Bigger is Better: Fission Uranium Sold and the Athabasca Basin is in Play

Starting Jan 31/15 we've been telling anyone who would listen: the Athabasca Basin is in play, and Fission Uranium Corp. will be bought out within six months. See earlier articles here and here and here. Our investment thesis was this part of the world has too many junior companies with me-too assets, weak management and depleted treasuries, which meant the only survivors would be the lucky and the strong.

Fission made sure luck had nothing to do with it and brought home a solid deal inside the six month window. On July 6/15 Fission and Denison Mines Corp. announced a binding Letter of Intent under which Fission's shareholders will receive 1.26 Denison shares for each Fission share. Each Fission shareholder also will receive $0.0001 per share in cash – there has to be some investment banking reason for this token but I don't know what it is.

The Resulting Issuer will be approximately 50% owned by each of Denison's and Fission's existing shareholders on a fully-diluted in-the-money basis. The combined market cap will be roughly $900M.

This math implies a price per Fission common share of $1.25 and represents a premium of about 18% over the 30 day volume weighted average price for Fission's shares as at July 3, 2015. The closing is subject to the usual adjustments and conditions.

This is a fair deal for both sides. The shareholders at both Fission and Denison should commend management and directors for working on their behalf (unlike the slow-motion disaster movie that is playing at Copper Mountain Mining Corp.) The shareholder approval needed to close the deal should be a formality.

Sometimes, a Cigar Lake is more than just a Cigar Lake. This consolidation of assets globally means bigger is better. It’s more expensive to drill here than in many other parts of the world. In the Basin all-in costs run $400 – $500 a metre to drill for uranium in fairly deep rock at 300plus metres, while in the Archaen rock of northern Ontario drill costs are less than $100 a metre. Consolidating Fission and Denison to reduce overhead and gain purchasing power makes financial sense.

It’s clear the Resulting Issuer will have a portfolio of exploration and development properties, plus the ability to eventually ramp up valuation by exploiting undervalued properties in Zambia and Mali. That mitigates risk for shareholders in the medium and long terms. What’s interesting in the short-term is free cash flow: the toll-milling of ore from the Cigar Lake Mine and management fees from Uranium Participation Corporation should provide the Resulting Issuer with free cash to help fund its activities.

There are of course weaknesses in the deal. Denison and Fission operate on opposite sides of the Basin which will reduce the operational savings otherwise expected. There will be some management reduction but not enough to materially matter. Denison’s package of assets is not as good as Fission’s, but this is offset by the free cash flow to be generated from Denison’s assets.

Overall, though, this transaction changes the game in the Basin. With over 20% of the world’s uranium coming from here, what happens in the Basin has global repercussions.

Denison and Fission hosted a joint conference call and webcast on July 7, 2015 to discuss the business combination. A live webcast of the conference call can be accessed via www.denisonmines.com or www.fissionuranium.com.

Uranium – De Profundis

Seems like an opportune time when all are universally negative to turn positive on a metal’s fortune. I have used “De Profundis” in titles in reference to Zinc in the past and now that metal seems to have broken out of its swoon. The term actually comes from Psalm 130, which starts off, in the Latin version, with “*De profundis clamavi ad te*”. Out of the depths I cry out to you….

Sounds apt.. so here goes..

Vague Stirrings

The yellow mineral had made fools and liars of many in recent years, including ourselves. That said, every dog has its day and some of the things that weighed on the uranium price (most notably the Japanese plant shutdown) are retreating as issues. At the risk of being made to look foolish again, we think the tide has turned for Uranium and would not be surprised to see it close to $40 per lb by year end and break through $50 per lb by the end of next year. This is scarcely the stuff of which booms are made but players in the uranium space need the price going consistently in one direction to restore confidence. As we have seen before the WORST thing is a spike because it inevitably presages a plunge.

This is a mineral that needs a consolidation and a slow build NOT another pump and dump. We suspect the flow of news will be all good from here on out with the Japanese reopening combining with the massive surge of building in China and elsewhere and the tapering sales from stockpiles (weren’t they supposed to be over by now?) leading to a Perfect Rain Shower, if not a Perfect Storm for the uranium price outlook.

Uranium Participation Corp – A Symbiotic Relationship with Denison

When considering how best to get back into the water after a “shark attack” like that uranium has suffered in recent years the mind turns first to the metal’s ETF.

Uranium Participation Corp (U.to) is an entity that has not come to the attention of institutional investors, at least not US investors. It is a quasi-ETF and its best parallel would be Dacha Capital in the Rare Earth space. Officially it is an investment holding company which invests most of its assets in uranium, either in the form of uranium oxide in concentrates (U_3O_8) or uranium hexafluoride (UF_6), with the primary investment objective of achieving appreciation in the value of its uranium holdings.

It is essentially a stockpiler and does not have an ETF’s elasticity of capital. As such it can fall to a discount during a bear market and rise to premium when its space is hotly sought. It provides an investment alternative for investors interested in holding uranium, which is not exactly the type of material that more mainstream ETF managers can handle. Therefore the manager of Uranium Participation Corporation is Denison Mines (TSX: DML, NYSE: DNN), the well-known and long-established Canadian uranium miner.

This company did not escape the Uranium blues and fell into a hole during the slump (well, the slump before the latest slump). A look-alike company from the bull market days called Uranium Ltd suffered a similar fate and eventually joined forces with UPC in a merger which was consummated in March 2010 via a share exchange (0.5 shares UPC for each UL share). This deal valued Uranium Limited at $139.4 M. Via this transaction UPC acquired 1,725,000 lbs of U_3O_8 and 412,000 Kg of UF_6 essentially at the bottom of the market.

When we last mentioned this name Uranium Participation

Corporation had an estimated net asset value (at April 30, 2014) was CAD$524.2 million or CAD$4.49 per share. At September 30th this had increased to $607.8mn, a healthy increase.

As at September 30, 2014, UPC’s investment portfolio consisted as follows:

This entity has passed under the radar of many investors but represents an almost faultless exposure to uranium in a way that we do not feel any of the individual stocks do. In theory the company should move in tandem with the Uranium spot price. Looking at the valuation of the U_3O_8 holdings, one notes that it is being bought (and valued) at spot which may undervalue the holdings when one considers that the long-term contract price, which is the level at which one would liquidate such a portfolio, is above $50 at the current time.

After a long period of somnolence (and having completed a $57.6 million bought deal financing in early February), UPC made its first purchase of uranium in four years. The company announced that it had purchased 850,000 pounds of U_3O_8 at an average cost of US$34.74.

Being a proxy in a sub-sector where the bulk of investors do not understand the product let alone the companies we would expect that any shining of the spotlight back onto the resurgent Uranium space would result in Uranium Participation, with its ETF-like qualities being the first port-of-call. Uranium Participation Corp is currently trading at $5.22, which represents quite a healthy move off its twelve-month low of $4.72.

And Denison Mines?

Because Uranium Participation does not have a license to purchase and hold uranium directly, the fund buys and holds the commodity through Denison Mines, which is, as mentioned earlier, the manager of the ETF and yet does not have any ownership interest in UPC.

So if UPC is the ETF on the metal and Denison has a symbiotic relationship with the ETF then there might indeed be some arbitrage possibilities in the "parent", particularly as Denison has a smaller market cap $477mn) at the moment than UPC. This stock has scarcely lifted off its bottom, trading at $1.08 at the moment compared to a 12-month low of $1.03 (and a high of $1.95). The main broadly comparable name is Cameco, which is trading at $18.84, compared to a twelve month low of $17.60. In percentage terms the move up from their lows is broadly similar but well below that of the ETF. However we would note that Cameco's market cap is nearly ten times that of Denison.

Conclusion

If the bottom in Uranium is now behind us then the safest first re-entry point is in the Uranium ETF. By the relative outperformance of the ETF over the two prime producers in the TSX universe we are not the only ones that think this way.