tonnes/day.
- Total estimated mineralized resources mined was 582,521 tonnes during the year. Mine development totaled 2,659 metres: 1,682 metres developed in mineralized resources and 977 metres in waste (access ramps and auxiliary workings).

It was the first time since its foundation that Telson recorded revenues from concentrate sales on its financial statements, after declaring commercial production at Campo Morado.

## Not all Smooth Sailing

Unfortunately, the theft of concentrates, excess mill down time plus some increase in costs, such as electricity which increased by 110% since year end 2017, affected the expected profitability of the Campo Morado Mine.

During 2018, the company lost mill operational time due to faulty liners that kept breaking regularly.

Apparently the supplier had difficulty with their own foundry and sourced liners from somewhere else without informing Telson, which resulted in a lot of downtime changing out the faulty SAG mill liners on a continual basis. Campo Morado lost just over two months of cumulative, not consecutive, downtime at the mill which was estimated to have reduced revenues by up to an estimated US\$8-10mn.

### **Going Greener**

In October of 2018, the company inked an 10-year take-or-pay purchase agreement for renewable-sources generated electrical energy at a cost of MXN\$1.10 per kilowatt hour (kWh) or equivalent to CAD\$0.072 per kWh at the reigning exchange rate.

The Green Energy Agreement comes into effect no later than June 2019 with Telson committed to 42GWh per year.

This Green Energy Agreement goes a long way towards mitigating the previously mentioning negative hit from soaring electricity prices during 2018. The cost per kWh is approximately 32% lower than the last nine-month average price paid and approximately 54% lower than September's kWh price alone.

The company estimated its operating cost savings at approximately CAD\$2mn during the first-year equating to an estimated 3.5% decrease in overall current operating costs.

### **Campo Morado Concentrate Thefts**

When at company presentations about mining in Mexico, the usual questions from attendees are related to the dangers inherent in operating in areas where the drug cartels are present. Rarely, to never, are other forms of criminality raised. Therefore it came as a surprise to the market when Telson revealed that it had become a victim of a sophisticated concentrate theft operation.

During the latter part of the year management determined from inconsistent assay results between sampling of concentrate loaded on trucks at the mine site and check assaying completed at the point of sale in Manzanillo, that Campo Morado concentrates were subjected to dilution by theft while in transit. The company has identified that some of the concentrate trucks were received in Trafigura warehouses with lower concentrate grades than reported by the Campo Morado mine site laboratory. After considerable analysis with the various labs and with security contractors, Telson has concluded that there was a sophisticated criminal operation to intercept certain concentrate trucks in transit, remove some part of the Campo Morado concentrate load from the trailer and replace same with lower quality concentrates.

Once Telson's management received the preliminary findings of its investigation into the theft, it has taken various measures to eliminate this issue with increased security including performing monitored and guarded concentrate transport from the mine to point of sale, having all transport trucks travel together in a convey non-stop to point of sale, increasing assay monitoring on a truck by truck basis at point of sale with more rapid turn-around of results to quickly compare results at delivery to assays from mine site at truck departure. Furthermore, all drivers compromised in the theft process employment were immediately terminated. Telson is considering all available legal remedies in conjunction with ongoing investigations by the appropriate authorities and based on recent results believes it has substantially eliminated the concentrate transit theft.

The estimated impact in the yearly cash selling value, although difficult to determine accurate numbers has been estimated by management through a rigorous statistical analysis to range between US\$2mn to US\$3mn, to a maximum of approximately 7% of total annual sales from Campo Morado.

Management points out that if not for the above noted concentrate theft, concentrate gross sales from the Campo Morado mine would have increased by the value of the concentrate stolen. In addition, the average grade of zinc concentrates sold, as quoted above, would have been higher by approximately 2%.

### **Going Forward**

The production experience has shown OpEx to be much lower than previously expected. Combined estimated total all in operating costs, including mining, milling, freight, royalties, smelter costs, etc. were US\$32.46 million, resulting on an estimated cost per ton of US \$55/tonne. These 2018 costs are approximately 45% lower than the estimated equivalent costs of US\$98.74 per tonne used for the same categories in the PEA.

The company processed 585,601 in 2018 and at the current production run rate would process 600,000 tonnes, however it now expects production to be closer to 750,000 tonnes per annum for 2019 if successful with planned improvement designed to increase production towards 2,500 per day.

Mill feed is now coming 95% from production with bulk underground mining methods and 5% from development. Average head grades for 1Q19 were 3.88% Zn, 0.99% Lead, 0.37% Copper, 107.9 g/t silver and 1.01 g/t gold. Average metal recoveries achieved during 1Q19 were 70% Zn, 33% Pb, 16.5% Au and 33% Ag, with an average Zinc concentrate grade of 46.8% Zinc and average Lead concentrate grade of 30% produced.

In late March the company reported positive testing results for increasing the SAG Mill throughput processing rate by at least 15% by reducing the size of crushed mill feed. During four hours of testing 382 tonnes were milled at 80% -2 inch obtaining an average processing rate of 95.5 tonnes/hour (equivalent to 2,292 tpd). Testing at 80% -2 inch achieved approximately 15% increase over processing 100% -5-inch feed. The testing also showed that the efficiency of other stages in the milling process, (vertical mill - Vertimill, flotation cells, thickeners and filters) were not affected by the higher throughput volume as Zinc recoveries and quality of the Zn concentrate at 47% Zn were maintained, showing that the mill worked smoothly at increased capacity.

### **Technology Kicker to the Precious Metals Tailings Potential**

The Campo Morado historic tailings (pictured on the following page) have a high precious metals content that may, in the future, be reprocessed if an economically viable method for precious metals recovery is developed.



The historic resource estimate (non-NI43-101 compliant) for the tailings derived from previous operators daily metallurgical balance reporting is shown below and gives a good idea of the potential of this otherwise ignored “asset” to contribute meaningfully to revenues.

<b>Campo Morado Tailings</b>						
<b>Tonnes</b>	<b>Au g/t</b>	<b>Ag g/t</b>	<b>Cu %</b>	<b>Au ozs</b>	<b>Ag ozs</b>	<b>AuEq</b>
3,290,622	1.57	94	0.3	165,662	9,954,590	298,161

In an interesting twist the company, in early April announced the results of historic Leachox Process testing for the possible increase of gold and silver recoveries on the Campo Morado tailings material in 2013 by Maelgwyn Mineral Services of Cardiff UK.

#### Final Tails

- The testwork achieved a maximum gold dissolution of 65 % after an effective 10 passes of Aachen oxidation, at a grind specification of 80% - 20 µm.
- The maximum silver dissolution of 75% was achieved after an effective 40 passes of Aachen oxidation, at a grind specification of 80% - 40 µm.

#### Reforma Zone Sample

- The testwork achieved a maximum gold dissolution of 45% after an effective 40 passes of

Aachen oxidation, at a grind specification of 80% - 20 µm.

- The maximum silver dissolution of 81% was achieved after an effective 40 passes of Aachen oxidation, at a grind specification of 80% - 10 µm.

In recent times the company became aware of preliminary testing of samples from Campo Morado in 2013 conducted for Nyrstar by Maelgwyn. The samples were from 2013 process tailings, presumably G9 Zone, as well as fresh mineralization from the Reforma deposit, a future target production zone.

The Leachox testing indicated that substantial increases in precious metal recoveries could be available using Maelgwyn Leachox Process. Very positive results were obtained in the 2013 testing for both of the samples submitted with a maximum recovery of 65% gold and 75% silver at a grind size of 20 microns from the process tailings sample and in a maximum recovery of 45% gold and 81% silver at a grind of 40 microns from the Reforma deposit sample.

This would represent a significant improvement from current levels of gold recoveries at 15-20% and silver recoveries at 30-40%, which would significantly increase the mine's profitability.

The Leachox process route has become a leading technology in the low-cost recovery of gold from refractory and sulphide orebodies. The Leachox process uses simple ultra-fine grinding equipment combined with the Aachen Reactor; a proprietary low pressure, high shear mass transfer device utilising oxygen to partially oxidise the sulphides. When combined with the liberation of gold by the ultra-fine grinding of concentrates it results in acceptable but, more importantly economic gold recoveries.

There is now world-wide installed capacity of Leachox to recover over 3 million ounces per annum of gold contained in sulphides in such operations as; the Kibali Mine in the DRC, the Tongon Mine in Cote d'Ivoire both now owned by Barrick Gold (formerly owned by Rangold Resources, the TGME mine in South Africa owned by Barberton Mines and the Vasilkovskoye Mine in Kazakhstan owned by Vasilkovsky MMC.

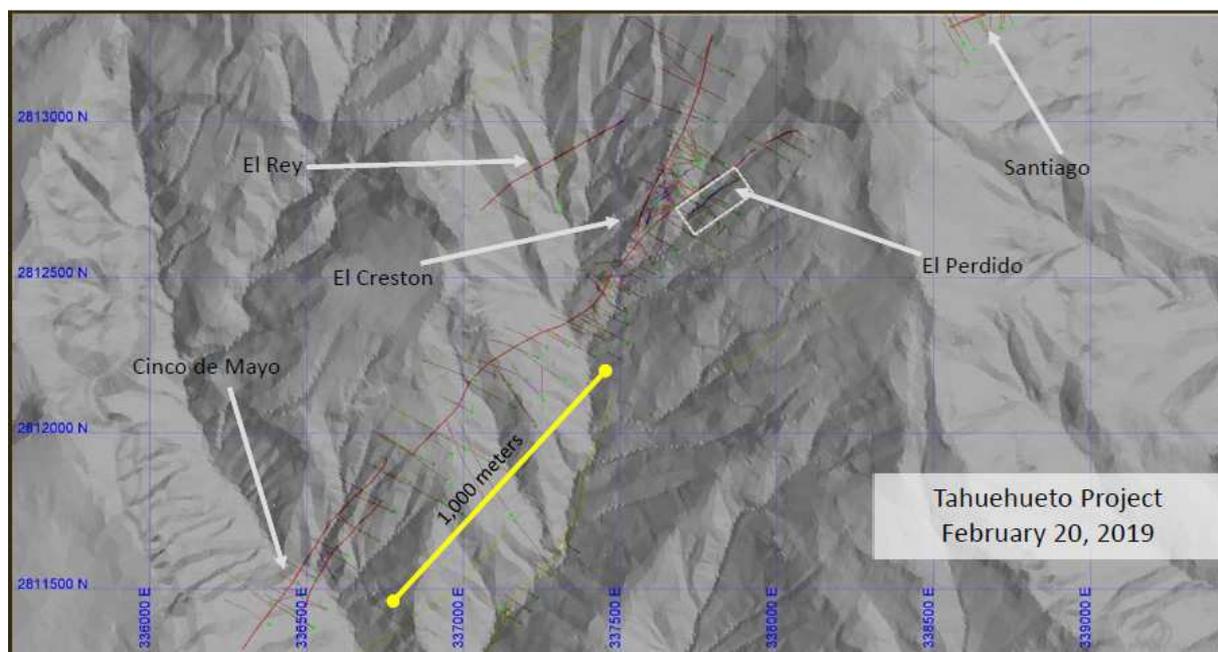
The obvious potential here is to not only exploit the tailings potential, but also to raise the recoveries from fresh tailings going forward.

### **Tahuehueto**

For a very long time the Tahuehueto Project was the main target at Telson. While it is currently in pre-production the deal with Campo Morado has somewhat stolen the limelight. We shall only deal with this asset in passing as we wrote extensively on it in our initiation of coverage in 2018.

The Tahuehueto Project is located in north-western Durango State and lies within the prolific Sierra Madre Mineral Belt. The project consists of 28 mining concessions grouped into five non-contiguous blocks that total approximately 7,492 hectares.

Tahuehueto is located in a zone which hosts a series of historic and producing mines and most of Mexico's active exploration and development projects. The project is situated about 25 km north of the Topia polymetallic-silver mine, 65 km northwest of the La Cienega gold, silver, base metal mine, 85 km southwest of the Guanacevi silver district, 280 km southeast of the Palmarejo silver and gold mine and 150 km northwest of the San Dimas mining district, most notable for the Tayoltita silver and gold mine.



### Mine Construction & Development

Telson, as of January 1, 2019, had advanced a total of 1.44 km of underground development, 365 meters within ore which supplied the pre-production toll milling feed and 1,074 meters in waste preparing the mine for future commercial production. Development included the Level 12 decline, the El Perdido development drift, El Creston development drift, the Haulage level portal and the main access decline for Level 20.

The company expects, during 2019, to have completed construction of the 1,000 tpd mill on site so that 2020 throughput should be around 350,000 tpa.

### Production at Tahuehueto

The pre-production mining commenced during July 2017 with toll milling operations starting during August 2017. Mining and toll milling continued through to mid-December 2017 when operations were shut down during Christmas holidays. Mining and toll milling resumed in January 2018.

Pre-production mining in 2018 produced approximately 37,711 tonnes of ore with average grades of 3.86 g/t Gold, 43.6 g/t Silver 3.92% Zinc, 0.24% Copper, 2.10% Lead,

Approximately 818 tonnes of Lead concentrate produced from pre-production was sold during with average grades of 82.22 g/t Au, 878.72 g/t Ag, 41.03% Pb and 2.50% Cu for approximate gross proceeds of US\$3.41mn.

Some 1,244 tonnes of Zinc concentrate produced from pre-production was sold during the 2018 fiscal year with average grades of 49.38% Zn, 91.95 g/t Ag and 6.92 g/t Au for approximate gross proceeds of US\$1.41mn.

### Grade Discoveries

Tahuehueto underground development along the major mineralized structure, El Perdido, has now been extended approximately 150 metres along strike to the north-east from the Level 12 access decline. The first 60 metres of this development was designed to prepare reserves identified by previous drilling for mining, however, the development drift is being extended in continuous mineralization beyond known reserves/resources and to date has exposed approximately an additional 150 metres of continuous mineralization beyond the know drilling. Some of the more notable intersections at El Perdido are shown below:

Width	Assays					
	Au (g/t)	Ag (g/t)	Cu %	Pb %	Zn %	AuEq (g/t)
6.74	3.8	53	0.42	2.42	5.21	9.59
4.40	5.39	62	0.46	3.01	8.5	13.69
3.55	8.61	35	0.12	1.39	0.88	10.48
6.77	5.36	109	0.25	0.27	2.38	8.65
3.03	5.27	54	0.14	0.27	2.29	7.69
2.00	5.54	42	0.12	2.17	6.18	11.17

As work on the underground development has progressed within the El Creston Zone sampling has returned significant grades over appreciable widths. Channel sampling results received to date are presented below:

Width	Assays					
	Au (g/t)	Ag (g/t)	Cu %	Pb %	Zn %	AuEq (g/t)
4.95	8.48	104	0.85	5.82	11.01	20.91
3.00	5.66	62	0.26	3.57	7.42	13.24
3.00	8.89	88	0.34	2.25	6.27	15.54
3.35	11.87	78	0.54	2.74	4.06	17.59
3.25	8.12	134	0.44	2.44	3.99	14.13

Additional channel sampling was collected within the El Creston Zone and results will be disclosed when assay results are received.

The underground development on the El Perdido zone has extended at least 150 m past known drilling and the zone is continuously mineralized along those 150 m so this is proving up the company's hypothesis that the El Perdido zone connects up to the Santiago zone (approximately 800 m distant). This is good news as Telson should be able to add new resources and potentially reserves when it starts to conduct underground exploration drilling.

### **Tahuehueto Offtake**

Telson also has an offtake agreement with Trafigura for this mine that was executed in late October 2017. It consisted of a loan facility with Trafigura for up to US\$15mn for mine construction and operation an ongoing 1,000 tonne per day mining operation at Tahuehueto.

The Offtake Terms were for 100% production of zinc and lead concentrates with a minimum fixed tonnage, starting delivery from January 2018 and ongoing until December 2022.

### **Financing**

In October of 2018 the company closed a \$6,843,603 Non-brokered private placement completed at \$0.75 per unit, which represents a 39% premium to Telson's last closing share price on the Toronto Venture Exchange prior to announcing the placement. Each Unit consisted of one common share and one half share purchase warrant. Each whole purchase warrant entitles the holder thereof to acquire one common share at a price of \$1.25 for a period of two years following the closing of the placement.

This was an extraordinary endorsement of the company's outlook by the company's management and seemingly went unnoticed by the market. The participants were the Mexican senior management (taking around 85% of the placing) and a major shareholder/director, plus the participation of a couple of junior managers. The Mexican major shareholders wanted to send a strong message to the markets of their commitment to the company.

The funding enabled Telson to request the second loan tranche of US\$5mn under its off-take loan agreement with Trafigura to finalize the construction of the Tahuehueto mine, which will have a processing plant capable of milling 1,000 tonnes per day.

The total issued and outstanding Common Shares of the Company after completion of the Private Placement is 139,559,153.

### **Zinc – Breaking Through**

Our year-end 2017 target for Zinc was \$1.50 per lb and yet that price was reached four months ahead of time. As Zinc busted through each key level it paused and market participants held their breaths to see if there would be a serious pullback and it just did not happen. The price peaked around \$1.60 at the start

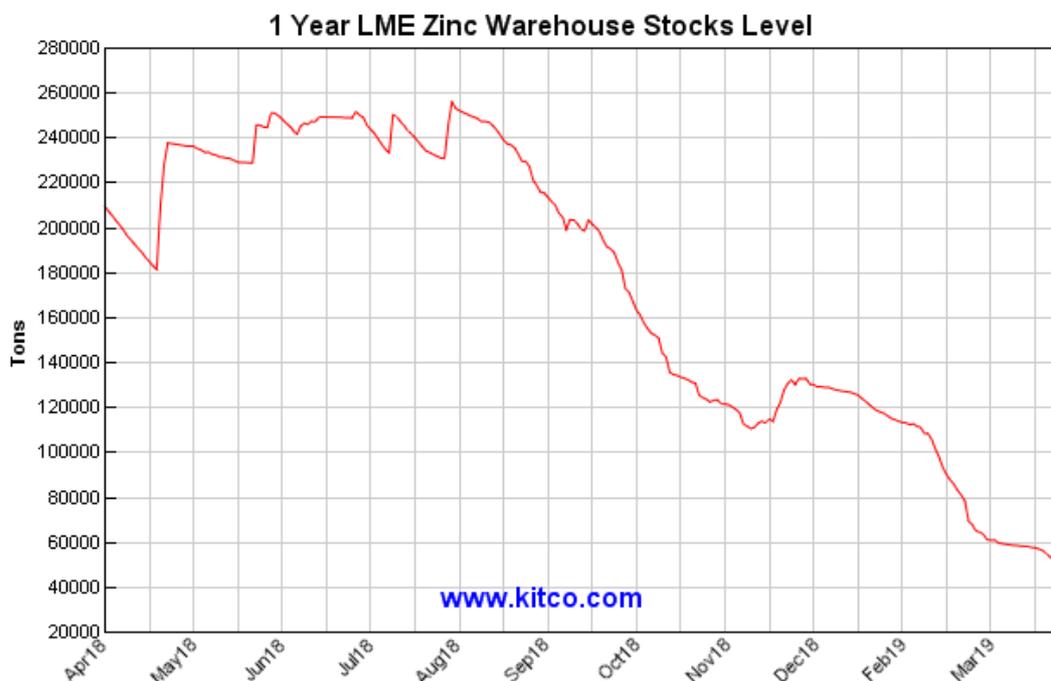
of last year. However the upward rush was derailed by the “hidden hand” of market forces (which we prefer to call a spade a spade and brand the Chinese as the culprits) in the wake of the Trump trade initiatives.

This caused the Zinc price to rapidly deteriorate stopping just short of the \$1.10 per lb level. The price then dwelt for a long time in close proximity to \$1.16 (funny that) and then started to recover vigorously from January 2019 and has recently broken above \$1.30 per lb.



The chart below shows the diabolical state of LME warehouse stocks when compared to the weakness for much of the early part of the decade. We would point out here the sawtooth nature of the rise in inventories. Verily as Zinc tried to rally, some party moved large amounts into the warehouse and slapped down the price. The usual perpetrators of this type of manoeuvre are well-known to those who dwell in this space.

However, it would seem that by September they have exhausted their armoury of “spare” Zinc stocks and inventories starting heading remorselessly down, which eventually had a positive impact on prices.



## Earnings & Outlook

Revenues produced during commercial production from Campo Morado and pre-production cash sales from both Campo Morado and Tahuehueto mines during 2018 resulted in estimated gross concentrate sales of US\$45.56mn (US\$40.75mn from Campo Morado and US\$4.81mn from Tahuehueto).

Our earnings model for the first few years of operations can be seen on the following page.

Points to note:

- We used the Hallgarten average price projections for the various metals
- We used current recoveries for the metals
- For CM operating costs we used the current OpEx per tonne
- For THH costs we used the Opex numbers in the PFS
- We used the GSA cost per tonne of CM for both projects throughout

As can be noted the numbers for the first three quarters are actual numbers as are the revenue numbers for the full fiscal year 2018.

For FY19 we have not factored in revenues for Tahuehueto as it will not be in commercial production for the whole year and it's still not clear when that might be though we suspect early in the second half. Revenues from Campo Morado should be up due to enhanced volumes, the elimination of the concentrate threat and (hopefully) the absence) of the liners problem. This gives a positive and much improved bottom line of a positive \$12.5mn (or EPS of 8.6cts per share).

<b>Telson Mining P&amp;L</b>							
CAD mns - December FY end							
	<b>FY20e</b>	<b>FY19e</b>	<b>FY18e</b>	<b>3Q18</b>	<b>2Q18</b>	<b>1Q18</b>	<b>FY17</b>
Revenues	<b>287.549</b>	<b>84.966</b>	<b>45.560</b>	<b>10.215</b>	<b>8.977</b>	<b>0.000</b>	<b>0</b>
Campo Morado	114.081	84.966	40.750				
Tahuehueto	173.469	0.000	4.810				
Cost of Mining/Milling/Tolling	<b>161.842</b>	<b>40.425</b>	<b>42.300</b>	<b>12.975</b>	<b>5.988</b>	<b>0.000</b>	<b>0</b>
Campo Morado	49.088	40.425					
Tahuehueto	<b>112.755</b>	0.000					
Gross Profit	125.707	44.541	3.260	-2.760	2.989	0.000	0
GSA	11.933	7.160	3.520	1.446	0.445	0.129	3.283
Depreciation	<b>7.000</b>	<b>3.000</b>	<b>0.180</b>	<b>0.069</b>	<b>0.039</b>		0.000
Total Expenses	180.776	50.585	46.000	14.489	6.472	0.129	3.283
Operating Result	106.774	34.381	-0.440	-4.274	2.505	-0.129	-3.283
Finance Costs	-4.800	-6.200	-7.734	-3.864	-1.291	-1.079	-0.040
Net Forex gain (loss)			3.350	4.587	-1.615	1.578	-0.210
Royalties - Campo Morado	-14.726	-12.128	-1.411	-0.340	-0.491		0.000
- Tahuehueto	-5.320	0.000					
Pre-tax Result	87.247	16.054	-9.585	-5.337	-0.854	-1.796	-3.533
Tax	19.194	3.532	0.000	0.000	0.000	0.000	0.000
Post-tax result	68.053	12.522	-9.585	-5.337	-0.854	-1.796	-3.533
Shares on issue	152.1	144.9	138.0	130.3	129.1	124.8	102.2
EPS	0.447	0.086	-0.069	-0.041	-0.007	-0.014	-0.035

In FY20, there is potential for a massive uplift in revenues with Tahuehueto hitting its stride and we posit earnings post-tax of \$68mn or EPS of 44.7cts.

Finally we would note that despite our bullish Zinc stance and flat gold outlook, revenues in FY20 and beyond for gold at Tahuehueto in our model still exceed the Zinc revenues.

## **Risks**

Amongst the risks at the current time are:

- Zinc price risk
- Financing risk
- Difficulties or inability to expand resource(s)

The Zinc price has over the last 18 months finally rewarded the stance of those long term bulls who foresaw a looming empty pipeline. Despite the “crisis” in Zinc supply being now a reality, the equity markets have not rewarded Zinc developers or even explorers with funding. This implies that the crisis shall roll on. When the Great White Hope of the industry is the reboot of the Century mine one can see that the end-users are clutching at straws. The Zinc price has paused at key levels on its trajectory upwards. The surge to over \$1.60 per lb was a bridge too far and retrenchment set in. Now the metal has established a new floor and should start to creep higher in coming months with our near term goal being a breaching of the \$2 per lb mark in 2020 or 2021. This is however, 18 months behind our previous timetable for it reaching that level.

In light of the rising revenue stream at Campo Morado in particular we do not feel it will be difficult to achieve a financing via equity (though this possibility may be to blame for the recent share price weakening) or via debt.

The potential to expand resources looks very propitious in both cases. Due to tight finances Telson could not undertake the level of drilling it would have liked after the crash of 2008. Its only now as underground development progresses at Tahuehueto that more potential mineralisation is coming to light. Thus financing is the biggest constraint upon resource expansion at this point.

Likewise at Campo Morado, Nyrstar conducted a great deal of surface exploration, both geochemistry and geophysical surveying that outlined numerous targets within the immediate area of the underground mine workings and on a regional property scale. Nyrstar only conducted limited followup drilling on these targets from within the existing mine which was insufficient work for expansion of known (or unknown) mineralisations.

Beyond these two factors merely recalculating existing resources at new price points for the major metals represented would expand resources. We would also note that Tahueheto already has a 12-year LoM with existing reserves and there are another three and a half million tons of resources that could in the future be upgraded to reserves and add additional LoM.

## **Conclusion**

The late 2018 Zinc swoon wiped the smile off the faces of the Zinc bulls (like ourselves) that thought that the bad old days of price manipulation were behind us. In the copper space, some spoke of the Chinese weaponising the red metal as some sort of revenge for the Trump trade strategy. We could extend that thesis to the Zinc space for LME warehouse stocks were low and now heading lower again. The price of Zinc has tried to creep higher again since the New Year and that has revived interest in Zinc miners and to a lesser extent developers. Unfortunately it has not (yet) fed into the share price of the likes of Telson.

Bringing one Zinc mine into production is feat enough in this day and age and now Telson has two in production. Telson is one of the few companies that have positioned themselves in the right metal at the right time.

Regular metal concentrate delivery and sales are underway from both projects (even though commercial production has not been declared at Tahuehueto yet). The company is also well-positioned with a reliable offtaker in the form of Trafigura.

With Zinc now several months into its turnaround it is quite surprising that the equities markets have not grasped this and started to move prices of universe of Zinc producers higher. We would expect there will be a moment of collective awakening that should benefit Telson and set its price climbing again as the extent of its future importance as a Zinc producer becomes known.

We added a Long position in Telson Mining to the Model Mining Portfolio in March 2018. We have lowered our twelve-month share price target from CAD\$2.00 to CAD\$1.10 in light of the setbacks in 2018 (which created a lower base from which the price to recover) and our perception that the market is taking a “believe it when we see it” attitude to the Zinc price rally.

Monday, April 8, 2019



## Important disclosures

I, Christopher Ecclestone, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers.

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