

# Action Note

Equity Research

July 26, 2018

Metals &amp; Minerals

## Uranium Participation Corp.

(U-T) C\$4.39

### Upgrading to BUY on Extended Suspension of McArthur River

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#### Event

Yesterday evening, Cameco Corp. announced that it will keep its McArthur River/Key Lake operations suspended for an "indeterminate duration".

#### Impact: POSITIVE

- Cameco's decision to suspend McArthur River, underscores its strong commitment, in our view, to balancing the uranium market and not deliver high-quality uranium reserves into prices which remain unsustainably low. Cameco's management has clearly stated that it will not resume production until output can be delivered into long-term contracts that provide an acceptable rate of return - we interpret this to mean term prices of >US\$40/lb.
- We believe that McArthur River will remain offline for several years, with a modeled return to production in mid-2021. The net impact of the long term suspension of McArthur River, combined with recent production curtailments at Kazatomprom (the world's largest producer), and the suspension of Paladin's Langer Heinrich mine set the stage for slight global uranium deficits for the next few years. The closure of McArthur River essentially removes 18-19mmlbs of annual production capacity from the market.
- Cameco will ramp-up its uranium buying program.** CCO management has indicated that it will purchase an additional 2-4mmlbs in 2018, above the existing commitment of 8-9mmlbs. For 2019, Cameco now expects to purchase 9-11mmlbs in order to deliver on sales commitments of 25-27mmlbs and maintain a target inventory of ~4.5 months of forward sales.
- Uranium price forecast increased.** We expect that the combination of lower supply and Cameco's purchasing activity in the spot market will force uranium prices higher (Exhibit 1). We have increased our industry 2018 price forecast to US\$25.57/lb (from US\$23.37/lb), and for 2019/2020/2021, we have increased our forecast prices to US\$35/lb, US\$40/lb, and US\$45/lb, respectively (from US\$27/lb, US\$30/lb, and US\$35/lb). NB prices in Exhibit to the right are for UPC's fiscal year.

#### TD Investment Conclusion

We are increasing our target price to **\$5.50 (previously \$4.75)** and raising our recommendation to **BUY (from Hold)**. Our target is based on 1.0x (previously 1.05x) our forward NAVPS estimate of \$5.67 using our increased uranium price forecasts that reflect the expected forward-looking uranium supply deficits.

#### Recommendation:

BUY↑

Prior: HOLD

#### Risk:

HIGH

#### 12-Month Target Price:

C\$5.50↑

Prior: C\$4.75

#### 12-Month Dividend (Est.):

C\$0.00

#### 12-Month Total Return:

25.3%

#### Market Data (C\$)

Current Price	C\$4.39
52-Week Range	\$3.47 - \$4.68
Mkt Cap (f.d.) (\$mm)	\$606.3
Mkt Cap (basic) (\$mm)	\$0.0
Float Cap (\$mm)	\$605.4
EV (\$mm)	\$550.8
Current Dividend	\$0.00
Dividend Yield	0.0%

#### Financial Data (C\$)

Fiscal Y-E	February
Shares O/S (f.d.)(mm)	138.1
Float Shares (mm)	137.9
Net Cash/ Shr (f.d.)	\$0.00
Net Debt (\$mm)	\$(30.5)
Cash/Shr (f.d.)	\$0.00
NAVPS	\$5.67

#### Estimates (C\$)

Year	2017A	2018A	2019E	2020E
EPS (basic)	(0.04)	(0.06)	(0.03)	(0.03)

#### Valuations

Year	2017A	2018A	2019E	2020E
P/E (basic)	(109.8)x	(73.2)x	(146.3)x	(146.3)x

#### Supplemental Data

Year	2017A	2018A	2019E	2020E
U3O8 (US\$/lb)	25	22	29	36
UF6 US\$/kg	71	63	82	103

\* Supplemental data represents our estimate uranium price for the company's fiscal year end (February).

All figures in C\$, unless otherwise specified



#### Company Profile

Uranium Participation Corp. (U-T, UPC) is a Canadian company listed on the TSX. Its primary objective is to provide direct exposure to uranium through its physical holdings of uranium oxide (U<sub>3</sub>O<sub>8</sub>) and hexafluoride (UF<sub>6</sub>).

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### Outlook

#### Exhibit 1. Revised TD Uranium Price Deck

US\$/lb	2018E		2019E		2020E		2021E		2022E		LT	
	Old	New	Old	New	Old	New	Old	New	Old	New	Old	New
Uranium	23.37	25.57 ↑	27.00	35.00 ↑	30.00	40.00 ↑	35.00	45.00 ↑	45.00	45.00	55.00	55.00
FX (US\$/C\$)	0.78	0.78	0.78	0.78	0.79	0.79	0.80	0.80	0.82	0.82	0.82	0.82

Source: Company reports; Ux Consulting; TD Securities estimates

**Cameco's 2018/19 additional purchase requirements total 11-15mmlb** - To meet its commitments in 2018, and taking into account the Orano loan of up to 5.4mmlbs, Cameco expects that it will need to purchase 2-4mmlbs of uranium this year in addition to existing purchase commitments of 8-9mmlbs. Looking at 2019, Cameco expects to produce 9mmlbs, has commitments to purchase between 5-6mmlbs, and sales commitments to deliver between 25-27mmlb. To meet 2019 delivery commitments and maintain a target inventory of ~4.5 months of forward sales in inventory, Cameco will need to purchase an additional 9-11mmlb. At the end of Q2/18, Cameco had 19.3mmlb of U3O8-equivalent in inventory.

**Three years of uranium supply deficits** - The deficits come with the suspension of McArthur River mine (18-19mmlbs of annual production) indefinitely, as well as the curtailments of Kazakh production to 21,600t U (from 23,000t U), and the IPO of Yellow Cake, a uranium holding company that will use its funds to purchase 8.1mmlbs of U3O8 from Kazatomprom. We now forecast uranium supply deficits in 2018, 2019, and 2020 of -7mmlbs (prev. -6mmlbs), -5mmlbs (prev. +14mmlbs), and -4mmlbs (prev. +10mmlbs), respectively.

#### Exhibit 2. Updated TD Uranium Supply/Demand Model

	2010	2011	2012	2013	2014	2015	2016	2017	2018E	2019E	2020E	2021E	2022E	2023E
<b>Mine Supply - Western World (mm lbs U3O8)</b>														
Total Mine Supply - Western World	85	86	90	93	85	106	103	103	82	86	90	95	106	108
Net Eastern Mine Supply (lbs U3O8)	55	55	59	60	60	57	62	54	53	56	56	56	56	57
<b>Total World Mine Supply (mmlb U3O8)</b>	<b>140</b>	<b>141</b>	<b>150</b>	<b>153</b>	<b>145</b>	<b>163</b>	<b>165</b>	<b>157</b>	<b>136</b>	<b>142</b>	<b>146</b>	<b>151</b>	<b>162</b>	<b>165</b>
YoY % change	5.9%	0.9%	5.9%	2.4%	-5.3%	12.2%	1.1%	-4.5%	-13.7%	5.0%	2.7%	3.5%	7.1%	1.8%
<b>Secondary Supply</b>														
Global underfeeding and tails re-enrichment*	9	5	5	15	20	20	18	19	18	16	15	15	15	15
Mixed Oxide Fuel (MOX)*	7	8	10	8	8	4	4.7	5	5	5	6	6	6	6
US government sales (DOE Proposed)*	6	5	5	8	8	7.3	4.2	3.1	1.6	0.0	0.0	0.0	0.0	0.0
Additional Russian secondary supply*	24	24	24	24	5	1.9	1.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other (commercial inventories)					4	8	7	7	7	7	7	7	7	7
<b>Total Secondary Supply (mmlb)</b>	<b>46</b>	<b>42</b>	<b>43</b>	<b>55</b>	<b>45</b>	<b>42</b>	<b>36</b>	<b>34</b>	<b>31</b>	<b>28</b>	<b>28</b>	<b>28</b>	<b>28</b>	<b>28</b>
<b>Total Supply</b>	<b>186</b>	<b>183</b>	<b>193</b>	<b>208</b>	<b>190</b>	<b>205</b>	<b>200</b>	<b>191</b>	<b>167</b>	<b>171</b>	<b>175</b>	<b>180</b>	<b>191</b>	<b>194</b>
<b>Total World Demand</b>														
Total World Nuclear Generating Capacity (MWe) *						345,333	351,251	358,799	369,682	374,838	379,949	382,842	383,809	385,821
Uranium requirements per MWe						464	474	470	470	470	470	470	470	470
Uranium demand (mmlb)						160	167	169	174	176	179	180	180	181
First Core Requirement (2 year lead)						-	-	-	-	-	-	-	-	-
<b>Total World Demand (mmlbs U3O8)</b>	<b>165</b>	<b>155</b>	<b>155</b>	<b>170</b>	<b>155</b>	<b>160</b>	<b>167</b>	<b>169</b>	<b>174</b>	<b>176</b>	<b>179</b>	<b>180</b>	<b>180</b>	<b>181</b>
YoY % change	-2.4%	-6.1%	0.0%	9.7%	-8.8%	3.4%	3.9%	1.2%	3.0%	1.4%	1.4%	0.8%	0.3%	0.5%
<b>Supply / Demand Balance (mmlb)</b>	<b>21</b>	<b>28</b>	<b>38</b>	<b>38</b>	<b>35</b>	<b>44</b>	<b>34</b>	<b>22</b>	<b>-7</b>	<b>-5</b>	<b>-4</b>	<b>0</b>	<b>10</b>	<b>12</b>
Historical Spot Uranium Price (US\$/lb U3O8)	46.46	57.08	48.73	38.57	33.60	36.89	26.57	22.12	25.57	35.00	40.00	45.00	45.00	55.00

\* Source: World Nuclear Association - Nuclear Fuel Report 2017-2035

Note - TD LT price assumption starts in 2023; a flat US\$55/lb price is assumed for 2023 and beyond.

Source: Ux Consulting; World Nuclear Association; Bloomberg; TD Securities estimates

Following the month of June, we calculate that UPC's shares were trading at a 6% premium to NAV, which is consistent with the company's average premium to NAV over the last 12-months (Exhibit 3).

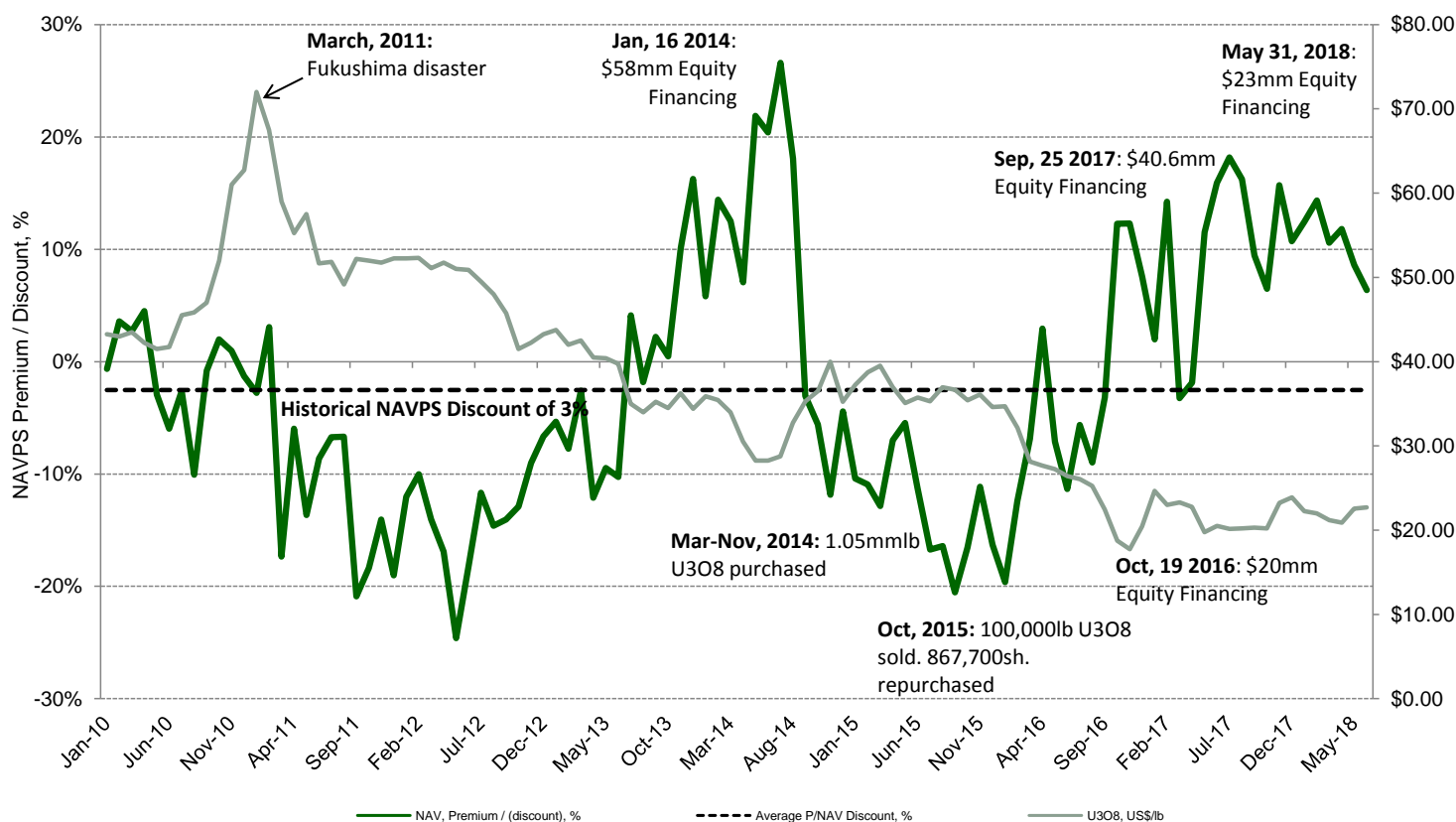
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We have updated our estimates to reflect the company's purchase of 675,000lbs of U3O8 at US\$22.76/lb (TD estimate was for 650,000lbs at US\$22.75/lb) following the close of the company's \$23.0mm bought deal financing. We calculate UPC's 12-month working capital at \$4.8mm following the 675,000lbs uranium purchase.

### Exhibit 3. Historical NAV Premium/Discount to the Uranium Price



Source: company, TD Securities Inc.

**Activity should pick up further in the spot market –** At a minimum, we expect activity in the spot market to increase over the remainder of the year, with UPC entering the market post the financing, and Cameco expected to be increasingly active in order to meet its contractual demands. Total spot market activity year-to-date stands at 45.6mmlbs, which is at a 10-year high and is closing in on the previous annual record of 56mmlbs set in 2011. Total term market volume year-to-date is ~16.3mmlb, which compares to 73.1mmlb for all of 2017.

### Exhibit 4. Pro-Forma NAV Estimate at Current Spot Prices

Current Uranium Holdings	Units	Inventories Held	Price US\$/unit	Implied Value US\$, mm	Price C\$/unit*	Implied Value C\$, mm	
Uranium Oxide in Concentrates, U3O8	lb	13,649,354	\$24.00	\$ 327.6	\$30.84	\$ 420.9	
Uranium Hexafluoride, UF6	kg	1,117,230	\$69.60	\$ 77.8	\$89.43	\$ 99.9	
<b>Implied Value of Inventories Held</b>				<b>\$ 405.3</b>		<b>\$ 520.8</b>	
						Working Capital	\$23.7
						Total NAV	\$ 544.5
						Shares Outstanding, mm	138.1
						<b>NAVPS</b>	<b>C\$3.94</b>

Forex CAD/USD 0.78

Source: Company, TD Securities Inc.

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## Valuation

Our forward NAV of \$782.6mm or \$5.67/share for UPC is based on our 12-month price forecast of US\$35.00/lb (previously US\$27.00/lb), using a 0.78 CAD/USD exchange rate. In addition, we assume a forward working capital position of \$4.8mm, following the purchase of 675,000lbs of U<sub>3</sub>O<sub>8</sub> at US\$22.76/lb (510,000lbs remain to be purchased). Our UF<sub>6</sub> price assumes a 2.83x UF<sub>6</sub>/U<sub>3</sub>O<sub>8</sub> ratio to convert the price of U<sub>3</sub>O<sub>8</sub> to UF<sub>6</sub> based on recent price quotes.

### Exhibit 5. Implied 12-Month Forward NAV and Target Price Calculation

Current Uranium Holdings	Units	Inventories Held	Price US\$/unit	Implied Value US\$, mm	Price C\$/unit*	Implied Value C\$, mm
Uranium Oxide in Concentrates, U <sub>3</sub> O <sub>8</sub>	lb	14,159,354	\$35.00	\$ 495.6	\$44.87	\$ 635.4
Uranium Hexafluoride, UF <sub>6</sub>	kg	1,117,230	\$99.45	\$ 111.1	\$127.50	\$ 142.4
<b>Implied Value of Inventories Held</b>				\$ 606.7		\$ 777.8
					Working Capital, C\$m	\$4.8
					Total NAV, C\$m	\$ 782.6
					Shares Outstanding, mm	138.1
					<b>NAVPS</b>	<b>C\$5.67</b>
				Implied Target, 1.00x multiple to NAV, weighted 100%		\$5.67
					Target Price Rounded	<b>C\$5.50</b>

\* Forex CAD/USD 0.78

Source: TD Securities Inc.

### Exhibit 6. NAVPS Sensitivity Analysis

C\$NAVPS to Spot U <sub>3</sub> O <sub>8</sub> and Forex CAD/USD		0.74	0.76	0.78	0.80	0.82	0.84
U <sub>3</sub> O <sub>8</sub> US\$/lb	\$22.50	\$3.85	\$3.75	\$3.66	\$3.57	\$3.48	\$3.40
	\$25.00	\$4.28	\$4.16	\$4.06	\$3.96	\$3.86	\$3.77
	\$27.50	\$4.70	\$4.58	\$4.46	\$4.35	\$4.25	\$4.14
	\$30.00	\$5.12	\$4.99	\$4.86	\$4.74	\$4.63	\$4.52
	\$27.50	\$4.70	\$4.58	\$4.46	\$4.35	\$4.25	\$4.14
	\$35.00	\$5.97	\$5.82	\$5.67	\$5.53	\$5.39	\$5.27
	\$37.50	\$6.40	\$6.23	\$6.07	\$5.92	\$5.78	\$5.64
	\$40.00	\$6.82	\$6.64	\$6.47	\$6.31	\$6.16	\$6.01
	\$42.50	\$7.25	\$7.06	\$6.88	\$6.70	\$6.54	\$6.39

Assumes the UF<sub>6</sub>/U<sub>3</sub>O<sub>8</sub> price exchange ratio is constant at 2.83x

Potential Return to Share Price (assumes 1.0x multiple to NAVPS)		0.74	0.76	0.78	0.80	0.82	0.84
U <sub>3</sub> O <sub>8</sub> US\$/lb	\$22.50	-5%	-7%	-10%	-12%	-14%	-16%
	\$25.00	6%	3%	0%	-2%	-5%	-7%
	\$27.50	16%	13%	10%	7%	5%	2%
	\$30.00	27%	23%	20%	17%	14%	12%
	\$27.50	16%	13%	10%	7%	5%	2%
	\$35.00	47%	44%	40%	36%	33%	30%
	\$37.50	58%	54%	50%	46%	43%	39%
	\$40.00	68%	64%	60%	56%	52%	48%
	\$42.50	79%	74%	70%	66%	62%	58%

Source: TD Securities Inc.

### Justification of Target Price

Our \$5.50 target price (previously \$4.75) and BUY rating (previously Hold) are based on 1.0x (previously 1.05x) our forward NAVPS estimate of \$5.67. We are upgrading UPC to BUY from Hold to reflect our increased uranium price forecasts that reflect improving fundamentals in the spot uranium market. We now use a lower target price multiple following the increase in our uranium price forecasts.



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## Key Risks to Target Price

The key risks to our target price include risks related to uranium and uranium hexafluoride supply, demand and price; financial risks (including those relating to the cost and availability of financing); foreign exchange rate risks; forecast risks; market risks; uranium loan risk; uranium storage facility risks; political risks, including legal and fiscal regimes; security risks (including potential for violence and access disruptions), title, litigation, access and key personnel retention, as well as environmental risks, among others. Company specific risks include the potential for the Manager to terminate its Management Service Agreement.

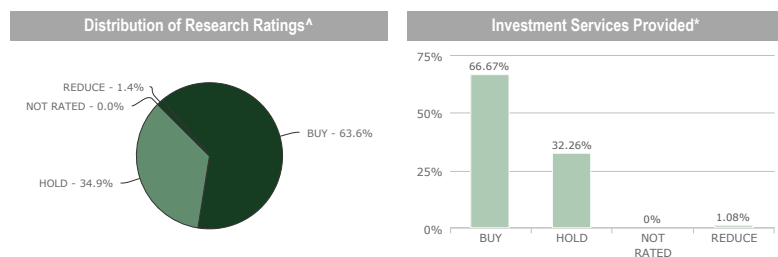


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# Action Note

Equity Research

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