Resource Maven
Independent Analysis of the Resource Markets
GWEN PRESTON

April 3, 2019

Maven Buys: Skeena Resources (TSXV: SKE)

Skeena fits my Strong & Splashy descriptor to a T. Backstopping its strength is a high grade, mostly open pittable resource at the Eskay Creek project containing 3 million oz. of gold. Skeena just published that resource and will next wrap a preliminary mine plan around the asset, while drilling to add ounces and confidence this summer.

That's strength of the kind I seek: a standout deposit with potential to become a mine, and where that potential is being laid out for the first time. The first economic study of a deposit leaves a mark; if it's good, a PEA can really improve investors' perception of a project's potential.

A strong PEA also means the next level of investors – funds that only invest in advanced assets – see attractive numbers the first time they assess the asset.

All told, a strong PEA can redefine a project and create a new, higher valuation backstop for a stock. And that's the beauty of projects that are past the discovery phase but not yet in the 'boring' permitting or engineering period: every accomplishment, from initial resource to growing the deposit to demonstrating good initial economics, has the potential to truly create new value.

Skeena is in that sweet spot. The company updated the Eskay Creek resource in February, its first major impact on the project since acquiring it from Barrick in 15 months ago, and the market liked what it saw.

Before I get into project details, let me set the scene. Skeena has been around a long time. Its founders included Ron Netolitzky, who helped discovery Eskay and define Snip, and Ron Nichols, who discovered Snip.

Skeena has 98 million shares outstanding. Using today's closing price of $0.405, the company carries a market capitalization just shy of $40 million. Using the basic metric of enterprise value per ounce in resource, the company is inexpensive (but that is a very basic metric as it doesn't incorporate how close to or far from production those ounces are).

In terms of share price, I think the more pertinent comment is that Skeena has spent the last few years repositioning and I think those efforts are now bearing fruit.

The company rolled back its share structure. It acquired the Eskay and Snip projects from Barrick, two high-grade gold projects in northwest BC that are now its two flagship assets. It brought in Hochschild, a respected miner, as partner for Snip. And it quickly demonstrated that Eskay offers millions of ounces of high-grade gold.

I applaud Skeena for the work it has accomplished in the last few years. I've been watching the whole time and, with all that work done, I now see it as a great opportunity for the coming gold market.

Skeena's projects are in British Columbia's Golden Triangle, where explorers and investors have been focused in recent years. The renewed interest follows new roads and power lines that have made an area where access has always been difficult much easier as well as receding glaciers that have exposed long-hidden rocks.

PROPERTY LOCATIONS – BC'S GOLDEN TRIANGLE

I won't spend time on GJ, though it's a large porphyry with a positive PEA. Skeena is not spending time or money on GJ right now but is holding the project as a call option on higher gold and copper prices.

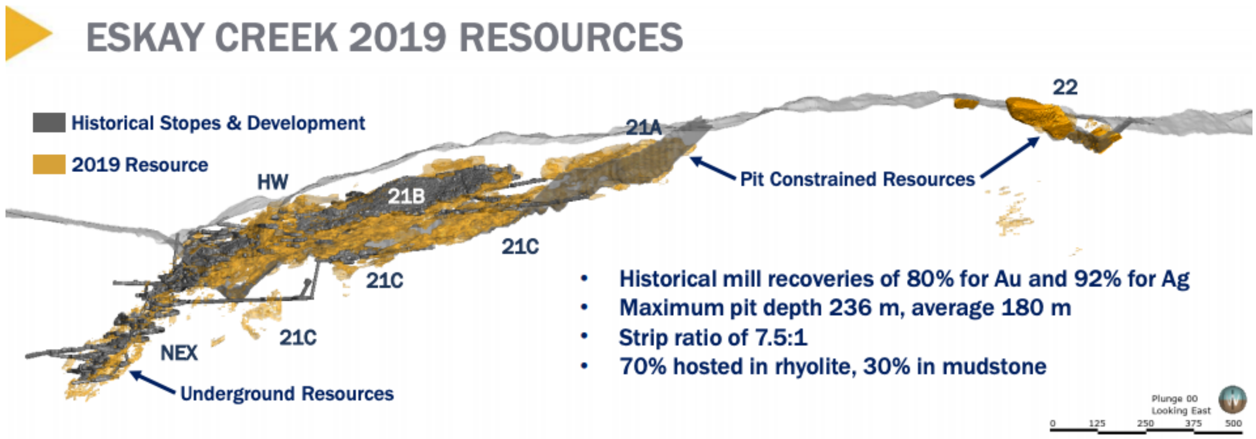
I will focus on the projects where Skeena is focused, which are Eskay Creek and Snip.

Eskay Creek

Eskay Creek was one of the world's highest-grade mines when it was in production. The mine tapped into lenses of massive sulphide mineralization in mudstones, which were mined underground. Much of the ore was not even processed on site but was direct shipped – it was that high grade that they just sent rock straight to the smelter.

Those lenses are mined out, but left behind are other lenses that remained undiscovered at the time as well as all the gold and silver in another rock type – rhyolite – that the historic operation did not mine.

Since acquiring the project 14 months ago Skeena completed enough sampling and drilling to define a new resource. The open pittable portion of that resource came in at 12.7 million indicated tonnes grading 4.5 g/t gold and 117 g/t silver plus 13.6 million inferred tonnes averaging 2.2 g/t gold and 42 g/t silver. The underground resource, which is in one area only, is much smaller.



	Tonnes (000)	Grade AuEq g/t	Au g/t	Ag g/t	Contained Ounces AuEq oz (000)	Au oz (000)	Ag oz (000)
Indicated Mineral Resources							
Pit Constrained	12,711	6.0	4.5	117	2,455	1,818	47,791
Underground	819	8.2	6.4	139	218	169	3,657
Total Indicated	13,530	6.1	4.6	118	2,673	1,987	51,448
Inferred Mineral Resources							
Pit Constrained	13,557	2.8	2.2	42	1,230	984	18,455
Underground	295	8.2	7.1	82	78	68	778
Total Inferred	13,852	2.9	2.3	43	1,308	1,052	19,233

A few important notes. First, most of the resource falls into conceptual pits. The strip ratio is high at 7.5 to 1, but grades like these can sustain a strip ratio like that.

Second, the inferred resource is much lower grade than the indicated resource. That is not geology in action but drill spacing – and is something Skeena will work to address this summer.

The resource estimate came out in late February. Skeena's share price jumped on the news and has held its gains since. I take that as validation that the market (1) recognizes Skeena for the changed entity that it is today and (2) was pleasantly surprised that SKE was able to define 3 million ounces of open pittable gold at Eskay in short order.

And Skeena is just getting started at Eskay. Through the rest of 2019 the project will keep generating important news:

- **Metallurgical results are due out this month.** As I will explain, the new resource differs from the deposit that was mined previously in important ways, metallurgically, and while Skeena is confident in that statement the company needs to publish its full suite of met results before the market will understand that the new resource is much easier to process
- **An initial PEA will be out later this summer.** Open pittable resources averaging 4.5 g/t gold are rare. Grades like that usually require more expensive underground mining; ore like that in an open pit should give Eskay some very nice numbers. (The market is also wrapping its head around Eskay as an open pit mine, as the historic mine was an

underground operation, so a PEA laying out the open pit plan will help recast this asset.)

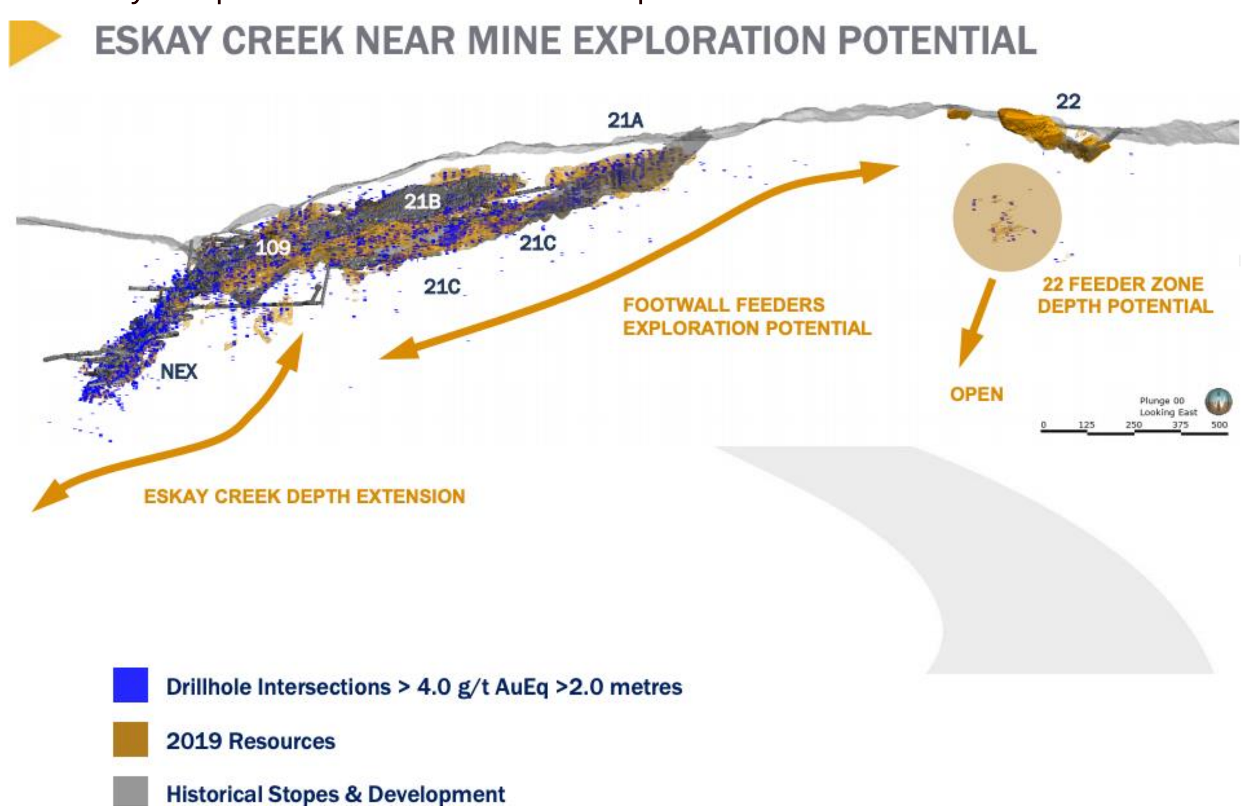
- **Drilling this summer** will focus on upgrading the inferred resource to indicated status. That sounds boring but it **will likely boost the ounce count a fair bit**. As a high-grade deposit the resource model is conservative, which means that strong intercepts aren't spread very far. In the indicated zones drill spacing is tight enough that high-grade hits connect but in the inferred areas the drill holes are too far apart, which means ground between holes is considered barren. Infilling those gaps should boost the inferred grade (which is half that of the indicated grade) and, in doing so, could well add a lot of ounces.

These are all significant news events that should build the 'strong' part of the Skeena story.

As for splash… To start, Eskay Creek is famous. This is a deposit that produced 3.3 million oz. gold and 160 million oz. silver from rock averaging 45 g/t gold and 2,224 g/t silver from 1994 to 2008. Yes, those numbers are insane, which is why Eskay is almost synonymous with high grade.

Of course, going back to a deposit isn't the same as discovering it, which is why today's Eskay Creek resource is much lower grade. The crazy high-grade mudstones were mined; the lower-grade rhyolites were left behind.

That said, there is lots of exploration potential here, which is another way of saying that there is lots of potential to drill into really high grades in untapped areas. Skeena will only dedicate about 15% of its drilling to exploration this year but, if they see some success, the kind of grades Eskay can produce are the definition of splash.



The schematic above outlines Skeena's exploration targets. They are really interested to test below the 22 Zone, where scattered hits show mineralization continues to depth. Looking for feeders below the main 21 Zone is also intriguing – historic holes hit into such structures in the past but weren't followed up because either the hit was too deep or the grade wasn't high enough. But with concerted effort there's certainly a chance that Skeena could identify nicely mineralized structures below the deposit.

Then there are the kind of grades Skeena that will undeniably drill into in its infill campaign, which could also attract attention. Connecting the dots in the inferred resource should return more of the kinds of intercepts Skeena generated last year, which includes 27.7 metres of 29.5 g/t gold and 973 g/t silver and 28.5 metres grading 14 g/t gold and 707 g/t silver.

Let me get back to the metallurgy. I mentioned in the bullet point above that the current resource differs from the mined resource in important ways. The basic explanation is that the really high-grade gold and silver sat in the mudstones, which are a muddy contact horizon between the underlying rhyolites and the overlying basalts. The rhyolites and basalts were lava flows that came at different times, with different chemistries and rates of cooling; the mudstones are the organic matter that settled in between and got contained and squeezed.

The mudstones ended up being a perfect host to grab gold out of fluids that continued to pulse out of the deep structures in the area. The rhyolites also took gold, though not as much.

What also matters, though, is that the mudstones are also laced with mercury, arsenic, and antimony. All three are undesirable – difficult to separate out from the gold and silver and deleterious. The rhyolites, by contrast, carry only trace amounts of these elements.

The new Eskay resource sits 70% in rhyolites and 30% in mudstones. The abundance of rhyolite means that, overall, the resource does not carry that much mercury, arsenic, or antimony. Metallurgical results will drive this point home – the results will show how well each technique recovers gold and silver as well as the concentrations of gold, silver, mercury, arsenic, and antimony in the final product. I am optimistic that the results will drive home that, with today's Eskay, deleterious elements are not a significant factor.

I said "each technique" because Skeena is not limiting its testwork to the process used last time this deposit was mine. That was flotation, which worked well, but Skeena is also testing the deposit's amenability to leaching. If leaching works, it could be a simple, low-cost way of processing ore.

Because of the arsenic/antimony/mercury factor, because of the potential to leach, and because of the need to fine tune flotation plans should that remain the preferred process at Eskay, these metallurgical results are important. Whether the market will immediately understand the importance is tough to predict – it depends how sophisticated the audience.

Whether the share price reacts to the news is only a short-term question anyway, as the met work is really needed to ground the PEA. You can't plan a mine until you know how you are going to process the ore! And that, of course, is the next big news event.

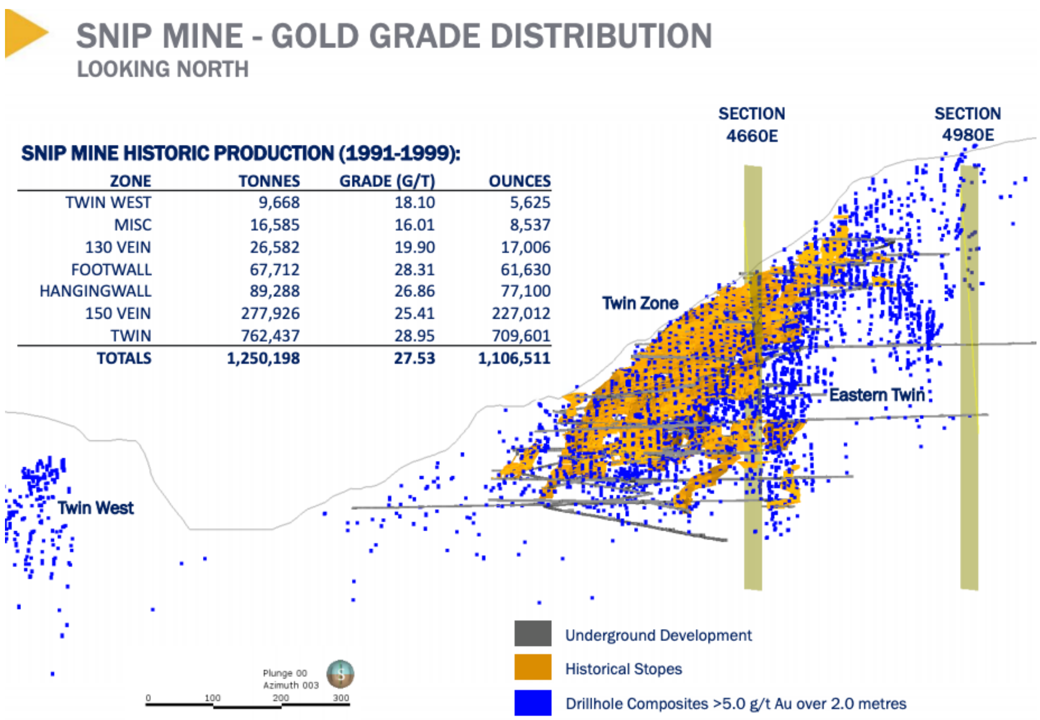
The deposit at Eskay has the kind of scale and grades to support a nice mine. The strip ratio will be high – 7.5 to 1 – which isn't great, but success converting inferred resources to indicated will help a bit. And at the end of the day this mine will stand out for being an open pit opportunity. Open pits are simply less expensive, more straightforward, and less risky than underground mines.

And an open pit mine averaging 4.5 g/t gold really stands out. The average grade at open pit gold mines globally is less than 1 g/t gold.

Snip

Snip shares similarities with Eskay. It too was mined historically, producing 1.1 million oz. gold from 1991 to 1999. It is also a high-grade orebody, with historic mill feed averaging 27.5 g/t gold.

Most of those ounces came from the Twin Zone. About a third of the historic tonnage came from other areas – and those areas are the opportunity today.



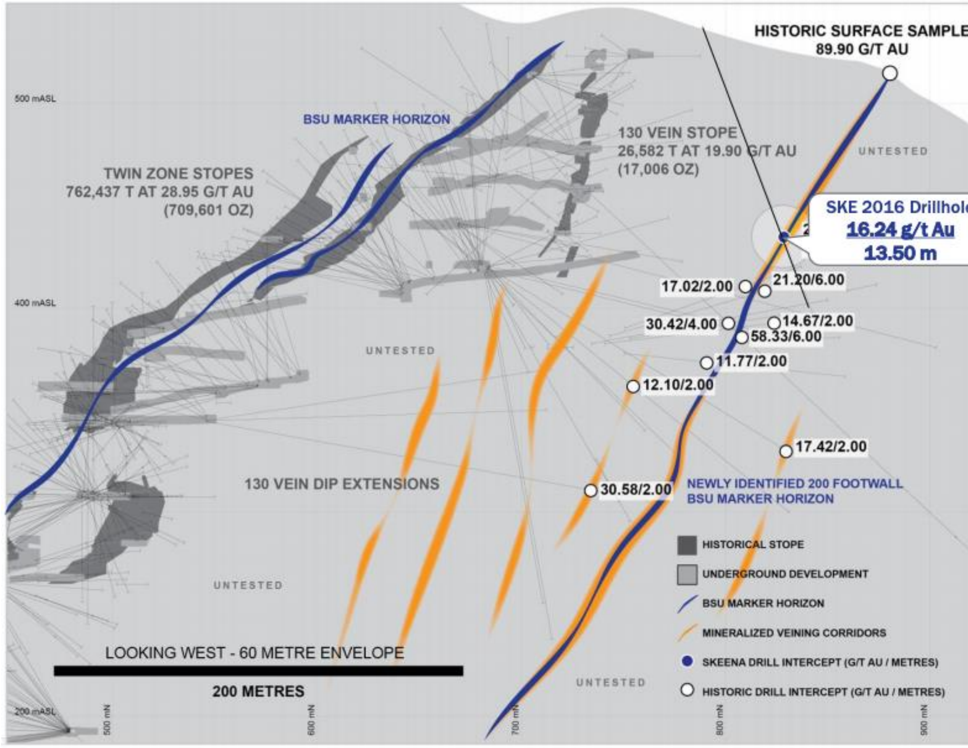
SNIP MINE HISTORIC PRODUCTION (1991-1999):

ZONE	TONNES	GRADE (G/T)	OUNCES
TWIN WEST	9,668	18.10	5,625
MISC	16,585	16.01	8,537
130 VEIN	26,582	19.90	17,006
FOOTWALL	67,712	28.31	61,630
HANGINGWALL	89,288	26.86	77,100
150 VEIN	277,926	25.41	227,012
TWIN	762,437	28.95	709,601
TOTALS	**1,250,198**	**27.53**	**1,106,511**

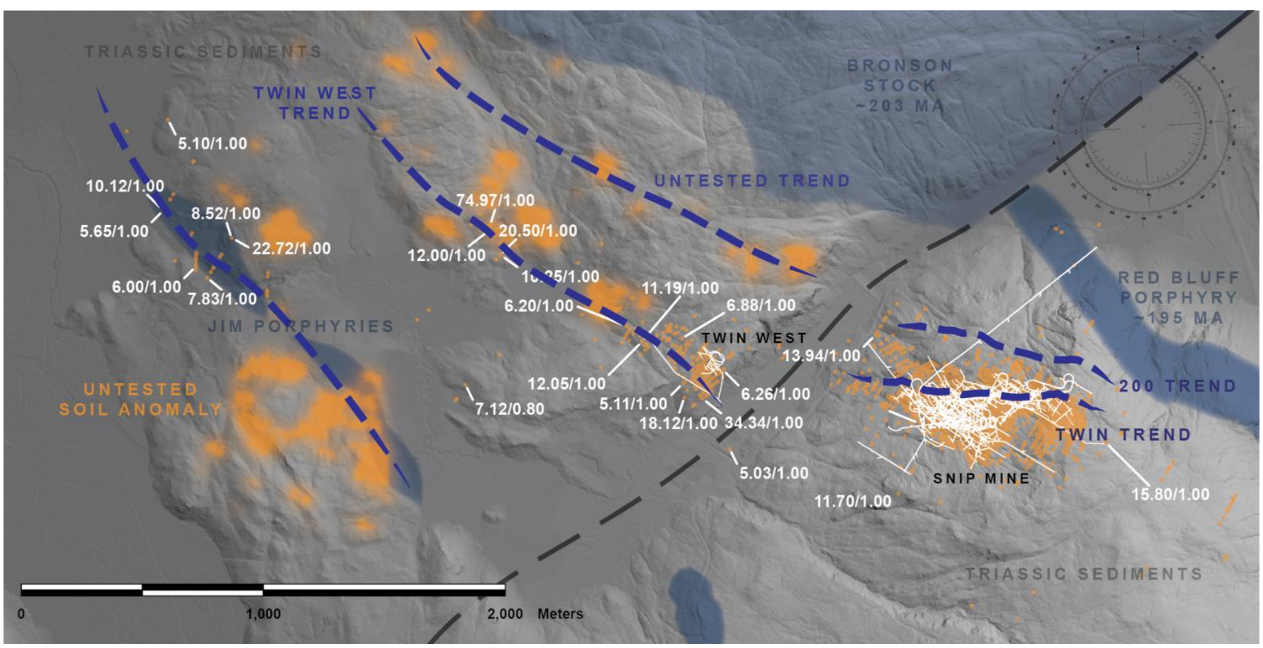
This image helps lay out the scene. The gold at Snip sits in veins that dip steeply south, cutting into the hillside you can see above. The Twin zone was discovered first and was easy to track, as it follows a change in rock type, so it was largely mined out.

The biggest new area is the Footwall zone, where Skeena has pulled some nice intercepts, including 16.2 g/t gold over 13.5 metres. In between Twin and Footwall are a series of smaller veins – the 130 and 150 Veins – that were mined to some degree in some areas but have large unexplored dip extensions. Stepping back: Twin and Footwall mark two sides of a gold-endowed shear zone, while the 130 and 105 veins are part of that zone.

SNIP 200 FOOTWALL - SECTION 4660E



There is also Twin West, which as you can see in that first schematic sits across the valley. And west of that is a large untested gold-in-soil anomaly along strike from a series of good exploratory drill holes.



Skeena has done 25,400 metres of drilling at Snip since acquiring the project from Barrick in mid-2017. The team has not yet published a resource. The grades are looking great, averaging something like 10 to 12 g/t gold, but it takes a lot of drilling to prove that mineralization is consistent along structures like these and the drill density isn't there yet.

As such I would guess an estimate today would yield several hundred thousand ounces…which is why they haven't issued a resource yet. Skeena would want to have more like a million ounces of high-grade gold before pegging Snip with a new resource.

The work planned at Snip this summer will help get them there. The focus will be on probing the Footwall zone with greater drill density. That work should generate a series of high-grade results, so while Snip is not the focus of the Skeena story it should add some momentum.

In fact, Snip has already added momentum to the Skeena story. Last year Skeena announced that London-based miner Hochschild was investing $6.7 million into the company and inking a deal whereby HOC can earn 60% ownership of Snip by spending twice what Skeena has already spent ($16.8 million) within a multiyear period.

Hochschild's involvement is great. First the deal layered confidence onto that project, as HOC is an experienced operator and specifically knows how to mine narrow, high-grade deposits. Second, the deposit is undeniably complex so adding HOC's geologists to the think tank can only help in figuring it out.

Wrap Up

Skeena has characteristics that I think will make it stand out as this gold market heats up.

- Projects that are not only located in the heart of the attention-grabbing Golden Triangle but that helped turn the area into a gold play through long-lived, high-grade gold operations
- Eskay Creek: famous for its grades, but burdened because historic ore was high in deleterious elements. The new Eskay resource is largely in a different rock type and therefore is almost free of arsenic, antimony, and mercury. Results from a full suite of metallurgical testwork are due this month and should help the market understand that today's Eskay is not the same as the historic Eskay in terms of elements contaminating the ore
- Eskay Creek: PEA out this summer will demonstrate how strong the asset is already, as a high grade, open pit mine. Meanwhile infill drilling should help upgrade the inferred resource grade while exploration drilling has the potential to turn up new excitement.
- Snip: very high grades, with exploration now guided by Hochschild, whose endorsement is significant.

No stock is perfect and Skeena has its things. First, the company is currently raising money. That's all well and good; I understand the raise is oversubscribed.

The bigger question is money down the road. To complete the Eskay earn in Skeena has to pay Barrick $10 million by December 2020, plus post $7.7 million to cover the environmental bond. The company is clever with all things finance; I know they are working some interesting angles ranging from royalty sales to returning a lesser project that covers important First Nations ground to the government, which would provide some compensation.

At the end of the day, the hair on the stock is the need to find $17.7 million in 18 months. The team will do it and will do what it can to limit dilution (after doing a roll back companies really cherish their share structures), but I do expect some significant financing over the next while to fund exploration and this payment.

I know the team is also in talks with several miners interested in potentially taking a stake in Skeena, so that is also a possibility.

In Skeena I see a stock that looks to have bottomed after a long slog, with two strong & splashy projects in a popular jurisdiction. I see strong news flow ahead, including an initial mine plan for Eskay plus the potential for splashy exploration results. And I think the company will attract involvement from a notable player in the mining world – another mining company as an investor or a royalty player buying in – sometime this year, which would add further credibility to its projects.
