

HALLGARTEN & COMPANY

Initiation of Coverage

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Colonial Coal International

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

Strategy: LONG

Key Metrics	
Price (CAD)	\$0.370
12-Month Target Price (CAD)	\$1.10
Upside to Target	197%
12 mth high-low	\$0.08-\$0.42
Market Cap (CAD mn)	\$55.02
Shares Outstanding (millions)	148.7
Fully Diluted (millions)	183.4

Colonial Coal Intl

Nascent Coking Coal Giant with All the Moving Parts

- + Two hard coking coal (HCC) projects strategically positioned in western Canada to service Asian steel producers
- + Management has past form in positioning coal assets for sale to the highest bidder at the most propitious moment
- + The price of coking coal has staged a strong rebound in the last two years now standing at almost twice the level of its nadir in mid-2016
- + A PEA was published in 2013 on the Huguenot property, with an updated PEA imminent
- + Management team has experience in positioning projects/companies either for acquisition by larger players, entering into joint ventures, or taking projects to production stage
- + Potential port acquisition in British Columbia represents a move into infrastructure that taps management's historical skillsets
- ✗ When it comes to the strategy of project/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 impacting production of steel and thus coking coal prices

Building a Coal Major

The management at Colonial Coal are no strangers to the “build it and they will come” philosophy of mining evolution. Over the booming years of the Commodity Supercycle of last decade the team built up and advanced the core metallurgical coal assets belonging to Western Canadian Coal and Northern Energy & Mining (NEMI). Western was later bought by Walter Energy 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.

Of course the landscape is different in this decade. The Supercycle has cooled, China is no longer perceived as the sole driver of demand, and investment capital is not as easy to come by. However, 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.

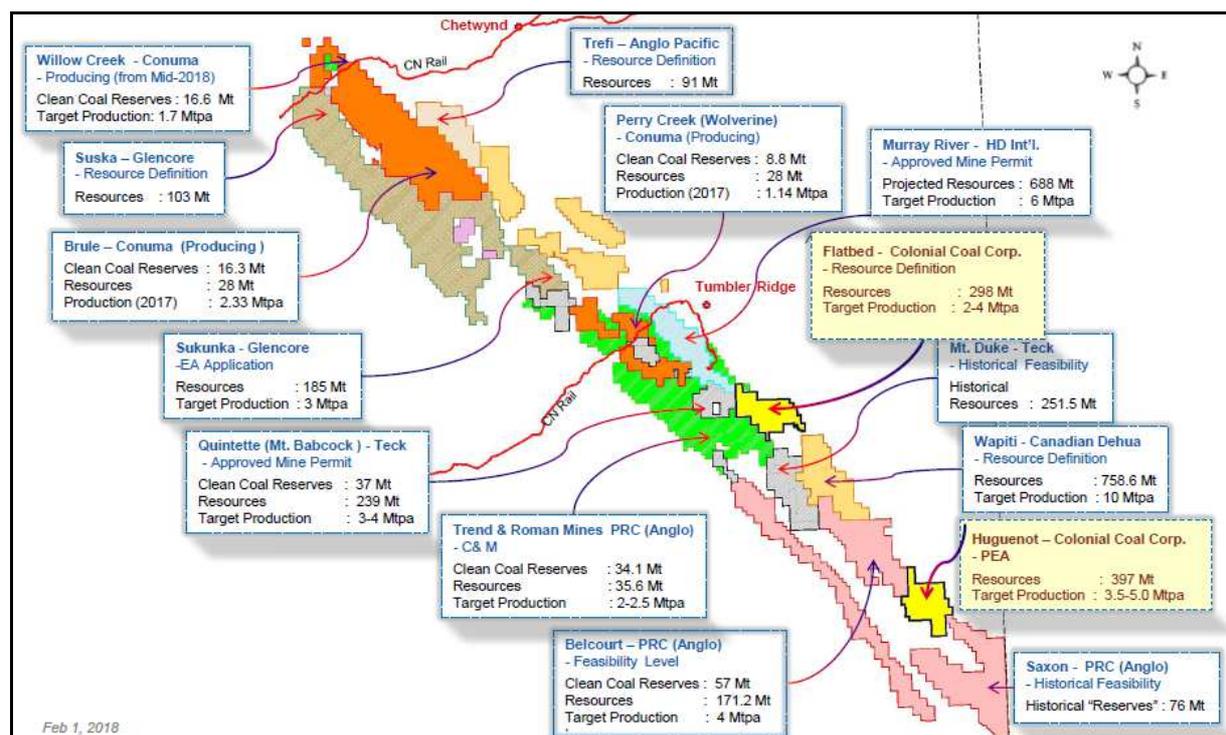
Much to the pundits' surprise coking coal has risen from the dead and yet few, besides Colonial, have

focused on creating a new pipeline of projects to meet this opportunity. In this initiation of coverage we shall review the progress at Colonial Coal, the prospects for coking coal, and possible takeout scenarios.

Coal in British Columbia

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.



From Slump to the Supercycle and Back

During a period of depressed coal prices in the mid-1990s, many coal licenses were dropped leaving ground available for later acquisition which, in the late 1990’s, enabled a team led by David Austin to acquire the original, core, coal licenses on which both Western and NEMI were founded. The Belcourt,

Perry Creek/Wolverine, Brule and Willow Creek properties were held by Western, while Saxon and Trend/Roman were held by NEMI. The Belcourt and Saxon properties were eventually transferred to Belcourt Saxon Coal Limited a joint venture company owned by Western and NEMI. Coal mining in the Tumbler Ridge region re-started in 2006 with the opening of the Perry Creek (Western) and Trend mines (NEMI), with the Brule mine (Western) entering production in 2007. In late 2010 Western was bought-out by Walter Energy (of which more anon) while in 2011, NEMI's coal properties were acquired by Peace River Coal Inc. (PRC), a subsidiary of Anglo American PLC. Also, beginning in 2011 Xstrata started building its presence in the Peace River Coalfield initially by acquiring First Coal Corporation for US\$153mn and then by purchasing Cline Mining Corporation's Lossan coal property for US\$40mn. In early 2012, Xstrata purchased the Sukunka property from Talisman Energy for US\$500mn. Xstrata followed this by selling a 25% interest in all of their Peace River Coalfield assets to JX Nippon Oil and Energy Corp. for US\$425mn.

Around this time several Chinese mining companies also began to build up their presence in the Peace River Coalfield, namely CKD Mines Co. (the Gething Project), Canadian Dehua Int'l Mines Group (the Wapiti Project) and HD Mining International (the Murray River Project). The most advanced of these projects is HD Mining's proposed Murray River underground coal mine.

The downturn in coal markets in 2013 through 2016 caused all of the aforementioned mines to be put into care and maintenance. In 2017, the Brule and Perry Creek mines re-started operations under the ownership of Conuma Coal Resources, who bought the wholly-owned coal assets of Walter, for an undisclosed amount, out of bankruptcy in 2016. The Belcourt Saxon properties previously operated as a joint venture between Walter and PRC are now owned entirely by PRC.

Huguenot

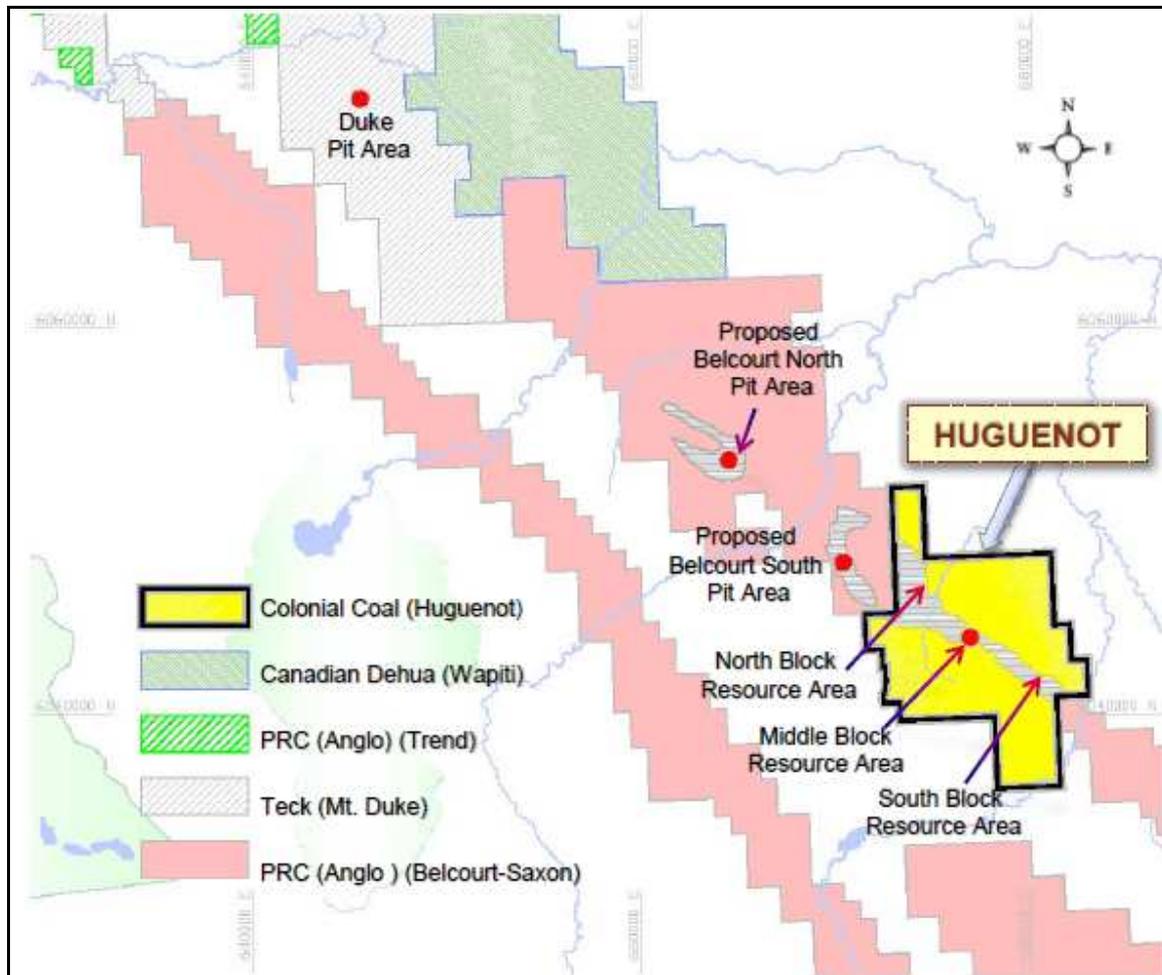
The Huguenot Coal Project covers a total area of 9,531 ha and consists of one contiguous block of 17 coal licenses that encompass previously explored deposits. The property is located approximately 125 road-km from the currently idled Quintette mine load-out and 132 road-km south-southeast of the town of Tumbler Ridge, and is amenable to open pit and underground mining. The coal quality is reflective of a premium, hard coking coal (HCC) product.

History

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.

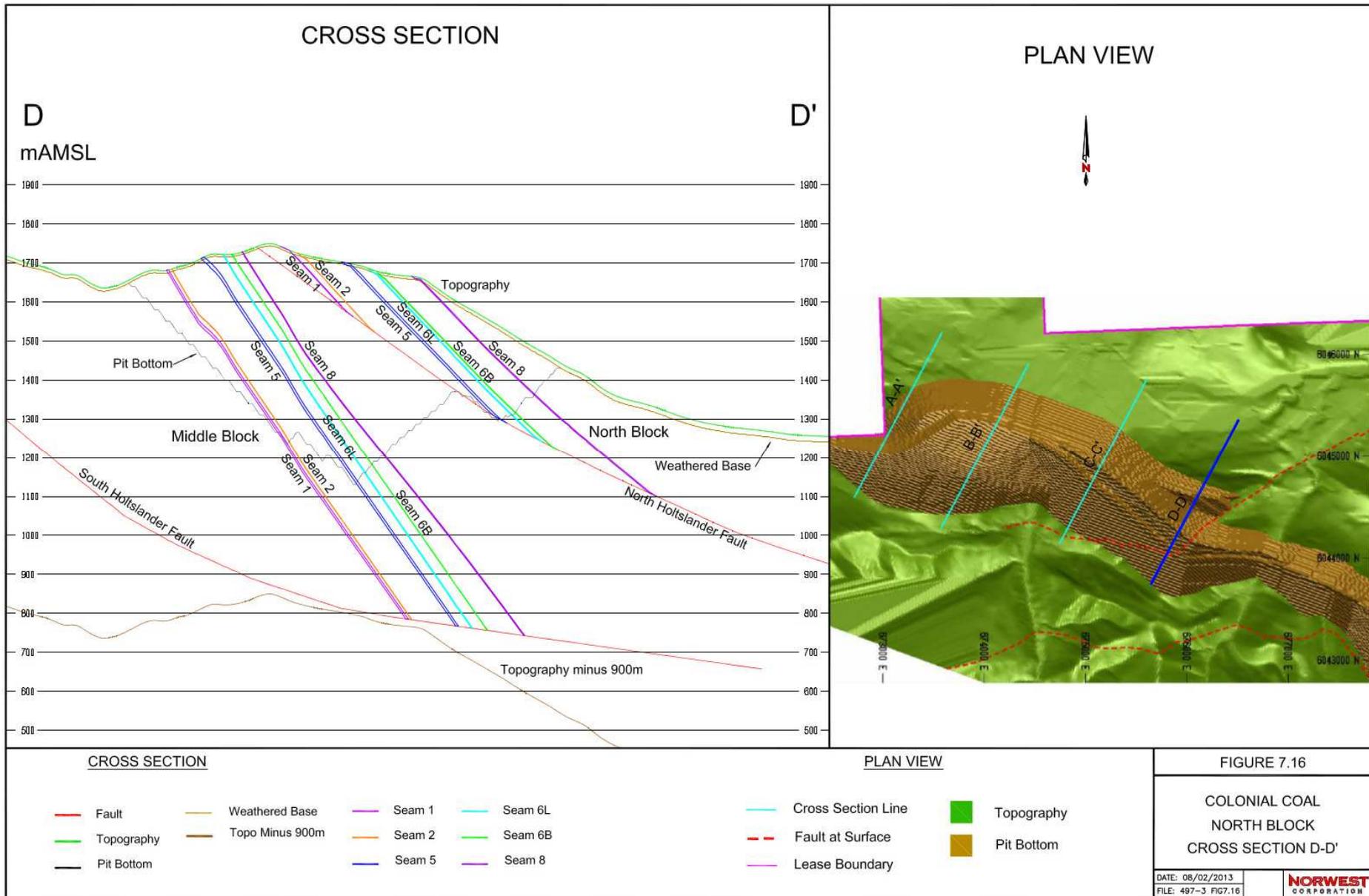
The map below shows the relationship of Huguenot to these other projects.



Geology

The Huguenot Coal Project lies within a belt of Mesozoic strata that form part of the Rocky Mountain Foothills of northeastern British Columbia. The stratigraphic succession broadly represents an alternating sequence of marine shale and marine and non-marine clastic lithologies. These strata were uplifted during the Laramide Orogeny, resulting in the development of thrust faults and intense folding.

The coal seams of greatest potential are found within Lower Cretaceous strata of the Gates Formation. At Huguenot, the Gates Formation contains ten coal seams and/or coal zones numbered, in ascending order, from 1 to 10. The thickest is Seam 5, which ranges between 2.59m and 9.71m (but is typically between 5m and 6m thick). A cross-section illustrating the North Block is shown on the following page:



The property consists of mostly easterly dipping strata that lie within three main structural blocks; each block being separated from the other by thrust faults. The North Block is underlain by the Holtslander North Thrust and is located in the north of the property. It contains near-homoclinal, moderate, northeasterly to easterly dipping, coal measures. The Middle Block is carried on the Holtslander South Thrust. Strata dip northeasterly throughout most of this thrust sheet. In this block, strata have moderate dips with localised steepening in the center of the area. In the south east of the property the South Block underlies the Holtslander South Thrust. Here, the strata are steep, easterly-dipping to slightly overturned and form the eastern limb of an asymmetric anticline, the fold axis of which defines the western limit of the coal measures.

Exploration

Within the area now covered by the Huguenot property, a total of eight diamond drill holes (2,451m), approximately 138 hand trenches and extensive geological mapping were completed as part of several helicopter-supported exploration programs conducted between 1976 and 1979.

Exploration carried out by Colonial from 2008 to 2012 included rotary, diamond and large diameter drilling along with mechanical and hand trenching and geological mapping. A summary of the 1976 to 2012 exploration activities conducted at Huguenot is shown in the table below.

Huguenot - Summary of Exploration Activities

	Air-Rotary Drill Holes	Diamond Drill Holes	Large Diameter Drill Holes	Mechanical Trenches	Hand Trenches
1976-1979	-	8 (2,451m)	-	-	138
2008	17 (1,623m)	-	10 (422m)	19	36
2011	16 (3,006m)	13 (3,399m)	4 (327m)	-	-
2012	11 (602m)	6 (964m)	19 (898m)	-	5
Total	44 (5,231m)	27 (6,814m)	33 (1,647m)	19	179

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.

Within the proposed surface mine areas between eight and 10 coal seams that meet the 0.60m thickness cut-off, will be targeted for mining. In the proposed underground mine area four seams that meet the 1.5m minimum thickness cut-off, will be targeted for mining. 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

PEA Outcomes

First we would note that the PEA dates from 2013 so is somewhat outmoded by the passage of time. However it still provides a good indication of the project economics. An updated PEA is underway and we expect to publish an update of this review once it is completed and made public.

It is important to note that the 2013 study was conducted at a time when the Canadian dollar was at par value with the US dollar. The key financial metrics of the 2013 study were:

- ✓ An indicative after-tax (and royalty) NPV of US\$1.1bn at a 7.5% discount rate at a base-case coal price of US\$192.50 per tonne
- ✓ Base coal price used of US\$192.50 per tonne
- ✓ CapEx of US\$310mn for the surface operation facilities (including wash plant and camp) plus certain infrastructure items
- ✓ Pre-production capital cost for the proposed underground mine is estimated US\$387mn including a 15% contingency allowance, with additional sustaining capital of US\$186mn over the life of the mine
- ✓ Payback of initial capital is estimated at eight years
- ✓ Cash operating costs are estimated at US\$77.84 per tonne clean coal (capital cost contingency only) at the mine loadout. This figure increases to US\$89.52 per tonne clean coal if an operating cost contingency is also applied

- ✓ Average direct cost plus all offsite costs (i.e. FOB cost) is US\$122.51 per clean tonne (with a contingency on capital costs only) and US\$134.19 per clean tonne (with contingencies on capital and operating costs)

The operating metrics were:

- ✓ 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
- ✓ Projected clean coal production from combined surface and underground mining operations ranges from 1.4mn tpa to 5.9mn tpa, averaging approximately 3mn tpa
- ✓ Projected clean coal production from the open pit averages approximately 3.2mn tpa (ranging from 1.5mn tpa to 4.3mn tpa) in Years 1 through 12, and 1.8mn tpa (ranging from 1.4mn tpa to 2.6mn tpa) from underground from Years 5 through 31

CapEx

The PEA projected capital costs for the Huguenot underground mining equipment, coal washing and coal handling systems as well as the facilities to support the operations. Surface mining equipment was to be acquired under a lease-purchase arrangement. The major capital cost components of the planned operation were:

- Site preparation including access improvement, stripping and grading
- Construction of the maintenance/warehouse complex plus office/dry and camp facilities
- Construction of a 230kV powerline to the site
- Development of pit access and pre-stripping
- Water management structures
- Coal wash plant
- Raw coal feed bin and conveyor system
- Clean coal stacking conveyor and stockpile area
- Rail loop and train loading system including scales and car sprayer system.

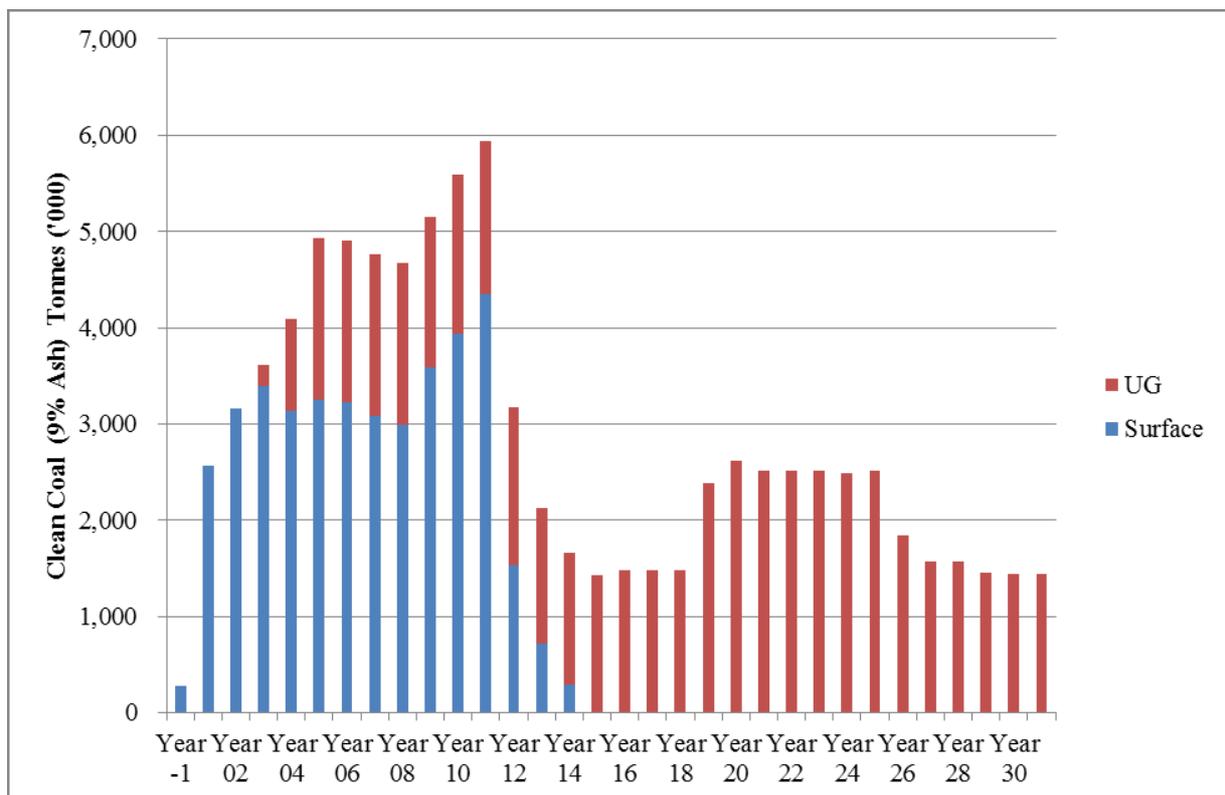
Mine Plan

The PEA from 2013 posited a combination of open-pit and underground mining at Huguenot. The report

suggested that there were sufficient quantities of near-surface resources that would support surface mining in the North, Middle and South Blocks. In addition, the dip and structure of the North Block may allow the thicker coal seams to be amenable to underground longwall mining techniques.

The PEA economic analysis is based on a conceptual open pit mine plan targeting 56mn tonnes of run-of-mine (ROM) resources at an average stripping ratio of 8.6:1 (bank cubic metres :ROM tonnes) plus a conceptual underground mine plan that targets an additional 66mn tonnes of ROM resources.

The schedule for production of clean coal is shown in the graphic below:



For surface mining, the PEA proposed pit shells based on mining criteria typical of the region and a maximum incremental strip ratio of 14:1. Two pit shells were proposed that exploited the North, Middle and South Blocks using a conventional truck/shovel mining technique with mid-sized excavators and mining trucks. One pit shell exploits the North Block and northern Middle Block, while the second pit focuses on the South Block and southern Middle Block.

Surface mining commences with pre-production in Year -1, and averages 3.2mn tpa of clean coal through Year 12 at steady-state production. The two surface pits are scheduled to be developed and mined concurrently.

Longwall mining in the North Block was identified as the most productive of the underground mining

methods likely to be economic for the Huguenot project, given the resource size, areal extent, dip and coal seam thicknesses. A conceptual mine plan proposes that the longwall operations be accessed through a shaft located north of the surface mine pits. Production from the longwall operation commences in Year 3 and averages 1.8mn tpa through Year 31 at steady-state.

It is proposed that ROM coal be sized, washed and loaded for transportation by rail at on-site coal-handling and coal-preparation plants.

Production of clean coal from the combined surface and underground mining operations averages approximately 3mn tpa, and ranges from 1.4mn tpa to 5.9mn tpa. The variance in coal production is driven by several factors, primarily being the sequence in which coal seams of varying thickness are encountered by the longwall operations and constraints by the equipment available.

How Huguenot Stacks Up

Analytical results indicate that the Gates coal seams are metallurgical coals that would yield a hard coking coal product after beneficiation in a wash plant. The PEA identified the Huguenot Project's potential coal production as HCC similar to coking coal currently exported from northeast British Columbia.

The table below compares Huguenot HCC quality to that of other British Columbian HCC exporters.

Huguenot Vs Canadian Comparables		Huguenot Coking Coal	Canadian NEBC HCC	Canadian SEBC HCC
Total Moisture	% as received	9%	8 - 9%	8%
Volatile Matter	% dry	22.5 - 23.5%	23 - 24.5%	21 - 27%
Ash Content	% dry	8.5 - 9%	8.25 - 8.6%	8.5 - 9.6%
Sulphur Content	% dry	0.40%	0.45 - 0.55%	0.35 - 0.75%
Free Swelling Index (FSI)		6.5 - 7	7 - 8	6 - 8
Mean Max Reflectance of Vitrinite	%	1.15 - 1.2%	1.15 - 1.25%	1.08 - 1.35%
Gieseler maximum fluidity	(ddpm)	100	150 - 300	40 - 300
Phosphorus In Coal	% dry	0.04%	0.008 - 0.04%	0.01 - 0.065%
Base/Acid Ratio of Ash		0.08 - 0.10	0.12 - 0.18	0.07 - 0.10
Coke Strength After Reaction	(CSR)	60 - 65	58 - 60	68 - 72

Huguenot HCC reports a FSI of 6.5 to 7, which is in the range of typical Canadian HCCs. Similarly, the project's HCC exhibits ash levels typical of other Canadian HCCs. With sulphur content at 0.40%, the HCC product is expected to be among the lowest sulphur HCC from Canada, which will positively affect the valuation of the coal.

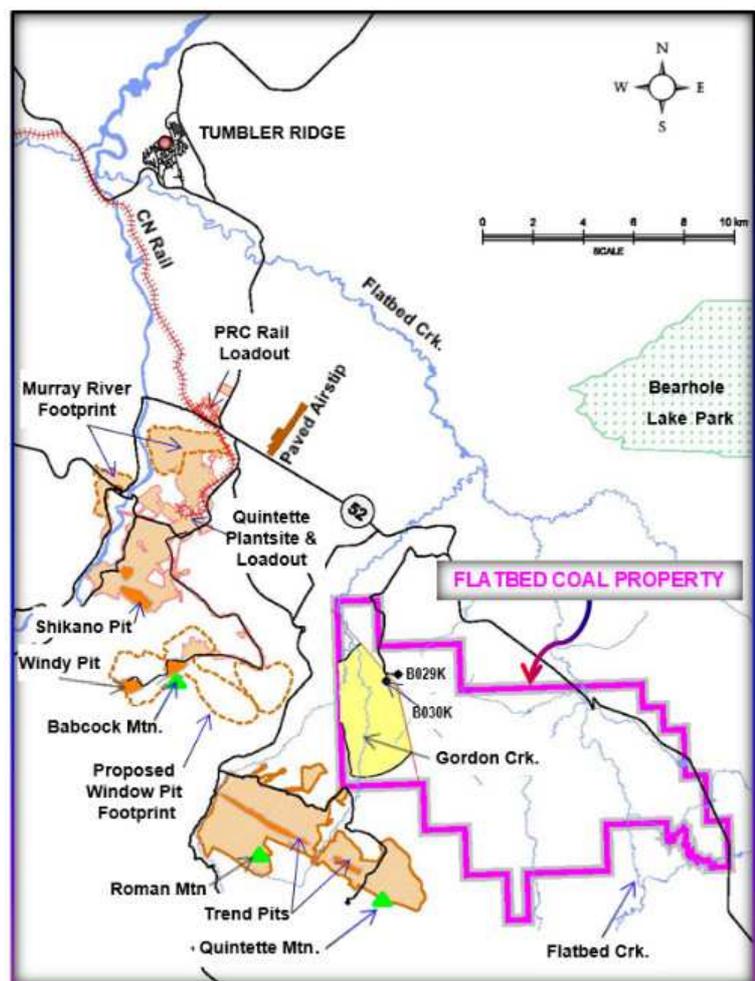
The base/acid ratios of clean coal analyses are lower than some comparable export Canadian HCCs, suggesting good coke strength.

Infrastructure

It is interesting to note that the PEA assumed that the Huguenot Project would be connected by rail to the existing rail line south of Tumbler Ridge near the currently idled Quintette mine load-out, and that a third party would construct this rail link, with costs being charged to the Huguenot Project on an annual basis. It was further assumed that other potential projects along that extended rail corridor would come on stream during the same general time frame as the Huguenot Project and that the rail costs would be shared among several users, such that the Huguenot Project's share of the annual costs would be no more than 50% of the total.

Flatbed

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 28kms south-southeast of the town of Tumbler Ridge. The property is adjacent to Anglo's (PRC) Trend mine and Teck Resources' proposed Window mine. The regional setting 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.



History

Portions of the Flatbed property have been held in the past by two different coal exploration companies; namely, Denison Mines from the early 1970's to mid-1980's, and Kennecott Canada between 2007 and 2009.

The only historic exploration undertaken within the property includes four O&G wells and limited

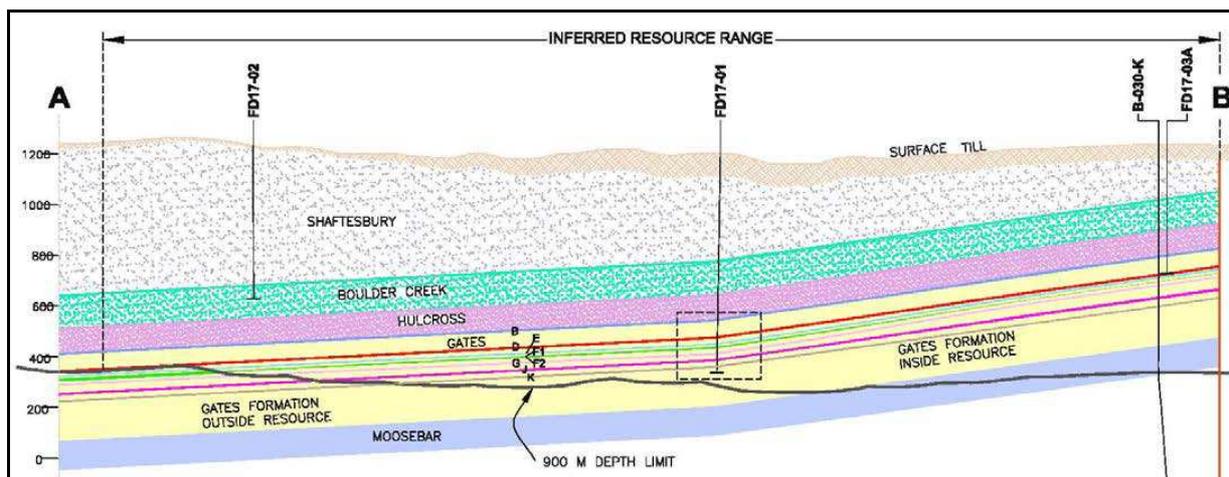
geological mapping by Denison in the 1970's. An independent review of O&G well data, completed in 2012, identified three targets within the property, as being worthy of exploration aimed at locating underground mineable coking coal deposits. One of these targets, the Gordon Creek area, was the focus of the Flatbed 2017 coal exploration program.

Geology

As with the Huguenot property, the Flatbed Coal Project lies within a belt of Mesozoic strata that form part of the Rocky Mountain Foothills of northeastern British Columbia. The coal seams of greatest potential are again found within the Lower Cretaceous Gates Formation which contains the largest systematically explored coal resources within the Peace River Coalfield. Significant thicknesses of Gates coal first occur in the Bullmoose Mountain area and continue southeast to the B.C./Alberta border, a distance of almost 140km, and beyond.

Within the Tumbler Ridge region, the Gates Formation is divided into three informal sub-divisions; the Quintette member, middle Gates and upper Gates. The main coal seams occur within the middle Gates while thinner, usually non-economic, coal seams are present within the upper Gates. Atypically, in the Gordon Creek area, the upper Gates contains a coal seam of potential economic importance (Seam B). In the Flatbed property, the Gates Formation ranges between 250m and 310m in thickness.

At Gordon Creek, the Gates Formation contains eight coal seams labelled, in descending order, from B to K. The thickest is Seam J, which ranges from 3.38m to 5.30m. Adjacent to the Gordon Creek area, at Babcock Mountain and Roman Mountain, aggregate economic coal seam thicknesses of 15m to 18m are common. Total thickness of the main coal seams at Gordon Creek is approximately 21m. A cross-section illustrating the Gordon Creek area of the Flatbed property is shown below.



The Gordon Creek area contains strata that dip approximately 11° towards the southwest. The resource area is delimited by the property boundary and, in the northeast, by a major high-angle fault that strikes parallel to the NW-SE regional structural trend.

Exploration at Flatbed

Exploration conducted by Colonial in 2017 consisted of five HQ-size diamond drill holes located on four, widely-spaced sites for a total of 2,832m of drilling; limited geological mapping was also carried out. Additional geological data was supplied by two O&G holes drilled in 2007 and 2008.

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 for the Gordon Creek area of the Flatbed property. The Flatbed coking coal underground resource estimates are summarized in the table below:

Flatbed - Gordon Creek - Resource			
Seam ID	Formation	Category	Resource mn tonnes
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

From the results of the initial coal quality testing program on Gates Formation coal seams in the Gordon Creek area, it is reasonable to anticipate that product coals from Seams B to G could be marketed as hard coking coals, while coals from Seams J and K (the deepest seams, representing approximately 28.6% of the reported resources, and the seams that would likely be mined last), would meet the requirements of the semi-soft coking coal market.

Mine Plan

Colonial intends to complete an internal study to evaluate the mining potential of the Gordon Creek deposit with the view to conducting a full PEA. Such a study would provide an estimate of the recoverable coal tonnes from the Inferred resource and would include a high-level mining engineering study, proposed coal beneficiation program, economic analysis and coal marketing report.

Logistics

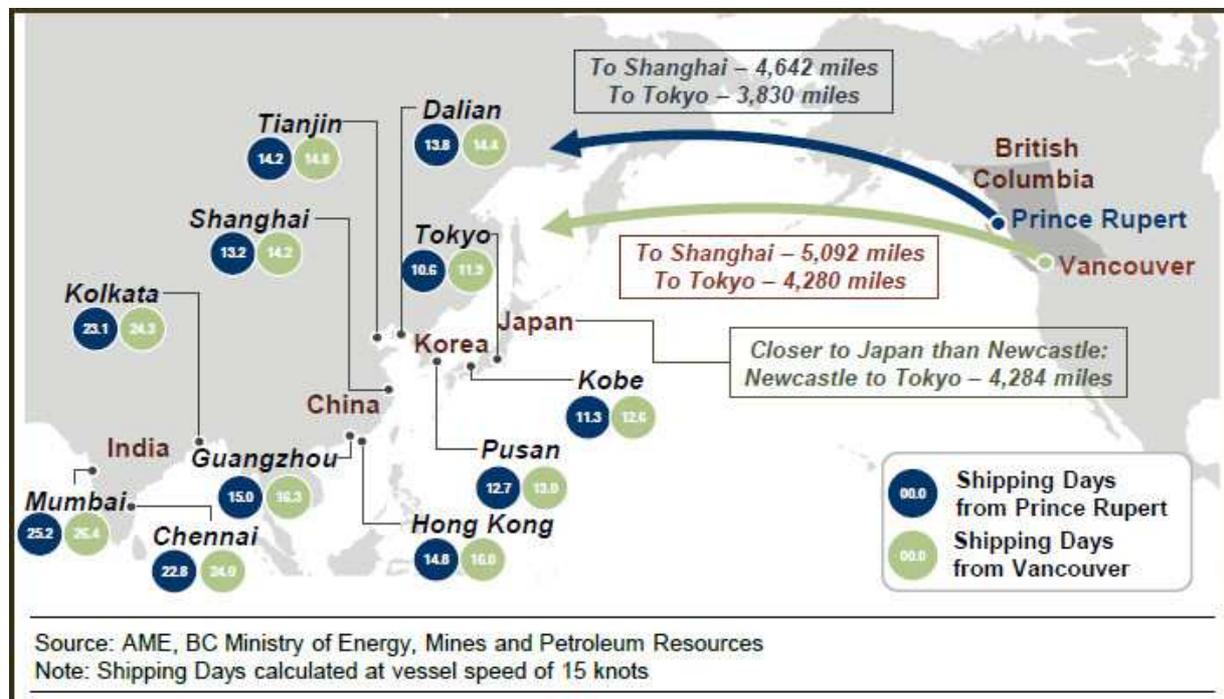
Production from Huguenot and Flatbed would be shipped by rail to export terminals on the west coast of British Columbia. The rail lines out of the Peace River Coalfield are operated by a Class I Canadian carrier (CN Rail, largest railway company in Canada) and have available capacity to support future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

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).

British Columbia's Shipping Advantage

British Columbia's ports provide the closest ports of entry on the west coast of North America to Asia. The map on the following page shows the distances in sailing days from ports in the Vancouver area and Prince Rupert to the various major ports in Asia that take coking coal for their respective steel producers.

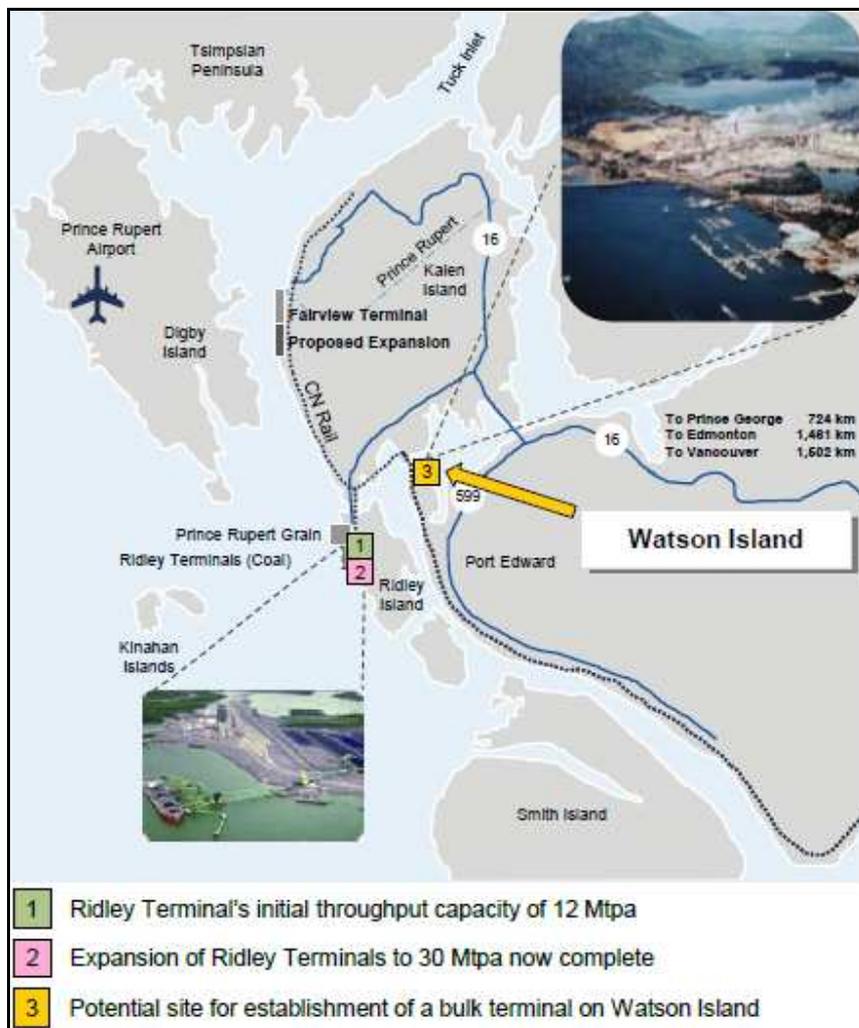


The distance for Hunter Valley coal exports from Newcastle, Australia to Tokyo is essentially the same as the distance from ports in the Vancouver area and Prince Rupert to Tokyo.

The value of coal production in British Columbia had been forecast to be CAD\$5.96 billion in 2017, up from CAD\$2.63 billion in 2016.

Entering the Ports Business

In 2012, Colonial Coal, through its subsidiary Watson Island Development Corp. (Watco), entered into a MoU with Lax Kw'alaams Band and Metlakatla First Nations with the intent of forming a JV for the potential acquisition of Watson Island from the City of Prince Rupert (COPR). Watson Island was the site of the former Skeena Cellulose Pulp Mill from 1951 to 2001. The regional setting of Watson Island is shown in the below map.



This prospective acquisition was initially based on Colonial's desire to secure coal shipment capacity at a time when the nearby major coal loading/shipping facility at Ridley Island was nearing capacity. Ridley has since undergone an expansion and has a current listed throughput capacity of 18mn tpa, with room for a further expansion if required. During 2017, Ridley exported nearly 7.6mn tonnes of coal and petroleum coke. Watco is now proposing that Watson Island be developed as a multi-product bulk commodity port offering a means to expand export capacity in British Columbia to deal with increasing regional bulk commodity production.

Watco had an exclusive arrangement with the COPR to purchase Watson Island. The transaction involved Watco compensating the COPR for actual land expenses in accordance with the terms of the Exclusivity Agreement. Watco hired consultants for an investigation into development and remediation of Watson Island and worked under an exclusivity arrangement with the COPR to acquire the site once a plan had been developed to deal with its environmental remediation. In the interim Watco paid ongoing expenses for remediation studies.

Up until now Watco has not been able to finalize the purchase of the property as the COPR advised that it would not proceed with the sale of Watson Island to Watco. The company is currently in litigation with the COPR in connection with the acquisition.

It is worth noting the two of the current board had extensive experience as terminal managers at British Columbia Ferry Services. However it is also important to note that the eventual disposition of Watson Island has no bearing on Colonial Coal's HCC projects or port availability for future coal shipments.

The Strategy

In broad terms the game plan at Colonial Coal is to repeat the strategy that company's founder, David Austin, pursued at the two coal companies he had previously founded, Northern Energy & Mining and Western Canadian Coal. The latter company was sold to Walter Energy in late 2010 for \$3.3 billion while in 2011 Anglo acquired the remaining 25% of PRC (held by NEMI and Hillsborough Resources) for \$166mm (\$664mn for 100%).

Colonial Coal was brought to life in 2005 and became a publicly-traded company on the TSX-V Exchange in late 2010 via an RTO, with a name change to Colonial Coal International Corp.

Later that year, in November 2010, Western Canadian Coal was put in play when its key shareholder, Audley Capital, agreed to sell its 19.8% stake to Walter Energy of Florida. Walter Energy quickly tried to buy all of Western's shares, leading to the exclusive negotiations between the two parties. Eventually in December 2010 a takeover of Western by Walter Energy was agreed upon. Walter Energy was attracted to Western for easy access to Asian markets because of Western's operations in British Columbia. Walter eventually went into bankruptcy protection and, their wholly-owned northeast British Columbia coal assets were purchased by Conuma Coal Resources in 2016. Conuma re-opened the Brule and Perry

Creek mines in 2017.

Possible Outcomes

It is 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 2018 coking coal is at US\$180 per tonne and the US dollar is at \$1.29 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 (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.

The measure that we would employ to assess the potential dollar value of a Huguenot sale would be a rough US\$1 per tonne of HCC in the ground. This would give 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. With the current market cap around US\$55mn this would imply that the stock is trading at one tenth of Huguenot's value alone using the very conservative \$1 per in-situ tonne metric.

Parsing Coal

A key factor to consider is the difference between thermal coal vs metallurgical/coking coal. Thermal coal is largely burned for electricity, while coking coal is a key ingredient in steel production.

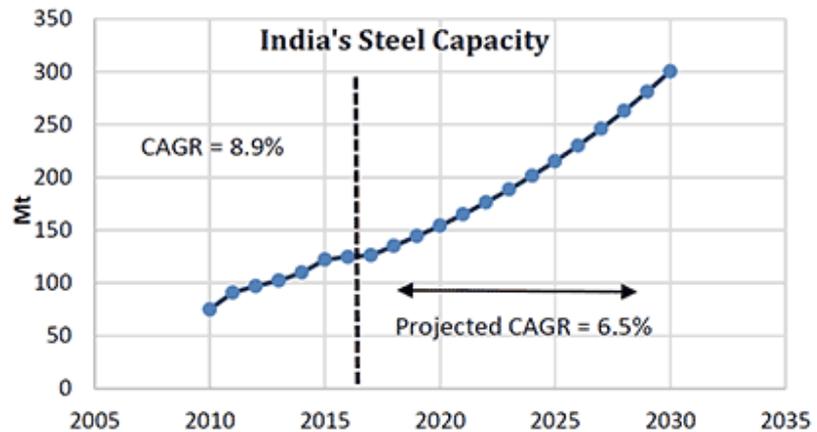
The main motor of global coking coal growth has been China for well-nigh two decades now, however that may be about to change. At the moment China has about a 6.7% GDP growth rate, but is being outpaced by India, which is the rising steel star, pulling ahead with a 7.36% GDP growth. In addition to China and India, most of the coal from British Columbia is sold into other eastern Asian markets, although a significant amount is also sold into Europe.

The outlook is for the Chinese and the Indians to be short of coking coal going forward. India has bought

coal out of northeast British Columbia during the current decade and quite a few coal companies are now looking at opening up markets through joint venture companies with Indian groups.

Projected Indian steel capacity from Metal Bulletin can be seen at the right.

India is not a name that is mentioned as much as it should be despite that its steel production is now estimated at 125mn tpa. While China and India produce some coking coal, India is only able to supply very limited



amounts and not of a good quality. The forecast growth of Indian steel production could have a significant effect because, even if they don't take coking coal from British Columbia, the coal must originate from somewhere, thus displacing supply to other markets (such as South Korea), so the knock-on effect of greater Indian purchases is the factor to consider. The actual amount of seaborne coal shipped worldwide is about 240mn tonnes per year. The bulk of this originates from Australia. When one looks at the coking coal demand by 2030, India alone will need around 210mn tonnes, around 122mn tonnes more than currently.

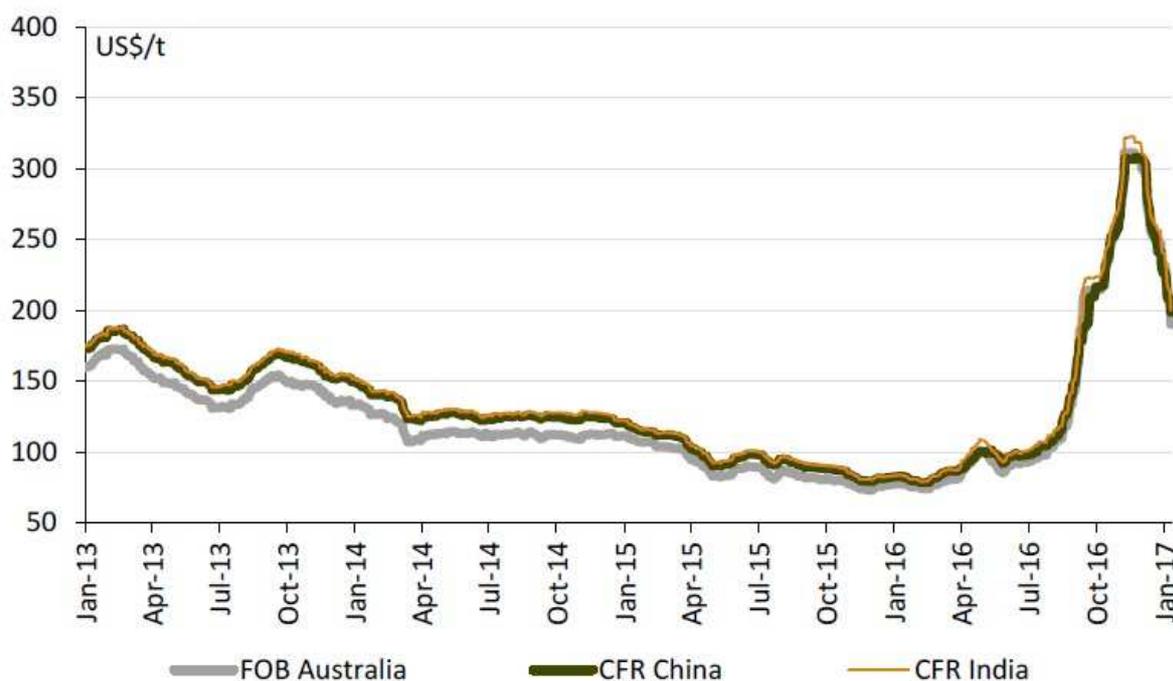
The reasons behind coking coal staging a dramatic recovery are multifarious. During the past few years of low coking coal prices, production was cut back in all the main exporting countries. The old story of "taking out capacity spurs a price rally" is repeated. From 2011 to mid-2016 the coking coal market was driven by both the reality and the perceptions of the direction of the Chinese economy. On the supply side it has been substantially affected by what the Australian producers were doing. The Australian dollar came down and the Australians ramped up their production. Some have viewed this as a strategy to knock the Americans out of the market. Some US producers had started to think about shipping out of British Columbia ports to remain competitive in Asian markets. This proved largely to be futile and the US producers have been squeezed out of Asia by access issues and the overvalued US currency.

Price Trends

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.

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.

China’s crude steel output reached 808 million tonnes in 2016 and Metal Bulletin Research estimated that production would set an official record of about 840 million tonnes in 2017. As China is the largest producer and consumer of metallurgical coal, this increased crude steel output has pulled coking coal prices higher as can be seen in this chart of coking coal prices from 2013 to 2017 below:



Source: Platts, Steel Business Briefing

Beyond the rising coking coal demand in China, there were new restrictions on the mining industry which reduced domestic supply and put further upward pressure on metallurgical coal prices since last year. 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 and helped push prices higher. Hence the dramatic “rising from the dead” of the coking coal price from mid-2016 that saw the price treble (something no other mineral, excepting Cobalt, has managed) which then prompted the inevitable pullback.

These impetuses from China coincided with interruptions in supply, notably in the world’s largest producing region of metallurgical coal, Queensland in Australia. A trigger for the soaring prices in April of 2016 was a cyclone which broke down railway links transporting coal from the mines to the ports. After miners declared force majeure due to floods and landslides after the cyclone, Australian exports halved from March to below four million tonnes in April.

Steelmakers scrambled to find an alternative supply of coking coal and prices spiked. The shortfall led large buyers in China, Japan and India to increase their imports from Mongolia, Russia and Mozambique.

As the chart below shows prices have now stabilized at a more sustainable level at around twice their 2016 lows.



Source: INO/Platts

In the view of management at Colonial Coal: “... at US\$180 a tonne, everybody makes good money. The steel companies make money, the coal companies make money, and everybody’s in good shape”.

This is particularly true for Canadian and Australian coking coal vendors who are operating with a strong competitive currency advantage in comparison to US producers.

Board & Management

David Austin is the Chief Executive Officer, President, Chairman and a director, serving in those capacities since November 2010. From August 2005 to October 2010, he was President of Colonial Coal Corp (antecedent to Colonial Coal International Corp). He has held administrative positions with public companies for over 36 years. He was the founder of Northern Energy & Mining in 1995, acted as its

President until 2004 and continued as an Executive Director until 2008. He was co-founder of Western Coal Corp/Western Canadian Coal Corp. and acted in the capacity of director from 1997 until 2003. Until 2008, he was also a Terminal Manager with British Columbia Ferry Services, a company with whom he had been employed since 1974 and prior to that with P&O.

John Perry is the Chief Operating Officer and an executive director, and has served in those capacities since 2010. Formerly, he served as the Director of Exploration for the Belcourt Saxon Coal Limited Partnership from 2005 to 2008 as well of Manager of Exploration for Northern Energy & Mining from 2004 to 2006. He has extensive experience in the coal industry, originating with Denison Mines in 1976-1979, and later as a Geological Consultant for coal plus a wide variety of metallic and industrial minerals. He has experience with most of the main coal projects in northeastern British Columbia, in addition to many others throughout North America and elsewhere. He graduated from the University of Exeter in 1972.

Greg Waller was appointed as a non-executive director in 2017. He retired from Teck Resources, the world's second-largest, and North America's largest, steelmaking coal producer, in 2017, where he was Senior Vice President Investor Relations and Strategic Analysis. Over his 33 years with Teck, he gained extensive knowledge of various commodity markets, industry participants and significant mining assets globally. As a member of the senior management team at Teck, he was involved with major strategic decisions and was a leading spokesperson for the company.

Anthony Hammond is a mining engineer and graduate of Camborne School of Mines (1969). He has been a non-executive Director of Colonial Coal since 2010. He also served as a director for Northern Energy & Mining from 1997 to 2009. He has also been Chairman and Managing Director of Great Orme Mines Ltd in North Wales, UK since 1990. His career as a mining engineer includes eighteen years with Anglo American, three years as chief engineer with the Robertson Research group and twelve years as principal of Ashton Mining Consultants.

Ian Downie is a non-executive director. He has been a director and Chair of the Audit Committee of Colonial Coal since 2010. He currently also acts as a consultant for mediation and dispute resolution. He also served as a director of terminal operations for British Columbia Ferry Services. from 1999 to 2007.

Wayne Waters has been a non-executive director of Colonial Coal since 2010. He has spent much of his career as a Geological Consultant within the fields of mineral exploration, oil and gas and geothermal energy. He was a director of NEMI from 1999 to 2008, and has been a director of a number of other junior mining and energy companies over the past 20 years.

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

- ✘ Exchange rates moving closer to parity with the US dollar
- ✘ That the coking coal price moves sharply lower
- ✘ Financing difficulties
- ✘ An acquirer fails to materialise

The main danger 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 as 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.

Conclusion

Coal has fallen off the radar of the average mining investor in the last eight years. And yet, coking coal lives... after a massive price slump the mineral has doubled in price since 2016. With the blizzard of miseries in the mining space post-2011 (lasting through to 2016) the eyes of investors went off the entire mining space and particularly off the bulk DSO commodities that were perceived to be very tied to the Chinese economy. Nevertheless, steel production continued apace in the emerging economies, particularly China and India, and there was little being done to add to future reserves to service need when the global economy picked up.

The management team in their previous incarnation at Western and NEMI picked up strategically important coking coal assets at a time of low interest and low prices and were instrumental in moving these assets along the development curve such that they were sold at the top of the last coal wave with stunning value uplift. The Colonial Coal 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. This time around Colonial Coal looks ripe for “slicing and dicing” with Huguenot as first cab off the rank then, potentially, the port assets being spun out and Flatbed being brought up to a saleable state for a later disposal subsequent to a PEA or PFS.

Even using a very conservative valuation of US\$1 per in-situ tonne at Huguenot the stock is trading at one tenth of realizable value of just one of its three main assets. Recent price movements have only gone a small way towards reflecting this embedded value. Therefore we are classifying Colonial Coal as a **LONG** and adding a position to the Model Mining Portfolio with a 12-month target price of CAD\$1.10.



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. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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