

Uranium Series Special: COVID-19 Impact Update

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Daren: So, Chris, thanks for joining me again. I thought we should record our thoughts on the most recent news. In a way this is an update to our most recent podcast, which discussed the impact of COVID on our supply and demand thesis. So, maybe a place to start is: what were our assumptions regarding supply at the end of our last podcast? What did we say the impact of COVID was going to be on our supply forecast for 2020 and 2021?

Chris: Yeah, I think at that point we thought the impact was going to be about a twenty-million-pound hit to 2020 production. That number is probably gonna be up a little bit from that; it's yet to be determined, but it's not gonna be lower than that.

Daren: Yeah. Perfect, that's a good starting point. And we recorded that podcast and discussed our assumptions in...I believe it was early July, maybe mid-July.

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Chris: Right.

Daren: And what's happened since then is that Cameco reported their second-quarter update; Kazatomprom gave their second-quarter production update, although their actual financial results are scheduled for the next couple weeks. That's relevant because they might give more forward-looking guidance of production in late-August, but for now we can go off of what they gave us on August third. So, the stocks sold off a little bit, so what were the big news items out of Cameco and Kazatomprom?

Chris: So, maybe let's just take Cameco first since they reported first. The big takeaways were: number one, that they plan on restarting their Cigar Lake mine, which—again—is the biggest operating mine in the world right now, with about eighteen million pounds a year of production. So, they plan to attempt to restart that in September. I think the market was maybe thinking that that was gonna be closed for the rest of the year, so I think people were a little bit disappointed in that news. And then the other news from Cameco was that they were able to purchase almost fifteen million pounds of uranium in the open market during the second quarter and, you know, that was—I think—surprising to people just in terms of the volume that they were able to get there, at a price of around thirty-one dollars, the average price, so...

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Daren: Yeah, and even to add to that point that they were able to buy fifteen million pounds in the open market: they also described it as being surprisingly easy. That set off alarm bells when I was listening to the conference call.

Chris: Right.

Daren: Maybe the other embellishment to their decision to restart Cigar Lake is that I was expecting them to restart Cigar Lake for economic reasons. So, they took Cigar Lake off for COVID-related reasons, and they gave some pretty heavy hints that they wouldn't restart Cigar Lake until the economics justified it. And sitting here today, you look at that and go, "Well, it's not obvious to me that the economics justify restarting Cigar Lake." Maybe go to Kazatomprom and tell our audience what we learned from that press release.

Chris: Yeah. Okay, so Kazatomprom also sort of gave a second-quarter update, and what they said was that they also plan to try to ramp up their production here in August. They had been on a delay of doing drilling and pre-production work since April, and it was originally a three-month shutdown that was extended through July. Maybe that was also a little bit disappointing to the market, because it does appear like things on the ground in Kazakhstan regarding

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COVID are still pretty serious. I think the government has a nationwide lockdown that has been extended now through the middle of August. But, nevertheless, Kazatomprom—the company—is going to try to ramp up there. Mostly what they’re doing is drilling and getting land ready for production in the future, and that’s what’s been put on hold. And so, I think people maybe were thinking that that was gonna continue, so that was maybe a little disappointing as well to the market.

Daren: And maybe it’s worth a quick explanation of the ISR process and how that’s a long lead time [for] well development.

Chris: Well, I think is where maybe it gets interesting in terms of future production. They have to drill out their properties so that they can extract the uranium from the land, and so you really can only do that, feasibly, in the warm weather months in places like Kazakhstan or Wyoming, where we do it in the U.S., because the ground freezes down to five feet deep and the temperatures in Kazakhstan in the wintertime are frequently below zero. So, the main opportunity to sort of get the properties ready for uranium extraction is in the warm weather months, from April through October, and so they’ve lost more than half of that time. And so, what that means is, as you look into next year, they’re gonna be behind the eight-ball even if they are able to successfully restart here in

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August—it's just gonna give them maybe a couple months of drilling instead of seven or eight months. So, they haven't yet said what production is going to be for 2021. In that update for the second quarter they did say that production the second half was going to be severely impacted. They had previously said the three-month delay was gonna cause a ten-million-pound reduction in production for 2020, so the four-month delay [will] probably get you closer to twelve or thirteen million pounds. Again, we just don't know what's gonna happen in 2021, although they did also say that they like to keep a six or seven-month inventory, and there's going to be no opportunity to add to their inventory from production through the end of 2021. So, I think that gives you an indication that 2021 production is likely to be impacted, we just don't know how much yet.

Daren: Yeah, we're likely to find out at the end of this month when they give their final second-quarter results.

Chris: Yeah, and also production in the second was down five percent year over year so, you know, even though the brunt of the impact is ahead of them, there were some effects on production in the second quarter, as well.

Daren: Yeah, and then lastly, from that call, they

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disclosed that they had been buying in the spot market at the end of the quarter. So, the stocks sold off kind of across the board—they had had a huge run up across the board, as well—but I think that the immediate reaction to the Cameco news that day was negative; the stock was down something like ten percent. So, the market, in aggregate, took this news from both companies as negative. They confirmed that they're gonna bring their supply back online, despite the fact that the price of uranium, in the spot market anyway, is in the low thirties. And then secondly, both companies were able to participate in the spot market and accumulate pounds in the low thirties. And so, if you just look at that in isolation, that's not great news. But we reflected on it, and we gathered some more information, had a couple more conversations, externally and internally. Before you summarize it, I want to acknowledge that this is the perfect setup for confirmation bias. We were already very bullish, we get new information that could be interpreted as negative or positive, and we—I guess I'm giving away the game, here—we ended up interpreting this information positively. We're taking all this information we have and confirming our bullish thesis so, for you listeners out there, we are aware of the risk of confirmation bias; it's very difficult to fight it. We try to take that into account, but it's a real thing and it exists. But having said that, Chris, what's our latest thoughts on what we learned here from Cameco and Kazatomprom?

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Chris: Yeah. Yeah, and I would say, you know, upon further review, we viewed the announcements as more positive than the market, and here's why: so, Daren alluded to the fact that Kazatomprom was making purchases in the spot market in the second quarter. They also said that they're likely to continue to do so if they can. And so, we were kind of scratching our head about Cameco; "Okay, they're able to buy fifteen million pounds in the spot market, and the price of uranium's only in the low thirties. Why would they try to reopen their Cigar Lake mine?" Again, the spot market, I think, is where it gets interesting because—I guess one thing that Cameco pointed out on their call is that they noticed through their trading operations an imbalance between available supply in the first half and utility requirements in the second half of 2020. So, they think that the pounds that were available in the first half will not be as readily available in the second half. And then, when you get into the three biggest uranium suppliers in the world, you look at Cameco: you know, they have been buying in the spot market. When you look at 2021, even if you assume that Cigar Lake is able to ramp back up to full production of eighteen million pounds, and you assume that their Inkai JV in Kazakhstan is able to produce at full production, they're probably only going to have, through production, thirteen, fourteen million pounds, and we think that they have under contract somewhere in the low to mid-twenties, twenty million pounds of

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uranium for 2021. They won't say yet exactly what that number is, but they say that the five-year average is nineteen million pounds a year and it's front end loaded. So, we estimate that Cameco is probably ten million pounds short for 2021, that they're gonna have to buy in the spot market even with Cigar Lake up and running fully. That's number one. Then you look at Kazakhstan: they're buying in the spot market right now and, as we mentioned earlier, we think that 2021 production is going to be affected maybe more than the market thinks, as a result of their inability to prepare their land for production for next year. So Kazatomprom, the world's largest producer, is now a buyer of uranium in the spot market. And then, the third piece here that doesn't seem to get mentioned a lot is Orano. Orano is Cameco's JV partner on Cigar Lake. They haven't gotten those pounds, so they're short there. They're also Cameco's partner on McArthur River and they haven't gotten those pounds, either, since 2018. And, interestingly, in 2018 Cameco actually loaned them over five million pounds of uranium in order for them to fulfill some of their contracts, which they have to pay back to Cameco before the year end [of] 2023 in kind, in uranium. And then, lastly, their operations in Niger; the Cominak mine is scheduled to ramp down production and close in early 2021, so it seems likely that Orano is also short pounds. Orano also has JVs in Kazakhstan which are in the neighborhood of eight million pounds. So, when you look at all that, you have the three largest

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producers in the world now are likely to be buyers in the spot market for the next twelve to eighteen months going forward. And I think Cameco is looking at that and thinking that, "We probably need to restart the Cigar Lake mine in order to have a chance at having enough uranium for our own account, given the competition is probably gonna be out there for spot market pounds over the next year and a half." You know, we think that instead of it being bearish that they're restarting, we think it's bullish that they're restarting because they need the pounds.

Daren: Right. We know that Cameco's management team knows more than we do.

Chris: Right.

Daren: So, we're looking at their actions, and based on what they're doing, we are interpreting their actions that they are bullish. And they've lived and breathed the uranium market for decades and, because of their trading operations, they touch every part of the uranium industry, and they know what's going on in every part of the world. And so, if they're starting the Cigar Lake [mine] again it's because they see a supply deficit out there soon, which confirms what we're seeing from the big picture from the information we can gather. Again, we think it's confirmation of our supply deficit thesis.

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Chris: One other thing I want to mention about Cigar Lake is that, maybe not as acutely as in Kazakhstan, but they have a number of pre-production projects that they need to complete at the Cigar Lake mine to ensure that they can operate at full production in 2021. And, you know, as a result of the COVID shutdowns they're behind on that work, as well. So, even if they're able to fully ramp this up it's not a hundred percent certain that they can produce at full capacity in 2021, as well. And then, even stepping back from that, it's not a guarantee that either one of these restarts is actually going to work. Both have stressed the paramount importance of health and safety of their workforce, and so Cameco has to fly the workforce in, in and out of there every two weeks. So, people are, you know, going back to where they live and then flying back into the Cigar Lake mine, so there's definitely risk involved with that. And then, as I mentioned already, Kazakhstan the country is still under lockdown right now, as Kazatomprom is trying to ramp up. So, it's not a slam dunk that either of these things are going to be able to restart as they hope, so that's another variable out there that could work in our favor.

Daren: Yeah. Right. And again, looking at Kazatomprom's actions—so looking at their desire to restart wellhead development as soon as possible, basically, despite the fact that Kazakhstan is still under significant restrictions, basically a nationwide lockdown—again,

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indicates to us that they really feel pressure to get production going again. If they saw plenty of inventory out there for the next couple years, they wouldn't be so eager, in my opinion, to get going again.

Chris: Yeah, they might be more willing to just delay it and wait and see.

Daren: So, actually I want to circle back to one more topic. It's a bit out of order. I should have asked about Cameco's inventory buying. So, they were able to buy fifteen million pounds in the most recent quarter, so let's talk about where that came from and why we aren't giving that a lot of weight, that they were able to buy fifteen million pounds in one quarter. Where is it not coming from?

Chris: Right, right. They stated pretty clearly on the call that it was not coming from inventories that were held by either the Japanese—which is a long-standing source of concern in the market, that the Japanese were gonna sell down their inventories—they are not selling right now, and other global utilities are also not selling. So, the pounds are not coming from inventories, they're coming from producers, and they specifically mentioned BHP and Olympic Dam, where uranium's a byproduct of the copper mine, and so they just sell uranium into the spot market as it's produced. And then they also mentioned Uzbekistan as a source, as

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well as some traders. So, they stated clearly that it was coming from producers and not liquidation of inventory. Again, circling back to the beginning, we see mine production at a hundred-and-fifteen million pounds, maybe, this year, and demand is gonna be somewhere in the hundred-and-ninety-million-pound range. There's another thirty-five million pounds that come from secondary sources, but that still leaves you short forty million plus pounds this year in terms of overall supply. Mine supply is not a source of unlimited pounds; most of it's going to be used by reactors.

Daren: And going back to this idea of where those pounds came from: of the pounds that Cameco accumulated, [somewhere] in the five-million-pound-range came from producers. They were pounds that were actually produced that quarter. That implies that ten million pounds was absolutely inventory reduction, not from commercial utility-held inventories, but probably financial buyers—

Chris: Right.

Daren: Financial traders, as you say. That's gone for good. I mean, that's taken off the market. There's no question in our minds [that] that's pure inventory reduction. The bull market will be unstoppable when there is no inventory left in the world to buy for

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consumption, and we feel like we're closer to that day now than we were before.

Chris: And the price move from twenty-four to thirty-one probably pried loose some of those pounds from traders that were able to book a nice profit out of those in the short-term here. But then when they need to try to refill their inventory, they're gonna have to pay the going rate now, which is in the thirties.

Daren: Right. If they're lucky.

Chris: If they're lucky, right, yeah.

Daren: And we'll see if it's available. You know, we ask ourselves all the time, "Where is it gonna come from?" The amount of inventory that is out there is not inexhaustible.

Chris: Right.

Daren: We think we're very close to that exhaustion. In fact, it's possible we're there, but we just don't see how it could last through the end of next year. So, bringing it back to the point of this update: based on Cameco's management team's decision to restart Cigar Lake, based on Kazatomprom's decision to really push to try to get some of these wellheads developed so that they can produce next year, we think the management teams might be seeing the same lack of

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supply that we're seeing, and they've basically been communicating that for a while. The difference is it could be closer than what the market believes, that these restarts are actually confirmation that that supply deficit is really right around the corner and that's why these guys want production.

Chris: Right. Right, it's a sign of scarcity going forward here.

Daren: Alright, Chris, thank you. We covered everything in my notes, and I appreciate your thoughts on this.

Chris: Yeah, great, thank you.

Daren: Alright, talk to you soon.

Chris: Okay, bye.