

## CONTRA THE HEARD

(Last update Dec. 9, 2019)

UPDATE Dec. 16, 2019

### VICE-PRESIDENT'S PORTFOLIO

TSX Buy: Cameco Corp. (CCO)

Purchase Price	\$11.86
Shares	1,300
Buy Limit	\$14.50
Sell Range	\$27.50 to \$35.00
Current Price	\$11.73

For years we have been asked questions like "what do you think of uranium and Cameco?" If you are one of these people, here is our answer. We have been watching the sector and Cameco for years. Phil has owned it personally since late 2017, and on his computer, there are unfinished drafts like this one dated November 2016 and March 2018.

The company is an industry leader with low-cost mines, is the world's biggest supplier of uranium outside of Kazakhstan and has deep supply relationships with utilities around the globe. Over time, the management team has demonstrated flexibility and persistence in the face of various challenges.

As the post-Fukushima bear market dragged on, they reduced production from 14.7 million kg. in 2011 to 7.9 million kg. in 2017. Then in 2018 Cameco shifted strategy by putting the McArthur River / Key Lake facility on care and maintenance. This reduced supply, especially as it prompted similar actions in Kazakhstan. It also costs them about \$7-\$9 million a month.

To ensure Cameco could still fulfill its obligations to utilities, they started purchasing uranium on the spot market and selling it at a higher price on the contracted market. This strategy has been in place for roughly two years now and the price of uranium has stabilized. Going forward, Cameco is likely in a good position. If the price of uranium rallies, they can fire up the McArthur facility (which would take about nine months), and if the price remains low, they can continue the uranium trading strategy.

This brings us to the all-important question: where will uranium prices go? There appear to be two camps. One argues the market is well supplied through 2030, and another which maintains utilities will start facing supply shortfalls next year. These prognosticators expect the gap will be vast by 2030. If it turns out that the market is well supplied for the next decade, CCO could trade sideways for years. If supply issues are imminent then it could rally fast. Given that the bears currently have the upper hand, we conclude the stock is more likely to surprise to the upside versus the downside.

Cameco recently reduced its debt by a third or \$500 million, increased its 2019 outlook, and is trading near record low valuations. Insiders have also bought \$1.6 million in stock over the last year and haven't sold a dime.

In addition to the big picture, Cameco has faced legal challenges from the Japanese utility TEPCO, the CRA, and the IRS. The CRA case remains in play. They allege Cameco owes roughly \$2 billion for improper use of foreign marketing and trading subsidiaries in the 2000s. In 2017, Cameco won a similar case versus the IRS, and in 2018 the Tax Court of Canada ruled in Cameco's favour.

In October 2018, the CRA appealed the decision to the Federal Court of Appeals where a decision could take up to two years. That verdict can potentially be appealed to the Supreme Court of Canada. Unlike the lower court, the Federal Court of Appeals is not fact finding, it is reviewing the Tax Court's decision. Given that Cameco was awarded \$10 million for costs in the first round, we like their chances, but this legal case remains a wild card.

Potential investors must also consider the slow pace of Japanese reactor restarts, climate change policy, and natural gas competition. What the Trump Administration will do is another consideration and is currently driving share price volatility. The working group established to improve domestic supply on national security grounds is likely to recommend the purchase of more uranium from domestic mines. This may help Cameco given they have some of the lowest cost assets in the United States, but it may also hurt if new production comes on to the market.

Overall, the risk/reward profile on this one is attractive enough to throw a moderate amount of money at it.