

Action Note

Equity Research

September 28, 2018

Metals & Minerals

Cameco Corp.

(CCO-T, CCJ-N) C\$14.80 | US\$11.34

The Clouds are Parting; Tax Court Rules in Favour of Cameco

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Event

The Tax Court of Canada has ruled unequivocally in Cameco's favour in its dispute with the CRA for the 2003, 2005, and 2006 tax years.

Impact: POSITIVE

The Tax Court stated that "none of the transactions, arrangements or events in issue in the appeals was a sham". The Tax Court ruled that Cameco's marketing and trading structure involving foreign subsidiaries and the related transfer pricing methodology used for certain inter-company uranium sale and purchase agreements are in full compliance with Canadian laws for the tax years in question (2003, 2005, and 2006). Cameco will be making an application to the court to recover costs incurred over the course of this case, which are estimated at ~\$57mm.

The Tax Court indicated in its ruling that the Minister's transfer pricing adjustments for each of the taxation years under dispute shall be reversed. The Tax Court decision is not legally binding for other tax years in dispute; Cameco believes that there is nothing in the decision that would warrant a different outcome for the other tax years in question.

Cameco has been required under Canadian tax law to remit 50% of the potential cash taxes and penalties arising from the dispute; the company has prepaid (or otherwise secured) \$781mm (\$1.97/share) to the CRA, of which ~\$300mm (\$0.76/share) was in cash payments.

CRA has 30 days from the date of the decision to appeal to the Federal Court of Appeal. Cameco estimates that it would take about two years for the Federal Court of Appeal to hear and decide the matter. CRA cannot submit new evidence related to the case, according to Cameco management. Although an appeal is possible, the CRA could use the judgement to lobby the Canadian government for changes in existing tax laws governing transfer pricing.

TD Investment Conclusion

We are maintaining our BUY recommendation; our target price increases to \$20.00 (from \$18.00). We have elected to remove a negative ~\$600mm adjustment from our NAV-10% which approximated the CRA prepayments remaining to be paid by Cameco. Our NAV increases to \$13.44/share (from \$12.06/share). Our target is based on a 1.5x NAV multiple.

Recommendation:	BUY
Risk:	HIGH
12-Month Target Price:	C\$20.00↑ Prior: C\$18.00
12-Month Dividend (Est.):	C\$0.08
12-Month Total Return:	35.7%

Market Data (C\$)

Current Price	C\$14.80
52-Week Range	\$9.90 - \$15.95
Mkt Cap (f.d.) (\$mm)	\$5,857.8
EV (\$mm)	\$6,864.5
Current Dividend	\$0.08
Dividend Yield	0.5%
Avg. Daily Trading Vol.	1,659,253

Financial Data (C\$)

Fiscal Y-E	December
Shares O/S (f.d.)(mm)	395.8
Float Shares (mm)	395.8
Net Debt/Total Cap	17.0%
NAVPS	\$13.44
Working Cap (\$mm)	\$1,674.4

Estimates (C\$)

Year	2016A	2017A	2018E	2019E
EBITDA (\$mm)	581.0	568.0	480.0	305.0
EPS (f.d.)	0.36	0.15	0.28	(0.03)
CFPS (f.d.)	0.99	1.31	1.00	0.41

EPS (f.d.) Quarterly Estimates (C\$)

Year	2016A	2017A	2018E	2019E
Q1	(0.02)	(0.07)	0.06	-
Q2	(0.14)	(0.11)	(0.07)	-
Q3	0.30	(0.13)	0.03	-
Q4	0.23	0.46	0.27	-

Valuations

Year	2016A	2017A	2018E	2019E
EV/EBITDA	11.8x	12.1x	14.3x	22.5x
P/E (f.d.)	41.1x	98.7x	52.9x	n/m
P/CFPS (f.d.)	14.9x	11.3x	14.8x	36.1x

Supplemental Data

Year	2016A	2017A	2018E	2019E
U3O8 (US\$/lb)	27	22	26	35
U3O8 Prod. Mlb	27	24	10	9

All figures in C\$, unless otherwise specified



Company Profile

Cameco is one of the world's largest uranium producers. The company's flagship McArthur River and Cigar Lake mines are located in the Athabasca Basin in Saskatchewan, Canada.

Details

The clouds are parting — Although an appeal of the Tax Court ruling is a distinct possibility, the unambiguous clarity of the decision is a significant win for Cameco, in our view; while the process may not be over, a significant overhang has been lifted from Cameco's share price and the company's balance sheet — particularly in light of the potential +\$2bln exposure the company could have faced if it had lost the decision. We anticipate that Cameco will end 2018 with cash plus short-term investments of +\$1.1bln and well-positioned to repay a \$500mm debenture due in September 2019. If the CRA does not appeal the Tax Court decision, we anticipate that \$303mm in cash prepayments that Cameco has made to-date would be returned to the company. In addition, Cameco would likely recover \$57mm in costs it has accumulated fighting the case.

Tepco arbitration expected in Q1/19 — Tepco unilaterally cancelled its uranium supply contract with Cameco in late-January 2017. The contract termination affected 9.3mmlb of uranium deliveries through 2028, worth ~\$1.3bln in revenue. In 2014, Cameco successfully defended a claim of 'force majeure' in arbitration with a utility citing "government regulations" as the reason for terminating its contract. The 2014 arbitration process took 30 months. Cameco received the NPV of the difference between the contracted price and the market price at that time — the net payment was ~\$66mm. The Tepco arbitration will take place in Q1/19; Cameco management has indicated that it believes that based on the net present value of the difference between the contract price and market prices, the arbitration award for the Tepco contract would be ~US\$682mm (\$887mm).

Potential upside to our NAV — Although we have elected to remove the remaining CRA prepayments from our net asset value, we have not gone so far as to include the potential cash awards that the company could receive that we have outlined above. The return of CRA cash prepayments plus the potential award of costs and the possible Tepco arbitration settlement combined totals ~\$1.25bln, or \$3.15/share — none of which is included in our net asset value.

Exhibit 1. Potential Upside to Our Net Asset Value

Return of Cameco's cash pre-payments on CRA's 2003-2011 notice of reassessments	C\$m	303.0
Potential award of CRA's tax court legal cost	C\$m	57.0
Potential Tepco arbitration award	C\$m	887.0
Total potential cash receipts	C\$m	1,247.0
Total potential cash receipts	C\$/sh.	3.15

Source: TD Securities Inc. estimates

Prices rising for all elements of the nuclear fuel supply chain — The spot uranium price has climbed 15% YTD and is close to the highest level in two years. Mine supply curtailments and producer and fund buying are largely behind the improved price levels. Based on our forecasts, the uranium market should be in a supply/demand deficit through 2021. Pricing for conversion services has increased sharply this year following the closure of the Converdyn UF6 conversion plant in late-2017. This week, Ux Consulting (UxC) reported that the spot SWU price ticked up by US\$1/SWU — the first price increase for SWU since 2010. UxC noted that there continues to be ample supplies of enriched uranium product (EUP); however, the spot SWU market may have found a bottom. The SWU spot price is an indicator of current demand for enrichment services. We believe that the improvement in pricing across the nuclear fuel supply chain is indicative of the broad improvements in the fundamentals in the uranium market and the steady increase in global nuclear generating capacity.

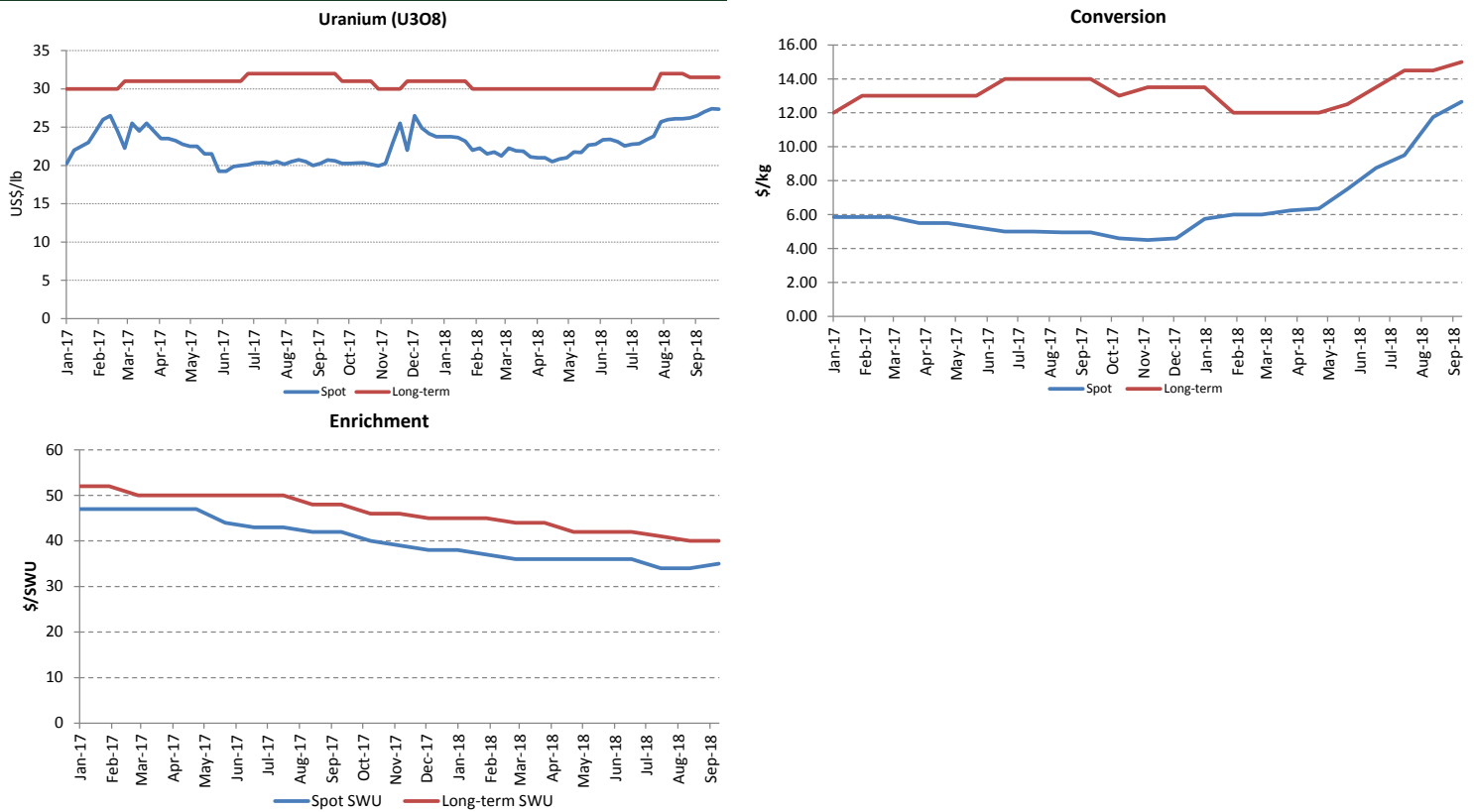


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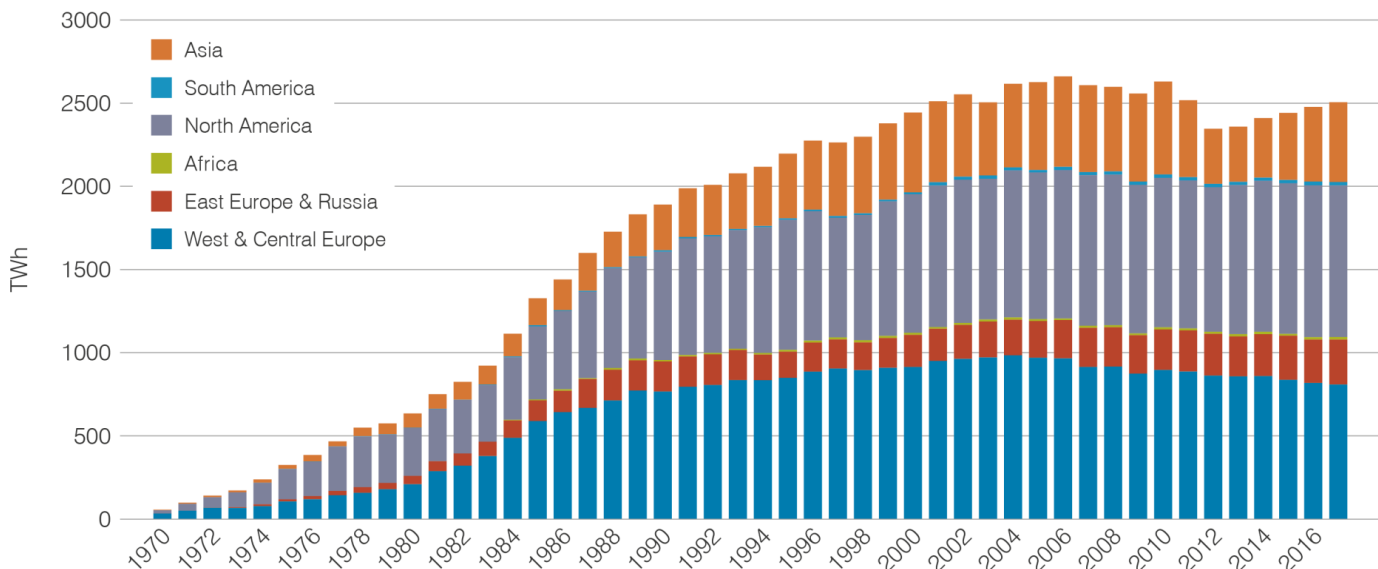
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Exhibit 2. Prices Rising for All Elements of the Nuclear Fuel Supply Chain



Source: Ux Consulting; TD Securities Inc. estimates

Exhibit 3. Global Nuclear Generation Output Increased for the Fifth Consecutive Year in 2017



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

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Exhibit 4. TD Securities Uranium Supply/Demand Model

	2010	2011	2012	2013	2014	2015	2016	2017	2018E	2019E	2020E	2021E	2022E	2023E
Mine Supply - Western World (mm lbs U3O8)														
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
Total World Mine Supply (mmlb U3O8)	140	141	150	153	145	163	165	157	136	142	146	151	162	165
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%
Secondary Supply														
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
Total Secondary Supply (mmlb)	46	42	43	55	45	42	36	34	31	28	28	28	28	28
Total Supply	186	183	193	208	190	205	200	191	167	171	175	180	191	194
Total World Demand														
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)						-	-	-	-	-	-	-	-	-
Total World Demand (mmlbs U3O8)	165	155	155	170	155	160	167	169	174	176	179	180	180	181
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%
Supply / Demand Balance (mmlb)	21	28	38	38	35	44	34	22	-7	-5	-4	0	10	12
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, Bloomberg, TD Securities Inc. estimates

Outlook

We have elected to remove a negative ~\$600mm adjustment from our NAV-10% which approximated the CRA prepayments remaining to be paid by Cameco. Our NAV increases to \$13.44/share (from \$12.06/share).

Exhibit 5. Cameco Net Asset Value

Cameco Net Asset Value	8%		10%			
	C\$000	C\$/sh	C\$000	C\$/sh		
Nuclear Operations						
McArthur River		69.8% JV	1,706,013	4.31	1,409,567	3.56
Cigar Lake		50.3% JV	1,684,017	4.25	1,531,975	3.87
Rabbit Lake		100%	184,280	0.47	150,736	0.38
Inkai		40%	1,580,007	3.99	1,218,974	3.08
Highland-Smith		100%	190,200	0.48	190,200	0.48
Crow Butte		100%	108,600	0.27	108,600	0.27
Conversion		100%	286,971	0.73	264,940	0.67
Total Operations			5,740,088	14.50	4,874,992	12.32
Existing Mines (50% inferred resources @ C\$10/lb)	708,000	1.79	708,000	1.79		
Pipeline projects (50% total resources @ C\$4/lb) *	629,200	1.59	629,200	1.59		
Nukem	300,000	0.76	300,000	0.76		
Mining/Project NAV	7,377,288	18.64	6,512,192	16.45		
Plus:						
Working Capital	1,674,409	4.23	1,674,409	4.23		
Equity Investments	16,812	0.04	16,812	0.04		
Minus:						
Corporate G&A	(555,055)	(1.40)	(477,805)	(1.21)		
CRA Tax dispute	0	0.00	0	0.00		
Debt	(1,495,057)	(3.78)	(1,495,057)	(3.78)		
Reclamation	(910,062)	(2.30)	(910,062)	(2.30)		
Plus/(Minus) balance sheet items	(1,268,953)	(3.21)	(1,191,703)	(3.01)		
Total NAV	6,108,335	15.43	5,320,489	13.44		

* Pipeline projects include: Yeellirrie, Kintyre, Millenium and Fox Lake

Source: TD Securities Inc. estimates

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Valuation

Cameco is trading at an EV/2019 EBITDA multiple of 22.5x and a P/NAV multiple of 1.1x, compared with its large-cap producer group average of 9.7x and 0.98x, respectively.

Justification of Target Price

Our revised \$20.00 target price is based on an NAV-10% multiple of 1.5x (100% weighted). We use an NAV multiple as opposed to EBITDA, as we believe that it is more reflective of the long-term value of the company.

Exhibit 6. Historic P/NAV — Cameco



Source: ThomsonOne, TD Securities Inc.

Key Risks to Target Price

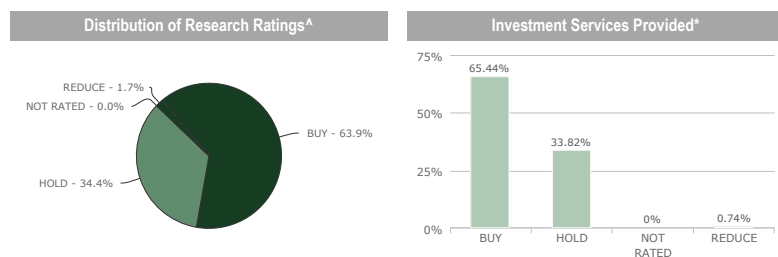
The main risks facing the company include forecast, financial, technical, and political risks. Among other things, these include risks related to uranium prices, input costs, and fuel prices; the governing fiscal and legislative regimes; the timing of key developments; market conditions; capital and operating costs; foreign exchange rates; resources and reserves; operating parameters; permitting; environment; and staffing and key personnel retention. Our forecast of Cameco's realized price could be substantially different from that actually realized by the company. As Cameco is primarily a uranium mining company, it faces heightened environmental risks relative to other mining companies. The disputes with the CRA and TEPCO are additional risks.

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Current as of: September 28, 2018

^A Percentage of subject companies under each rating category: BUY (covering ACTION LIST BUY, BUY and SPECULATIVE BUY ratings), HOLD, and REDUCE (covering TENDER and REDUCE ratings).

^{*} Percentage of subject companies within each of the three categories (BUY, HOLD, and REDUCE) for which TD Securities Inc. has provided investment banking services within the last 12 months.

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