Tuesday, October 19, 2021

HALLGARTEN & COMPANY

Coverage Update

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Colonial Coal Intl

(TSX-V: CAD, FSE: A1C8BM, OTC: CCARF)

Strategy: LONG

Key Metrics	
Price (CAD)	$2.30
12-Month Target Price (CAD)	$3.55
Upside to Target	54%
12 mth high-low	$0.50-$2.53
Market Cap (CAD mn)	$400.82
Shares Outstanding (millions	174.3
Fully Diluted (millions)	183.4

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Colonial Coal Intl

Sharks Begin to Circle

- + Predators may be rippling the water around Colonial's stock price as new undeveloped hard coking coal (HCC) projects, of size, are a rare breed
- + Both its HCC projects strategically positioned in western Canada to service Asian steel producers
- + Coking coal has taken off in recent times, riding on the coattails of strong steel demand
- + Management has past form in positioning coal assets for sale to the highest bidder at the most opportune moment, entering into joint ventures, or taking projects to production
- + The travails of the Rinehart interests in Alberta may, ironically, be to Colonial's advantage
- + Using a conservative metric of USD$1 per in situ tonne of resource then, between the two projects, a valuation of around USD$700mn would be appropriate
- ✖ A strategy of projects/company acquisition by a larger player the company is somewhat at the mercy of corporate development decisions, which are outside its control
- ✖ The fortunes of coking coal are closely tied to the steel industry which in turn is closely correlated with global economic activity, particularly in emerging economies. Any slowdown in global activity could impact production of steel and thus coking coal prices

Let the Feast Begin

We have written various times on Colonial Coal in the past and it has long been a constituent of our Model Resources Portfolio. Their exclusive focus is on two major met coal properties in British Columbia, which is the management team's traditional stamping ground.

The management at Colonial Coal are no strangers to the "build it and they will come" philosophy of mining evolution. In broad terms the game plan at Colonial Coal is to repeat the strategy that management pursued at the two coal companies that David Austin previously founded and advanced, Northern Energy & Mining and Western Canadian Coal. The latter company was sold to Walter Energy in late 2010 for CAD$3.3 billion while in 2011 Anglo acquired the remaining 25% of PRC (held by NEMI and Hillsborough Resources) for $166mm ($664mn for 100%). Admittedly that was the go-go years of the Commodity Supercycle when such assets were traded for eye-watering multi-billion dollar prices.

In the more subdued environment of the current decade the team has sallied forth to repeat the building process. Underlying met coal prices initially looked challenging but now have returned to robust good health and yet the investor universe is still confused between met coal and thermal coal in the age of global warming. There is no replacing met coal in the steel making process.

Much to the pundits' surprise, coking coal has risen from the dead and yet few, besides Colonial Coal, have focused on creating a new pipeline of projects to meet this opportunity.

In this update we look at the progress thus far and why the feeding frenzy around the company is gaining momentum.

Coal Confusion – Out of the Mouths of Babes

We are tempted to view Greta Thunberg as some sort of Joan of Arc for our times. Then again, we could go even further back to the Children's Crusade, a massively ill-fated event led by one Peter the Hermit, who, as one can guess by the name was not exactly all that worldly.

Out of the mouths of babes frequently come less than fully-formed concepts. While Greta's soundbites may rail against the evils of the likes of coal she fails to grasp that the economic ecosystem is based upon the likes of steel, and that this metal is created by a process that involves iron ore and metallurgical coal.

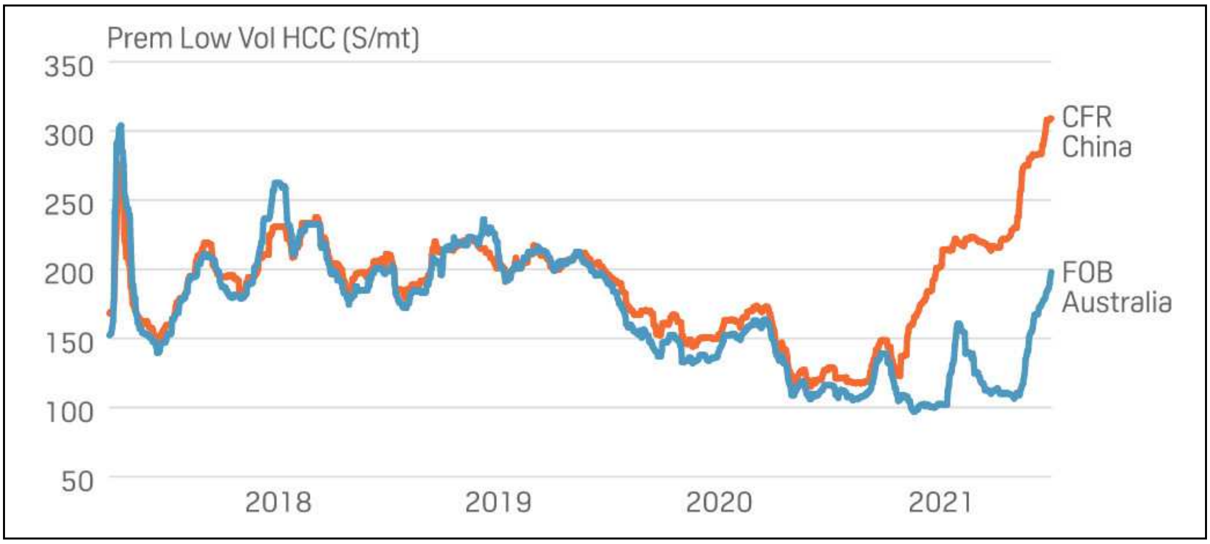
This common fallacy that lumps thermal coal with met coal is held by 99.9% of the population of the Western democracies and created a back wash against met coal that is proving difficult to counter. Nevertheless the trade in met coal goes on and most of the producers thereof "get it" though a proposal for a new met coal mine in the north of England has fallen afoul of the mass ignorance on the subject and allowed the NIMBYs to run amok.

Steel's Fortunes

Coking coal is joined at the hip with the steel industry. According to World Steel Association, 70% of steel produced today uses coal, and China is the most important part of the puzzle as it produces half of the total crude steel in the world. With China as the largest consumer of metallurgical coal, in recent years its rising crude steel output has pulled coking coal prices higher.

It was inevitable that, with the Commodities Supercycle being driven by the Chinese and the key underpinning of that Supercycle being steel, that coking coal should have been driven up by that economic phenomenon and then sucked back down as sentiment turned against bulk minerals and, indeed, all minerals after 2011.

Data from S&P (charted on the following page) shows a curious bifurcation in price between China and Australia. Of course, China has been in a huff towards Australia over the latter's refusal to suspend disbelief on the sources of the pandemic.



Source: S&P Global Platts

Recently Platts noted that there was a sharp 279% YoY increase in the spot transaction volume for the first half of 2021 for premium hard coking coal on an FOB Australia basis. The increase was driven mostly by strong European spot demand, especially over late Q1-early Q2.

An even more curious parting of the ways can be seen in the movement of the prices of met coal versus iron ore. As the following chart shows a bizarre inverse relationship has surfaced between the two key minerals in the steel-making process.

Source: S&P Global Platts

Indeed, coking coal has surpassed iron ore to become the most expensive raw material input for global steel makers with the benchmark Platts Premium Low Vol HCC hitting a 10-year high of $379/mt FOB Australia on 16th of September 2021.

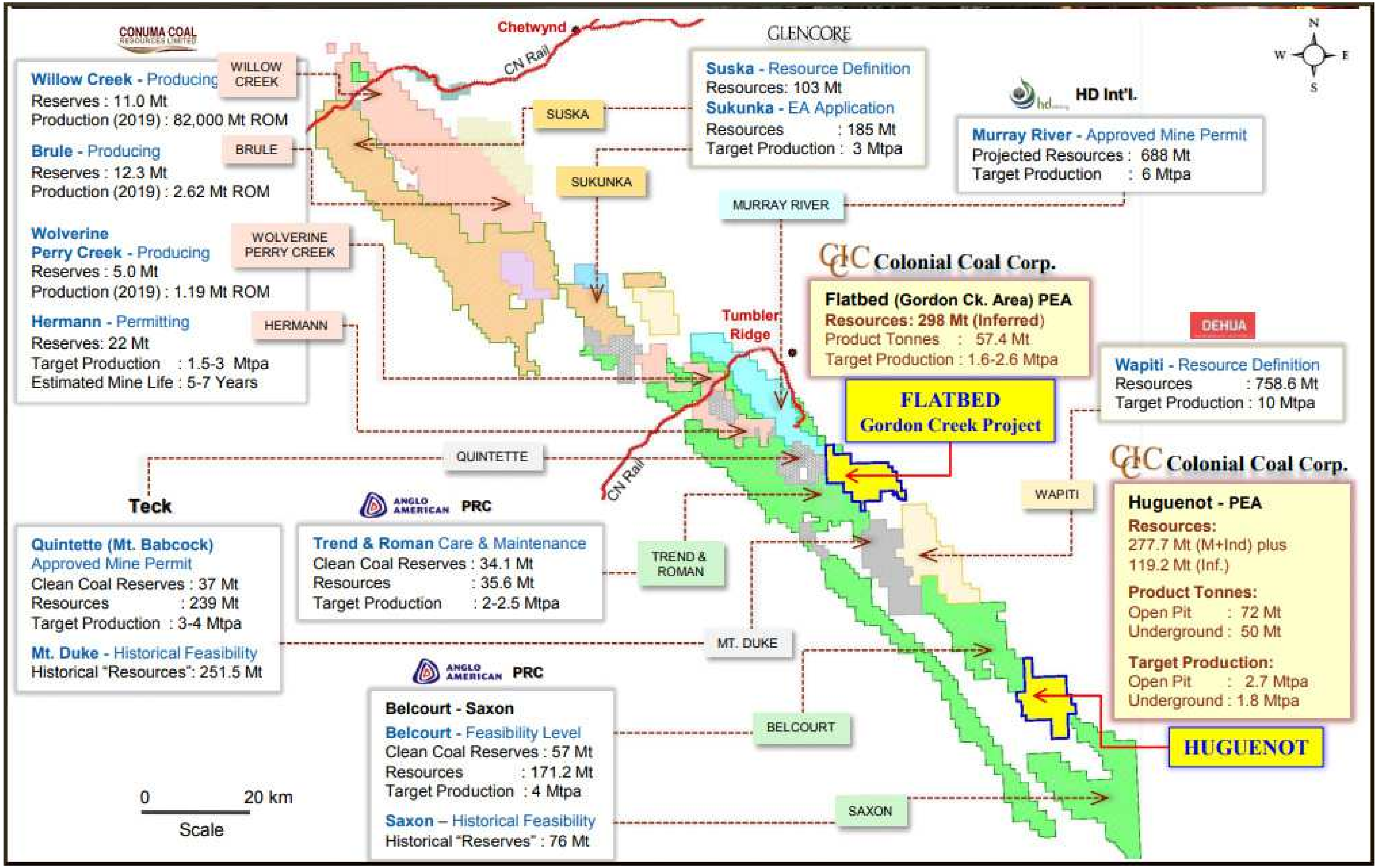
Back to Colonial Coal

Colonial Coal's portfolio consists of two projects, Flatbed and Huguenot, both in the prime postcode of the Peace River coal district. These are shown on the map on the following page in juxtaposition to their heavyweight neighbours.

These are clearly for sale either together or separately. Usually we eschew the type of developers that do not intend to move to production themselves but actually bringing a coal mine of this potential size to production is definitely only a task for the very resourced. Colonial's management team has form in wrapping up a package to deliver to a buyer in a plug-and-play format. The projects can stand alone due to their sheer size. For example, Huguenot, with a total of 397mn tonnes and a proposed production of between 3.5 and 5 million tonnes per annum, is one of the most substantial coal resources in the region. Meanwhile, Flatbed consists of 298 mn tonnes, all in the Inferred Resource category.

The shark fins started to appear in the water of late (obviously also did not get Greta's memo) and the stock took off in September with an exponential rise then retreated and then gained a second wind. From a low in June of just above 50cts the stock nearly touched $1.80 in the last month.

China is no longer perceived as the sole driver of demand in the steel space with India as a rising power. Steel production has continued apace in the emerging economies, particularly the rising star, India, and there has been little done in recent times to add to future reserves to service need when the global economy picked up.



CONUMA COAL
Chetwynd
CN Rail
GLENCORE
HD Int'l.
Willow Creek - Producing
Reserves : 11.0 Mt
Production (2019) : 82,000 Mt ROM
WILLOW CREEK
Brule - Producing
Reserves : 12.3 Mt
Production (2019) : 2.62 Mt ROM
BRULE
Wolverine
Perry Creek - Producing
Reserves : 5.0 Mt
Production (2019) : 1.19 Mt ROM
WOLVERINE PERRY CREEK
Hermann - Permitting
Reserves: 22 Mt
Target Production : 1.5-3 Mtpa
Estimated Mine Life : 5-7 Years
HERMANN
SUSKA
SUKUNKA
Suska - Resource Definition
Resources: 103 Mt
Sukunka - EA Application
Resources : 185 Mt
Target Production : 3 Mtpa
Murray River - Approved Mine Permit
Projected Resources : 688 Mt
Target Production : 6 Mtpa
MURRAY RIVER
Colonial Coal Corp.
Flatbed (Gordon Ck. Area) PEA
Resources: 298 Mt (Inferred)
Product Tonnes : 57.4 Mt
Target Production : 1.6-2.6 Mtpa
Tumbler Ridge
FLATBED
Gordon Creek Project
DEHUA
Wapiti - Resource Definition
Resources : 758.6 Mt
Target Production : 10 Mtpa
WAPITI
QUINTETTE
Teck
ANGLO AMERICAN PRC
Quintette (Mt. Babcock)
Approved Mine Permit
Clean Coal Reserves : 37 Mt
Resources : 239 Mt
Target Production : 3-4 Mtpa
Mt. Duke - Historical Feasibility
Historical "Resources": 251.5 Mt
Trend & Roman Care & Maintenance
Clean Coal Reserves : 34.1 Mt
Resources : 35.6 Mt
Target Production : 2-2.5 Mtpa
TREND & ROMAN
MT. DUKE
Colonial Coal Corp.
Huguenot - PEA
Resources:
277.7 Mt (M+Ind) plus
119.2 Mt (Inf.)
Product Tonnes:
Open Pit : 72 Mt
Underground : 50 Mt
Target Production:
Open Pit : 2.7 Mtpa
Underground : 1.8 Mtpa
HUGUENOT
ANGLO AMERICAN PRC
Belcourt - Saxon
Belcourt - Feasibility Level
Clean Coal Reserves : 57 Mt
Resources : 171.2 Mt
Target Production : 4 Mtpa
Saxon – Historical Feasibility
Historical "Reserves" : 76 Mt
BELCOURT
SAXON
0 20 km
Scale
N S E W

A Proven Formula of Building Value

The management at Colonial Coal are no strangers to the "build it and they will come" philosophy of mining evolution. The team built up and advanced the core metallurgical coal assets belonging to Western Canadian Coal and Northern Energy & Mining (NEMI) during the go-go years of the Commodity Supercycle. Those assets were acquired for an eye-watering multi-billion dollar price. In the more subdued environment of the current decade the team has sallied forth to repeat the building process. Underlying met coal prices initially looked challenging but now have returned to robust good health and yet the investor universe is still confused between met coal and thermal coal in the age of global warming. There is no replacing met coal in the steel making process.

Much to the pundits' surprise coking coal has risen from the dead and yet few, besides Colonial, have focused on creating a new pipeline of projects to meet this opportunity.

A Densely Populated Field

Although coal was first discovered in the Peace River region in 1793, subsequent operations were limited to small tonnages to serve local needs. The expansion of steel production in the mid-1960s, led by the Japanese steel mills, stimulated worldwide exploration for coking coal. In western Canada, exploration focused largely on coal deposits located within the Rocky Mountain Foothills of British Columbia and Alberta.

By the mid-1970s, most of the land within the Peace River Coalfield that contained a potential for surface and underground mineable coal had been acquired by various mining and O&G companies. In northeastern British Columbia, this work culminated in the opening of the Quintette and Bullmoose coal mines which operated from 1983 to 2000 and 1984 to 2003, respectively.

The map below shows the current coal land status of the majority of the district, with Colonial Coal's properties highlighted in yellow.

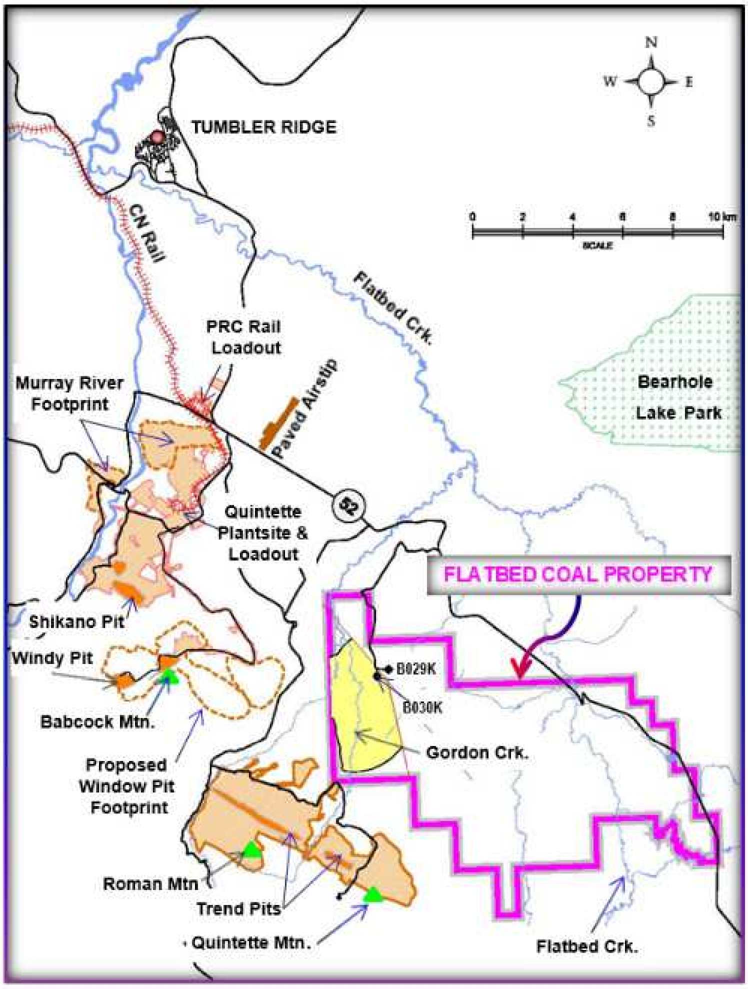
The Flatbed Project

The Flatbed Coal project covers a total area of 9,607 ha and consists of one contiguous block of eight coal licenses. The property is located within the Peace River Coalfield, approximately eight and 10 kilometers from the existing Quintette and PRC (Trend-Roman Mine) loadouts, respectively and approximately 27kms south-southeast of the town of Tumbler Ridge.

Flatbed - Gordon Creek - Resource

Seam ID	Formation	Category	Tonnes mn
B	Gates	Inferred	52.2
D	Gates	Inferred	36.6
E	Gates	Inferred	19.1
F1	Gates	Inferred	21.0
F2	Gates	Inferred	49.2
G	Gates	Inferred	34.8
J	Gates	Inferred	54.2
K	Gates	Inferred	30.9
	Total	**Inferred**	**298.0**

The position of the property with respect to population centres, roads, rail lines, coal mines and other major coal deposits is shown in the map at the right.



Flatbed is located adjacent to Anglo-American's Trend mine (under care and maintenance since January 2015), Teck's proposed Window open pit (Mt. Babcock, Quintette), and close to HD Mining's advanced underground coal mining project at Murray River.

Flatbed Resource

A NI43-101 compliant Resource estimate on the Gordon Creek area of the Flatbed property was prepared by Norwest in January 2018. Using a 1.0m minimum seam thickness, and depth of cover limit of 900m, an in-situ underground mineable coking coal Inferred resource of 298mn tonnes was estimated.

From the results of the initial coal quality testing program on Gates Formation coal seams in the Gordon Creek area, Seams B to G would be marketed as hard coking coals while Seams J and K, meeting the requirements of semi-soft coking coals, would be better marketed as premium PCI coals.

Analytical results indicated that the Gates coal seams within the Gordon Creek area are metallurgical coals and coal from Seams B to G would yield a coking coal product after beneficiation in a wash plant at an 8% to 9% ash air dried basis (adb) product range.

The Flatbed PEA

In late 2018 the company reported the results of a PEA for the Gordon Creek area of the Flatbed property. The NI 43-101 compliant PEA was prepared by Stantec Consulting Services.

The PEA is based on a conceptual underground mine plan that targets 111.6mn run-of-mine tonnes of resource, with a yield of 51%, producing 57.4mn tonnes of clean coal over a mine life of 30 years. Seam E is not mined and Seams F1 and F2 are combined to form one mining section referred to as Seam F.

In full mine operation, projected clean coal production ranges from 1.6mn tonnes per annum to 2.6mn tonnes per annum, averaging approximately 1.9mn tonnes per annum.

Economics

The PEA, utilising an exchange rate of US$1.00 equals CAD$1.30, estimated that the Gordon Creek project has an indicative after-tax (and royalty) net present value of US$690.5mn (CAD$897.7mn). This calculation used a 7.5% discount rate, and produced an IRR of 24.4%, based on a weighted average coking coal price of US$164.80 per tonne and a premium PCI coal price of US$140.50 per tonne.

Pre-production capital cost for the underground mine is estimated at US$300mn (CAD$391mn), with additional sustaining capital of US$406mn (CAD$528mn) over the life-of-mine.

The payback of initial capital is estimated to be within three years from the start of coal production.

Opex

Total costs FOB port, including direct mine site costs, offsite costs and indirect costs are estimated at US$80.91 (CAD$105.19) per tonne. This includes mine site costs of US$41.16 per tonne, offsite costs of US$25.42 per tonne for trucking, rail car loading, rail and port charges, and indirect costs of US$14.33 per tonne for mineral taxes, royalties and corporate overhead.

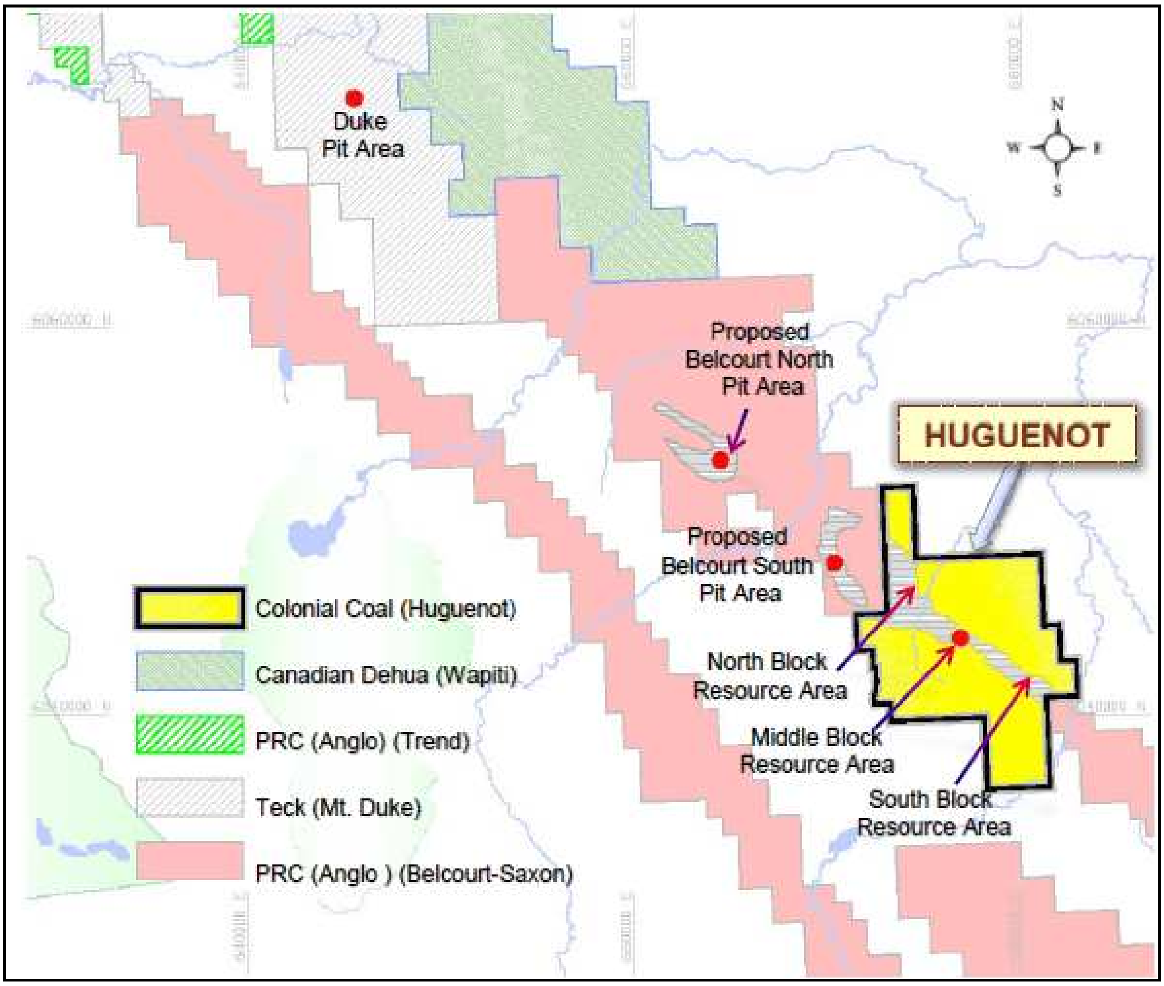
The Huguenot Project

The Huguenot Coal Project covers a total area of 9,531 ha and consists of one contiguous block of 17 coal licenses that encompass previously explored deposits.

The property is located approximately 125 road-km from the currently idled Quintette mine load-out and 132 road-km south-southeast of the town of Tumbler Ridge, and is amenable to open pit and underground mining. The coal quality is a premium, hard coking coal (HCC) product.

The Huguenot property covers part of the old Belcourt property initially owned by Denison Mines Limited, but later joint ventured with Gulf Canada Resources. Exploration of the property began in 1970 and carried on until the early 1980's. This work defined three major targets for open pit mine development; two (at that time called Red Deer and Holtslander) are located north of the Huguenot property and one (Omega) lies to the south.

More recent exploration on these three areas was carried out in 2005 and a feasibility-level study supporting surface mines on the Belcourt North (Red Deer) and Belcourt South (Holtslander) projects was completed in January 2009.



The southern end of the Belcourt South pit lies just 477m north of the Huguenot property boundary.

Huguenot Resource

A PEA on the Huguenot property was prepared by the specialist coal consultants, Norwest Corp., in September 2013. It included HCC resource estimates for all three Blocks, categorized as mineable using either surface or underground mining methods.

Total in-situ surface mineable resource estimates using a 0.60m thickness cut-off are: 131.95mn tonnes of Measured and Indicated (Measured = 96.2mn tonnes; Indicated = 35.75mn tonnes), plus 0.53mn tonnes of Inferred.

Total underground resource estimates using a 1.5m minimum thickness are: 145.73mn tonnes in-situ Measured and Indicated (Measured =18.85mn tonnes; Indicated = 126.88mn tonnes), plus 118.66mn tonnes of in-situ Inferred resources.

The Huguenot HCC open-cut and underground resource estimates are summarized in the table below:

Huguenot Resource Estimate

	Open-Cut				Underground			
	Measured Mt	Indicated Mt	M & I Mt	Inferred Mt	Measured Mt	Indicated Mt	M & I Mt	Inferred Mt
North	58.32	7.91	66.23		7.18	30.41	37.59	86.84
Middle	37.88	9.02	46.90	0.53	11.67	19.5	31.17	1.58
South		18.82	18.82			76.97	76.97	30.24
Total	96.2	35.75	131.95	0.53	18.85	126.88	145.73	118.66

The Huguenot PEA

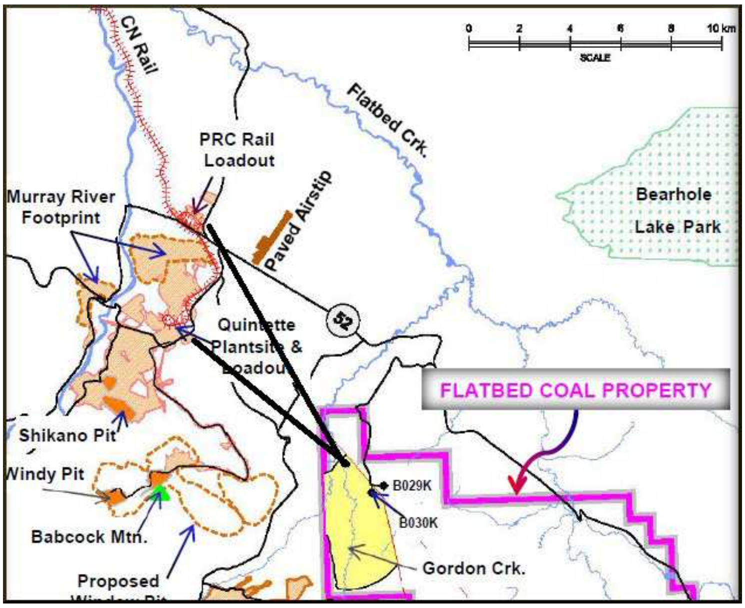
The updated Huguenot PEA dates from 2018, being a revision of the initial version dating from 2013. Over time, the economics have been strengthened by the CAD moving from parity with the USD at that time to a significant discount at the current time. Therefore, the updated PEA uses an exchange rate of US$1.00 equals CAD$1.30.

- Projected mine life of 31 years, with the open pit (Years -1 - 14) and underground (Years 3 - 31) operating simultaneously during Years 3 – 14
- Total projected clean coal production of 89mn tonnes over a mine life of 31 years
- The Huguenot Project has an indicative after-tax (and royalty) net present value of US$1.166 bn (CAD$1.516 bn), using a 7.5% discount rate, and an IRR of 33%, based on a coal price of US$172 per tonne
- The financial analysis suggested that the break-even price is less than US$116, US$120, and US$125 per tonne for discount rates of 5%, 7.5% and 10%, respectively
- The PEA indicates that for a 15% IRR, a minimum coal price of US$135 would be required

Logistics

Production from Huguenot and Flatbed would be shipped by rail to export terminals on the west coast of British Columbia. The rail lines out of the Peace River Coalfield are operated by a Class I Canadian carrier (CN Rail, largest railway company in Canada) and have available capacity to support future production from Huguenot and Flatbed.

The PEA on the Gordon Creek deposit assumed that the output would be trucked 16km by road to the existing rail line south of Tumbler Ridge. The rail line would be accessed via a loadout located in the area of an existing coal loadout operated by Peace River Coal. Costs for trucking product coal to the proposed loadout were included in the project's operating cost projections.

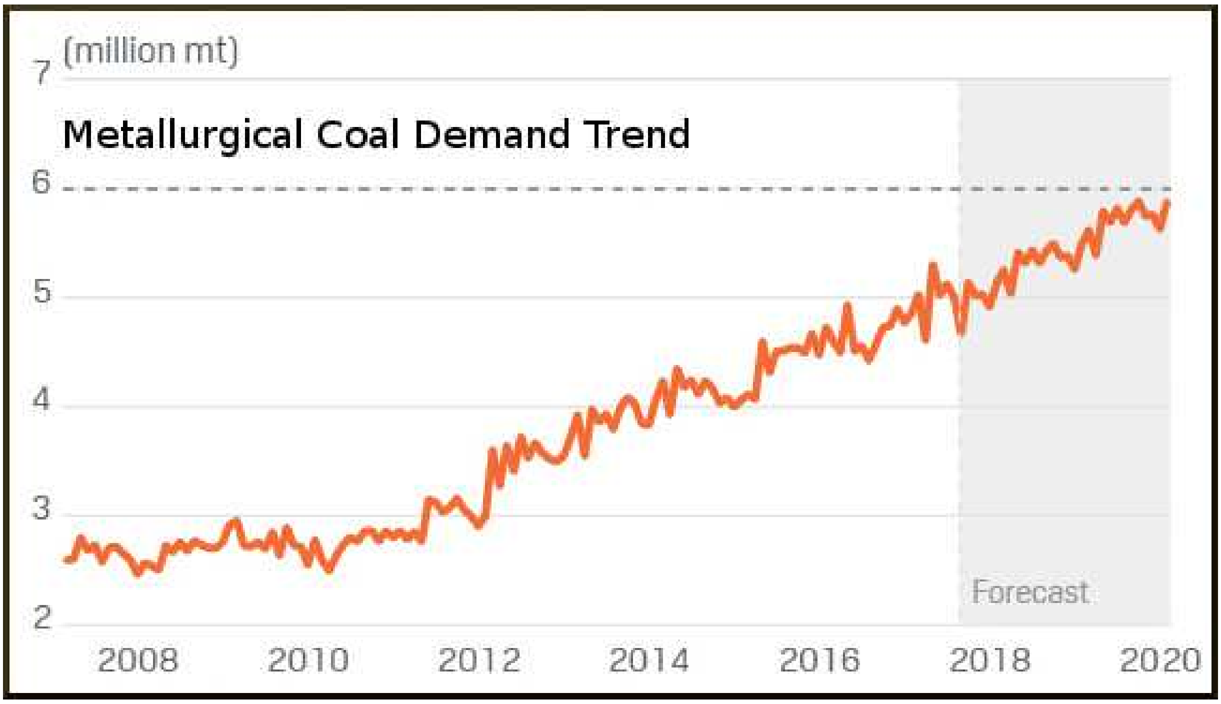


From the existing rail loadouts, coal is hauled by rail approximately 1,000 km to the Ridley Terminal in Prince Rupert. Coal from Huguenot would require an additional 85km rail haul from a rail load out at the proposed plant site, while coal from Flatbed would only require a spur line a few kilometres in length to connect to existing rail.

The Ridley Terminal is a deep water port with a total coal capacity of 18mn tpa. It has one of the deepest, ice-free natural harbours in the world and is 100% owned by the Government of Canada. The port is capable of supporting cape-size vessels (i.e. 250,000 DWT).

Coking Coal Price Dynamics

As mentioned earlier coking coal is joined at the hip with the steel industry and the vibes in that space have been confusing to say the least in recent years, with perceptions that China must eventually reach peak steel production/demand, environmental factors impinging (the green revolution) and then the years of the trade war (not gone but now *sotto voce*). Despite this the steel industry is not looking as battered as one might expect and reports of its death are much exaggerated, to paraphrase Oscar Wilde. Indeed, 2020 into 2021 have proven to be remarkably strong despite the backwash from the global pandemic.



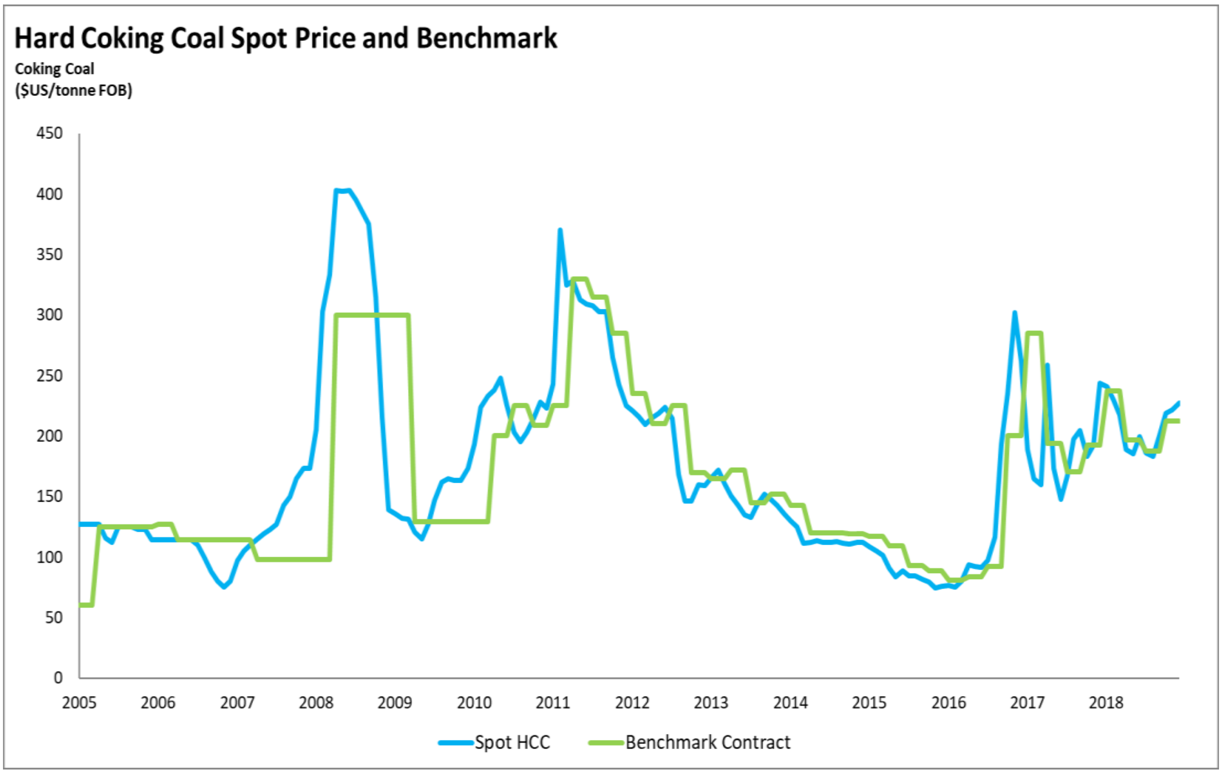
Source: World Steel, S&P Global Platts

According to World Steel Association, 70% of steel produced today uses coal, and China is the most important part of the puzzle as it produces half of the total crude steel in the world. With China as the largest consumer of metallurgical coal, in recent years its rising crude steel output has pulled coking coal prices higher.

It was inevitable that, with the Commodities Supercycle being driven by the Chinese and the key underpinning of that Supercycle being steel, that coking coal should have been driven up by that economic phenomenon and then sucked back down as sentiment turned against bulk minerals and, indeed, all minerals after 2011.

As can be noted from the chart on the following page, HCC prices have risen from the dead three times in the last 15 years. The first was in the run-up to the great crash of 2008, the second wind came a few years after that. Then a long five year slump was only broken by an upsurge in 2016.

The 2016 move was attributed to rising coking coal demand in China, compounded by new restrictions on the coal mining industry there, which reduced domestic supply and put further upward pressure on metallurgical coal prices. At the time, Metal Bulletin reported that the Chinese government implemented a cap on the number of working days for miners, which curbed domestic production of metallurgical coal. This helped push the coking coal price higher from mid-2016 with a trebling which then prompted the inevitable pullback.



The "trade war" between China and the US may now be in abeyance (or gone underground) but it did the Chinese government to provide further economic support to domestic industries, especially the infrastructure sector, which supported steel production (even during the worst pandemic months) and ultimately helped coking coal demand.

We reiterate thought that we are more inclined to a view that the Chinese economy's growth rate has been long overstated and may in fact have been in low- (to no-) growth mode for several years now.

Gina on the Prowl?

Gina Rinehart, Australia's richest person, has been one of the principal wavemakers in met-coal assets in recent years. In 2019 as she waded into the space with an aggressive bid for a Canadian player, This move introduced Australia as a potential new source of predators, where they had previously only prowled on their own patch. Ms Rinehart is nothing if not resourced as Forbes puts her estimated net worth at AUD$14.8bn (US$10.35bn). Her vehicle, Hancock Prospecting had more than $3bn in cash reserves at the point where it made its latest takeover move.

In February of 2019, Hancock Corporation, a wholly-owned subsidiary of her vehicle Hancock Prospecting, launched an all-cash offer worth up to $591mn to acquire the remaining shares in ASX-listed coal explorer Riversdale Resources, which has a prominent position in the Western Canadian coalfields with its Grassy Mountain coal project in Alberta forecast to produce 93 million tonnes of coking coal over a 24-year mine life. After a series of bids and counter bids, Hancock ended up acquiring Riversdale for around AUD$725mn (USD$491mn).

Grassy Mountain was viewed by some commentators as a good strategic fit for Hancock adding to its existing iron ore interests in Hope Downs, Roy Hill and Atlas Iron. However Grassy Mountain is not proving to be as cut-and-paste as it might seem with a joint federal-provincial review panel denying the permits needed by the proposed mine after ruling the environmental consequences would likely outweigh the economic benefits.

The panel's decision was largely based on concerns about Selenium, a contaminant commonly found in coal mines that can be toxic to fish. The element is found in virtually all the coal seams in Alberta that are currently being explored and considered for mine development.

Riversdale Resources says in a statement it's consulting with lawyers about the decision and ploughing through the 680-page report to better understand its conclusion. Meanwhile the ruling against the mine was welcomed by opposing environmental groups and the Alberta government claimed that it was proof that the province's regulatory system works.

This has thrown a serious spanner in the works of Rinehart's plans. Acquisition of one, or both, of the Colonial Coal assets would prove useful interim actions to maintain her forward momentum an show the Alberta government that they risk being left behind if they do not show more flexibility.

Resetting the Valuation Bar

The Riversdale transaction is useful in two respects. Firstly it adds Australians to the potential buyers list for BC coal assets, which has hitherto not been the case. Secondly it gives a transaction to compare with Colonial's assets. The most obvious comparison is between The Grassy Mountain asset and Colonial's Huguenot. Grassy Mountain has a projected 93 million tonnes of product coal over its currently proposed 24-year mine life while Huguenot has a similar(ish) total projected clean coal production of 89mn tonnes over a mine life of 31 years.

It is also notable that with sulphur content at 0.40%, the HCC product from Huguenot is expected to be among the lowest sulphur HCC from Canada, which will positively affect the valuation of the coal.

Then Flatbed gives an extra kicker on another 60% (producing 57.4mn tonnes of clean coal over a mine life of 30 years).

Thus if Riversdale is "worth" slightly under USD$500mn, then Colonial Coal's project pairing is worth at least USD$700mn and quite possibly more as it is significantly nearer to Pacific ports and Huguenot has a top-grade HCC product.

Possible Outcomes

In the past we have employed a measure to assess the potential dollar value of asset sales of a rough US$1 per tonne of HCC in the ground. This gave a valuation of USD$278mn to Huguenot on just the M&I resource and potentially another US$119mn when applying the same metric to the Inferred resources. Using the same approach at Flatbed (where the entire resource is Inferred) then one would add a further $298mn in value.

With the current market cap around CAD$400mn (USD$325mn) this would imply that the stock is trading at way less than half of the combined value of Huguenot and Flatbed, using the very conservative $1 per in-situ tonne metric.

It is also useful to consider the similarities between now and when the previous Western Coal and NEMI deals were consummated. A number of years have gone by since the last fevered moment in the coking coal space but it is interesting to look at some differences between now and then:

- In 2010, coking coal was at US$140 per tonne and the US Dollar was at parity with the Canadian dollar
- In 2019 coking coal is around US$200 per tonne and the US dollar is at $1.33 to the Canadian dollar

The move in price and currency juices up the valuations at which asset sales are likely to be transacted compensating for the absence of the euphoria that existed at the tail end of the Supercycle period when the last bout of transactions were undertaken.

It should also be remembered that back at the end of the last decade it was widely posited that the acquirers would be steel mills in Asia or at least big industrial mining groups, particularly from China while, in reality, the most aggressive bidders were Western mining groups bent on accumulation.

This time around it will be both the Western groups (with Australians now in the mix) needing to replace depleted reserves to remain in the game, and the end-users, who will most likely slug it out to get positioned in new developments.

Risks

There are a number of potential risks that should be taken into consideration:

- Global economic conditions deteriorate due to a rising interest rate scenario or slowing growth or both

- ✘ That the coking coal price moves sharply lower
- ✘ An acquirer fails to materialise

The main dangers for Colonial Coal are the co-related risks of a slower global economy (with steel production slackening) and a consequent slide in prices for coking coal if steel industry demand softens.

It is not a fanciful projection to posit that insufficient projects will appear to satisfy coking coal demand as there has been underinvestment for some years now and new districts are not being identified (if they indeed exist). If realized, this scenario would extend the upward price cycle, making a campaign by majors to mop up independents such as Colonial Coal more likely. Thus the prospect of predators sitting on their hands is unlikely.

As for an acquirer failing to materialise, one may wonder why the sharks are circling? It seems the feeding frenzy is already underway.

Conclusion

Colonial Coal's management team has patiently worked their assets through the most recent mining lull with the goal of producing a similar feat to that which they pulled off in 2010 and 2011. As we have noted before Colonial Coal looks ripe for "slicing and dicing" with Huguenot or Flatbed or both being eminently saleable assets now that both have a PEA in hand. Finally the penny has dropped with investors and the stock is being nipped at by piranhas, if not sharks, with an attendant uplift in price and volumes.

The long-awaited payday may be approaching, rewarding management's persistence. Through the long drought of 2011-2016, when investor interest in mining was at a multi-decade low and when certain metals/minerals were regarded as untouchable, Colonial Coal continued to advance its collection of synergistic assets in British Columbia with the goal of servicing the still burgeoning Asian demand for coking coal.

Originally we had thought that the buyers of the assets might be Indian, as the equation for delivery from BC to India is viable compared to the distance to Australian sources. Now we are beginning to suspect that Australian buyers may be stalking Colonial. If they were to make a move (and we should not discount the mighty Gina Rinehart after her travails elsewhere) then the Indians would be doubly over a barrel having to negotiate with the Australians or the Australians. Not much choice there.

This is where Colonial comes to the attention of those looking for the next addition to the supply equation.

Even using a very conservative valuation of US$1 per in-situ tonne at Huguenot and Flatbed the stock is trading at one half of realizable value of its two main assets.

The intriguing question for Colonial's watchers at the moment is whether this is just initial skirmishing (with battle to be joined over the longer term) or indeed the "beginning of the end" with the sharks fighting it out for the tasty morsels in a competitive battle, such as management have been able to engineer in the past.

We reiterate Colonial Coal as a **LONG** in our Model Mining Portfolio and we are lifting our 12-month target price from $1.10 to $3.55 per share, but in a takeover scenario the expected price might be $5 or higher.

Important disclosures

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