

RIO Professional Investors Fund - Energy Fuels Inc

In a November 2006 we highlighted Uranium as a commodity set to out perform, one company profiled was Energy Fuels Inc. [TSX:EFR], a near-term uranium producer with a quality team behind it, possessing the depth necessary to take uranium deposits and monetize them through conventional mining.

The stock was then trading at C\$2.60 per share. Today, EFR closed at C\$4.27 per share, off from a high of C\$5.20 achieved before Christmas.

What this means is that since our last piece, EFR paper has under performed uranium itself, which has nearly doubled. We feel that this is about to change. The sticking point has been that the market is awaiting news that EFR has done a deal to utilize mill capacity, presumably from Denison, which would allow the company to produce uranium in 2008.

This was anticipated in Q1 but did not materialize. The important thing to remember is that EFR has been progressing at Whirlwind as though an agreement will be made, and so whether something is signed in one month or three months, it does not affect Energy Fuel's ability to produce the forecast amount in 2008.

We believe that if the deal were signed today, EFR shares would be changing hands at C\$8 per share. So the real question that investors should be asking is, will Energy Fuels sign a deal to use Denison's mill capacity, or someone else's, or will they have to build their own mill?

In our mind, there is only one answer to that – and the answer is that the odds truly heavily favour a deal being done (because it is a win/win for both sides). For that reason, we consider a milling agreement to be a foregone conclusion, and hopefully signed, sealed and delivered in this quarter just beginning.

The Reasons Why

The reason why is that you don't need one hand to count the amount of serious players that can compete with EFR in terms of their ability to deliver on production in the next 12-18 months.

Further, the likes of Denison and SXR don't yet have enough feed of their own from that part of the world to use their mills full time.

The other thing is that Denison knows that EFR has the depth to deliver the production committed under the milling agreement. Few listed companies combine all of these skill sets. Consider this management chart pulled from the Energy Fuels corporate presentation linked above, and remember that the old Energy Fuels referred to was the largest uranium producer in the U.S. and produced 5 million pounds of U308 per annum.

Indeed, as we stated in November, these guys, “have mined uranium, built mills, run mills, gone through the permitting process – in short, these are highly experienced, highly skilled personnel.”

”This gives EFR a major competitive advantage, and also puts them in a class with just a small number of other uranium producers and near-term producers who have the ability to get the job done - and that is exactly what they intend to do.”

The Valuation Shift Emerging

With uranium surpassing our bench mark of \$100/lb and now at \$113/lb, we believe that the market will at some point in the next year become saturated with companies who can report millions of 43-101 pounds in the ground. While companies with pounds in the ground can receive a valuation \$5/lb or more right now, it is our contention that as the market becomes aware that most of these companies are promoting inaccessible or un-mineable pounds or have management teams that can't take their companies into production, that non-quality pounds in the ground will receive lower valuations. They will be treated as pure leverage plays, achieving maybe \$1/lb or \$2/lb valuations.

Near-term producers on the other hand, because of their incredible dearth, will command even bigger premiums as the market separates the men from the boys.

EFR will be one of maybe five or six listed companies producing uranium, and EFR has properties with loads of historical data and lots of pounds that will be mined or 43-101'd over time. Given this, and the cash flow that the company can generate, we see a big profit in this quality trade.

Cash Flow

Nothing has changed in terms of projected production of uranium and vanadium, or projected share structure at time of production for EFR. The only thing that has changed is the price of uranium.

Readers should remember our the old original previously e-mailed to see how we arrived at our numbers before (it is good background as well), but at current uranium prices we see EFR cash flowing as much as \$2/share in 2008 and \$4/share in 2009.

This is some serious cash flow, and given not only current peer cash flow multiples, but also our belief that the market will begin to value producers in a league of their own, we see a potential C\$40 handle on Energy Fuels within 18 months.

Conclusion

Since our last piece Energy Fuels has not run as hard as some other near-production names. The key is the deal with Denison, and we believe that it is an inevitability. Given that, and the caliber of the team at EFR, it is entirely possible that the scale of gains in this stock over the next 12-18 months could become geometric.

Uranium is the hot commodity and in all likelihood will continue to be. Energy Fuels is one of the handful of listed companies (you can count them on one hand) that has the wherewithal to be a uranium producer in the near-term.

This bodes extremely well for shareholders as institutions will have so few names to turn to for uranium production and pounds in the ground that will actually be produced, that names like EFR will be elevated above other listed companies, to a new level.

If the Denison deal is signed this quarter, and we understand that good progress is being made there, investors will have an instant double. Beyond that, as the company enters production, and if uranium prices hang around these levels or go higher, it is possible that we may witness a 10-fold increase in share price over the next 18 months.

William Gray
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RIO Club