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Results Note

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Almonty Industries (TSX:AII, FSE: 1MR, OTCQX: ALMTF) Strategy: Long

<u>Key Metrics</u>			<u>2017</u>	<u>2018e</u>	<u>2019e</u>
Price (CAD)	\$	0.90		n/a	n/a
12-Month Target Price (CAD)	\$	1.40		\$0.06	\$0.06
Upside to Target		56%			
High-low (12 mth)		\$0.225 - \$0.98			
Market Cap (CAD mn)	\$	163.6			
Shares Outstanding (millions)		181.80			
Management stake		21%			
Consensus EPS				n/a	n/a
Hallgarten EPS				\$0.06	\$0.06
Actual EPS			(\$0.07)		
P/E			n/a	14.7	13.9
Dividend	\$	-	\$ -	\$ 0.01	\$ 0.02
Yield			0.0%	1.1%	2.2%

Almonty Industries

Back to the Black on APT Surge

- + Almonty has bounced into the black with a net profit of \$3.76mn in just the March quarter
- + Upsurge in the price of APT over the last year took the price from \$220 per MTU a year ago to over \$350 in June 2018
- + The company is a producer of Tungsten in Spain and Portugal with a mothballed mine in Australia, and two development properties in Spain and South Korea
- + The consolidation of Tungsten operations around the globe makes it the only geographically diversified Tungsten miner accessible through Western capital markets
- + Of the upcoming projects, Almonty has two of the most advanced in Sangdong and Valtreixal
- + Upgrading our 12-month target price from \$1.12 to \$1.40
- ✘ Tungsten prices has taken a dive in recent weeks losing ten percent off the price of MTU
- ✘ The Chinese as both the largest producer and one of the main consumers have a vested interest in higher prices but that does not mean that they may not push prices down to achieve other policy or strategic goals

Out of the Woods?

Tungsten has been a pursuit for only hardcore fans over the period since 2011. Prices slumped and the market's downturn carried two of the then producers, Malaga and North American Tungsten, to their doom. Wolf came into production and has had several near death experiences and Almonty soldiered on with profitability eluding it for many years.

Surely as day follows night, the sun is shining again in the Tungsten space but in a more measured and rational way than back at the tail-end of the Supercycle. For Almonty the price rebound in APT has brought a return to the black in quite dramatic fashion and it is this development that we discuss in this update.

Background

The principal business of Almonty Industries Inc. is the mining, processing and shipping of tungsten concentrate from its tungsten mines. Its initial production source was the Los Santos Project, located approximately 50 kilometres from Salamanca in western Spain. The Los Santos Project was acquired by Almonty in September 2011. The mine was originally opened in 2008 and commissioned in July 2010 by its former owner. The company's other principal mine is the Panasquiera mine in Portugal that was

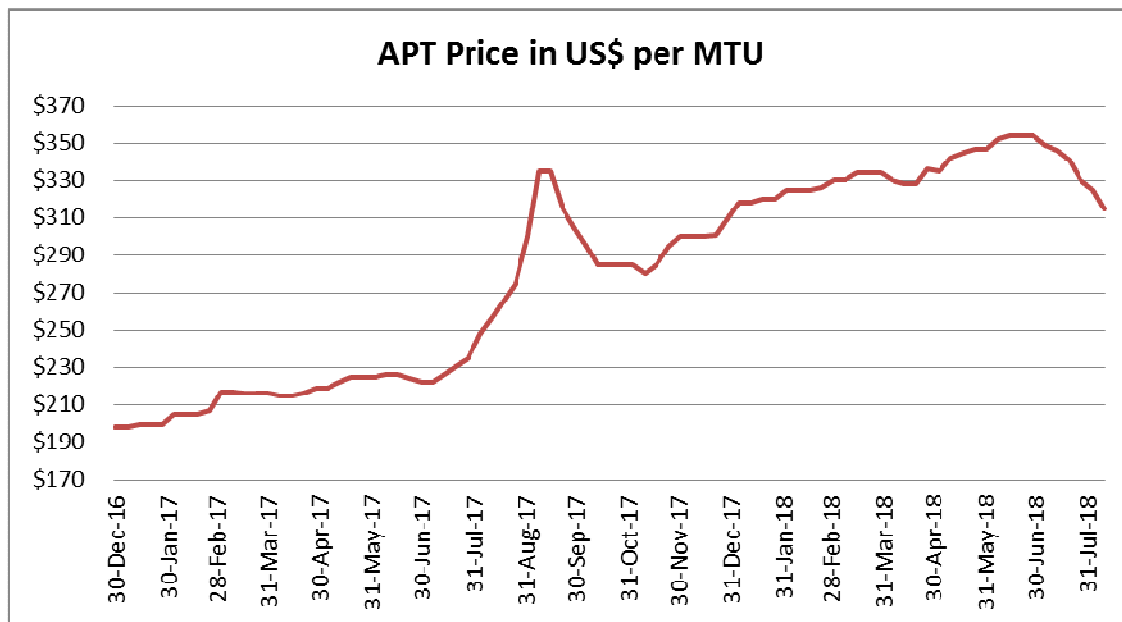
originally developed by the company's management in a previous reincarnation then sold to Sojitz and now Almonty bought "back" the mine in 2017 in a very canny transaction just on the verge of the Tungsten price turnaround.

The company also has a mine called Wolfram Camp in the Australian state of Queensland. It was acquired in 2014 and produced for several years before being mothballed around two years ago to focus capital on the main producing assets. The company also owns the Valtreixal project in Galicia in northwest Spain and the Sangdong project in South Korea.

Tungsten Pricing

The price of APT was showing a most encouraging tendency since last 2016. The metal had long been mired in conflicting currents of slack western industrial demand and Chinese control of the bulk of the metal's supply and its associated use of pricing levers under its control to achieve many and various aims of the "Mothership".

The loss-leading could not go on forever and major Western end-users, in a quite extraordinary sign of solidarity with non-Chinese producers, had acted to encourage firmer pricing that ensured profitability of the renascent Tungsten mining operations in the West. The goal here was to ensure that non-Chinese sources continued to exist to stop the Chinese effecting against Western machine tool manufacturers the same type of manoeuvre that had reduced the Japanese to impotence in the value-added chain of the Rare Earths space.



The strategy has worked thus far with a select band of Tungsten producers starting to evolve, particularly notable being the resurgence in the Iberian peninsula. Almonty was the first of these but now several others are following in its wake.

Most had remained in various states of suspended animation during the four-year price slump with only Almonty and Wolf's Hemmerdon mine in the UK achieving production. The rise in price from below \$200 in 2016 to a peak of over \$350 resulted in a broad change in mood and interest, though fortunately the space has not been subject to faddism like the battery metal space. It is notable that most of the up-and-coming players are non-Canada oriented and non-TSX-listed.

In recent weeks though the price has trended down with most of the other metals as the "trade wars" noise has filled the airwaves. In the process it has retreated 10% off its highs, which in comparison to the likes of Zinc, is comparatively little. One market player we spoke to attributed the sagging price to the summer holiday doldrums with few buyers in the market and the few that there were pushing down the spot price on measly volumes.

We would see the price start to trend back up again once the current static of "trade wars" and the doubts they engender is removed from the picture or at least the volume fades. Our latest projections are shown in the table below.

Tungsten APT Pricing Projections	MTU (US\$)
2016	\$198
2017	\$301
2018e	\$345
2019e	\$395
2020e	\$415

Recent Results

After four years of losses Almonty has finally rejoined the ranks of mining companies with a positive bottom line and becomes the only Tungsten miner in that select band. The turnaround is linked to two key factors:

- ✓ The addition (and turnaround) of Panasqueira
- ✓ The upturn in APT prices

Panasqueira added significantly to production and thus gave the company added economies of scale (to cover GS&A). Meanwhile its operating costs were slashed (and this is no overstatement) from the inefficient and bankrupting levels that Sojitz had "achieved". Cash operating costs at the Portuguese mine at \$159 per MTU were less than half the levels of FY16.

During the first six months of the current fiscal year, Almonty's primary customers continued purchasing all production from Almonty's operations over and above the minimum volumes specified in the supply agreements. The fixed price contracts that were entered into during calendar 2017 continued to positively impact the cash flow of both the company's mines during Q1 and Q2 2018.

With effect from the 1st of February 2017, Almonty entered into a one-year fixed priced contract representing 80% of the output of the Los Santos mine's tungsten concentrate production. This fixed price contract had a positive impact on the revenue received from the sale of tungsten concentrate at the Los Santos mine in 2Q18 when compared to 2Q17 when the contract was not in effect for the entire quarter.

The table below shows the production metrics for both mines:

Production Metrics				
FY ends 30 Sept.	2Q18	1Q18	FY17	FY16
Los Santos				
Ore mined (tonnes)	118,639	155,777	455,968	522,782
Ore treated (tonnes)	130,723	132,445	512,827	519,803
Average grade WO3 mined	0.30%	0.18%	0.23%	0.35%
Average WO3 recovery rate	61.20%	63.90%	59.70%	60.20%
W O3 produced (MTU)	21,808	17,919	67,211	93,102
W O3 sold (MTU)	21,894	16,926	66,698	94,201
Cash operating costs (US\$/MTU)	\$124	\$126	\$90	\$91
Panasqueira				
Ore mined (tonnes)	203,264	150,972	746,204	611,252
Ore treated (tonnes)	202,937	151,085	733,582	601,596
Average grade WO3 mined	16.50%	0.18%	0.12%	0.10%
Average WO3 recovery rate	80.40%	80.20%	80.00%	80.20%
W O3 produced (MTU)	24,130	20,926	80,273	66,164
W O3 sold (MTU)	23,141	19,373	80,757	71,787
Cash operating costs (US\$/MTU)	\$159	\$162	\$311	\$335

The production in MTU at Los Santos during the three months ended March 31, 2018 increased by 27.6% when compared to the three months ended March 31, 2017. The increase in production resulted from a lower strip ratio in Q2 2018 when compared to Q2 2017. The tungsten recovery rate continued to improve during Q2 2018 when compared to Q4 2017 and Q1 2017 and is now in line with the expected average tungsten recovery rate for the life of mine, expected to be maintained in the 60-65% range.

Interestingly, the run-rate of GS&A has gone down despite the addition of Panasqueira and we suspect savings have been due also to the removal of the high management expense involved in having the distant Wolfram Camp mine functioning back in FY16.

Almonty Industries														
CAD mns (FY ending Sept)														
	FY19e	FY18e	2Q18	1Q18	FY17	4Q17	3Q17	2Q17	1Q17	FY16	FY15e	FY14	FY13	FY12
Revenue	64.50	62.07	17.30	10.77	39.02	10.81	10.97	10.18	7.06	37.31	36.52	29.61	18.34	21.64
Cost of Revenue, Total	36.30	36.81	9.70	7.81	32.35	7.99	7.64	9.22	7.49	32.97	25.80	10.29	11.4	11.11
Gross Profit	28.20	25.26	7.60	2.95	6.67	2.82	3.33	0.95	-0.43	4.34	10.72	19.32	6.94	10.54
Selling/General/Admin.	7.80	7.90	1.786	1.982	10.326	3.74	2.36	2.53	1.70	8.96	5.77	4.38	3.08	3.33
Depreciation/Amortisation	8.40	8.50	2.073	2.362	6.40	1.88	2.03	1.55	0.94	8.20	7.67	4.61	3.45	4.86
Unusual Expense (Income)	0.00	0.00	0.00	0.00	-3.02	-3.02	0.00	0.00	0.00	5.35	0.00	0.00	0.53	0.00
Total Operating Expense	52.50	53.21	13.56	12.16	46.06	10.58	12.04	13.31	10.13	55.48	39.24	19.27	18.45	19.37
Operating Income	12.00	8.86	3.75	-1.39	-7.04	0.23	-1.06	-3.13	-3.07	-18.17	-2.72	10.34	-0.11	2.28
Other, Net	0.00	2.30	0.70	0.76	1.07	-0.63	-0.15	0.37	1.48	-2.35	0.00	0.00	0.93	-
Income Before Tax	12.00	11.16	3.05	-2.15	-8.11	0.85	-0.91	-3.50	-4.55	-15.82	-2.72	9.89	0.6	2.27
Tax	0.00	0.00	-0.71	0.00	0.12	0.12	0.00	0.00	0.00	0.66	-0.43	-0.50	-1.84	-0.15
Income After Tax	12.00	11.16	3.76	-2.15	-8.23	0.73	-0.91	-3.50	-4.55	-16.48	-2.29	10.39	2.44	2.42
Minority Interest	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net Income	12.00	11.16	3.76	-2.15	-8.23	0.73	-0.91	-3.50	-4.55	-16.48	-2.29	10.39	2.44	2.42
Weighted Average Shares o/s	185.0	182.0	178.3	174.7	121.53	169.75	139.95	110.90	110.90	110.90	90.7	43.15	37.04	37.02
EPS	0.06	0.06	0.02	-0.01	-0.07	0.00	-0.01	-0.07	-0.04	-0.15	-0.03	0.24	0.07	0.07
Dividends per Share	0.02	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.03	0.00	0.00

Earnings Outlook

A key factor in the on-going improvement at Almonty will be the long-term contracts it had with some of the Wester world's largest end-users of Tungsten (i.e. tool and machine-tool makers). It is important to note that effective from the 1st of January 2018, 100% of the production of the Panasqueira mine for calendar 2018 will be at a fixed price of US\$280 per MTU, the equivalent price of US\$358 per MTU of APT, assuming an industry standard 22% discount for an MTU of WO₃ tungsten concentrate.

The APT price peaked right at the end of the June quarter. Thus we would expect that the June quarter (3Q18) should show the benefits of the strong pricing all through the quarter with a bottom line of around \$5mn or more for the period. With the price already off more than 10% in the current quarter, we would expect the last quarter of Almonty's financial year to be quite substantially weaker. Thus we are positing a FY18 post-tax result of \$11.16mn for the full year or earnings of 6 cts per share.

We expect the price to rebound in the December quarter, in fact likely to trend up before the end of the September quarter. Costs should be slightly higher but revenues will also be higher with APT likely to be back above \$340 per MTU through the next fiscal year. We do not factor in the forex conversion gain for FY19 that occurred in the current year. This gives us an estimated post-tax net profit of \$12mn for FY19 or EPS of 6 cts per share. This might afford a small dividend.

Risks

The risks for the Tungsten space in general. These are:

- ✘ A return to a weakening Tungsten price
- ✘ The end of mine life is in sight for Los Santos
- ✘ A number of projects of other companies are starting to get traction on the APT price rebound and could result in oversupply
- ✘ Weakened global industrial demand (particularly in tools) that would soften prices and volumes
- ✘ China skewing the market in some way to again create distortions in prices and trade patterns

Most of these risks are different sides of the same price prism, with the exception of the market's perception/ disinterest in Tungsten. Curiously the mining market did come back to life but APT's price did not until the mining "boomlet" was itself rather long in the tooth. Thus when APT got going it was scarcely noticed except by hard-core Tungsten mavens, a rare breed indeed.

Los Santos has the Valtreixal property (not under full Almonty ownership) as its back-up with potential to relocate equipment and personnel at the new mine. Meanwhile the Sangdong property in South Korea is already advancing with offtakers lined up.

Global industrial demand is a variable driver of prices (at least in the background). The current moment though has a recovery going on in drilling activity in both mining and oil & gas which is always useful in pushing Tungsten demand higher.

Financing remains difficult and dilutive when it takes place. The only way to harvest the attractive prices is to be in production and the only way to do that is to finance mine-builds/reactivations. Almonty is

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leading the way in using cashflow to build its business rather than keep going back to the well with financings.

Conclusion

It has been a very long time since there has been a listed Tungsten miner that made a profit. Indeed the last one we know of was Almonty in its FY14. It's taken the company a while to climb out of the pit of despair that Tungsten players were tossed into early in the decade but it is now clearly leading the charge out of the Valley of Death.

Almonty's management team, last decade, managed to get one Tungsten producer off the ground and now they are on their second go-around. This time they are not building to sell it but rather putting together a long-term producer and creating that hitherto elusive investment opportunity, a geographically diversified multi-mine Tungsten player. Ironically the mine they built last decade (Panasqueira, is now back under their control.

The company now has two major mines on the go. Los Santos was the cash cow that fed (only barely) the rest of the Almonty empire during the dark days. With its reserve, its stockpiles, its tailings to rework and the planned mini- "super-pit", it should have another four years mine-life at least. Turning around the disaster scenario at Panasqueira took surprisingly little time considering the problems it inherited there and the outcome has been a true endorsement of management's skills.

Planning is already advanced for Valtreixal to pick up the slack and use equipment and personal form Los Santos as it becomes available. Then there is the Sangdong mine which now has an offtaker signed up and is in the planning stage for the (re)construction.

We regard Almonty as undoubtedly the long-awaited consolidator in the Tungsten space and therefore reiterate our **Long** position and we are raising our twelve-month price target from \$1.12 to \$1.40.

Tuesday, August 14, 2018



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