

# FINANCIAL ENGINEERING

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17 December 2022

Research Report – Bonus

## Yellow Cake

*Defensive choice in an explosive environment*



source: Photo by Pixabay on [pixabay.com](https://pixabay.com)

URANIUM IS A TOPIC THAT IS FREQUENTLY DISCUSSED AMONG PROFESSIONAL AS WELL AS RETAIL INVESTORS.

The big difference between a pro and a retail investor is the risk management component, I often try to emphasize.

A retail investor will probably only look at the possible upside and „invest“ powered by greed into speculative assets to become rich quickly – so the thesis.

A professional will look to not make unnecessary mistakes and to protect capital in the best way possible.

Here comes **Yellow Cake** into play.

It is more or less – but not entirely – a tracker for the price of uranium due to its interesting business model. But, what you are especially buying with this stock, is low downside with decent upside.

I explain the big, often seemingly underestimated risks of investing in other uranium-related assets, like uranium miners or utilities.

For me, Yellow Cake is the way to place a bet on a likely rising price of uranium.

Plus, you currently can buy in at a 10% discount to uranium spot prices.

### Topics of this report

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# About simplicity

## *To the point – from proven successful people*

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***“Behind every stock is a company. Find out what it's doing.”***

**&**

***“All the math you need in the stock market you get in the fourth grade.”***

**&**

***“If you're prepared to invest in a company, then you ought to be able to explain why in simple language that a fifth grader could understand, and quickly enough so the fifth grader won't get bored.”***

*(Peter Lynch)*

***“That's been one of my mantras – focus and simplicity. Simple can be harder than complex: You have to work hard to get your thinking clean to make it simple. But it's worth it in the end because once you get there, you can move mountains.”***

*(Steve Jobs)*

***“I am suspicious of thick and overly detailed reports. What is good is usually also quite simple, so lengthy explanations should not be necessary.”***

*(Marc Faber)*

***“I don't look to jump over 7-foot bars: I look around for 1-foot bars that I can step over.”***

*(Warren Buffett)*

***„Simplicity is the ultimate sophistication“***

*(Leonardo da Vinci)*

### ***Why do I write short reports and not long, extensive ones?***

***Short answer:*** It's about simplicity, comprehension and your time in today's information overloaded world.

***Long answer:*** For me the big goal (and challenge) is to be clear and on point with my investment theses. For every aspect I look at, the aim is to write down the main points cleanly on a single page.

*The research I am doing beforehand is not reduced, however, quite the opposite. My research process is extensive. I am spending several hours of time to crush together what is necessary into an easily comprehensible and digestible format for you.*

*It is a service from me and also my philosophy to be spot on.*

*Because I value your time!*

# Foreword

## *An asymmetric situation likely leading to a powerful explosion*

**F**OR YEARS IT HAS BEEN SAID THAT URANIUM IS GOING TO RUSH HIGHER.

A new bull market was already a foregone conclusion. Every dip was supposedly the last buying opportunity. What many didn't expect was that the bear market would take around a decade, not only a handful of years.

After 2011, it seemed as if the world would turn away from uranium, at least in the West which increased the pain and pushed uranium prices way lower to unimaginable levels where even the industry heavyweights were stress-tested.

The price of uranium fell so low that many mining projects went into care and maintenance, because production was not profitable.

Over the last few years, however, a new thesis emerged:

The world is awaiting a structural supply deficit which simultaneously meets a (*likely*) growing demand. The main demand drivers will be Asia and the Middle East. The sudden turn of many Western countries that put a higher value on energy security only pours in more fuel into the fire of the thesis.

Stocks of many uranium producers already caught hot steam under their wings and blasted off from

their lows. But I am afraid investors with exposure to these mining companies could face pain ahead.

The overall thesis may be right, but miners might be the wrong choice due to economical and operating challenges lying ahead.

Even at current prices which doubled from the lows, there is a very low incentive for most producers to reopen. Only the first ones are reentering the stage. However, they will only restart production in 2024 in bigger, meaningful quantities.

Likely, demand will outpace supply, nonetheless. Unless the price of uranium rises another 30–50% or even more, there won't be enough uranium to buy for utilities to refill inventories, even for the existing nuclear reactors. The newly build plants are not even factored into this equation.

You have a huge and growing deficit potential with supply being constant at best, but unlikely. The tensions are becoming only bigger with time, also because supply is so slow-moving.

Demand for uranium from utilities is rather inelastic. This means, utilities are willing to pay nearly every price, because the fuel costs only are breadcrumbs for them, compared to the whole construction



and operating costs that can go even into the double digit billions.

**Yellow Cake** which derives its name from crushed uranium (*before enrichment*), is my favorite choice to play this increasing supply and demand imbalance.

The reasons are clear: Limit your downside and participate to the upside. This is what Yellow Cake offers. As a big plus, the London listed stock currently trades 10% below its net asset value (*NAV*).

This means, you can get exposure to physical uranium at a discount.

I recommend you to read this report together with my [current Weekly](#) for more background information.

**I hope you enjoy this new report.**

All the best and a merry Christmas,

**Alan Gałeczki**

*Founder of Financial-Engineering.net*

# The investment case in a nutshell

*What you need to know on one page – because I value your time*

## YELLOW CAKE STOCK IS A WAY TO PARTICIPATE IN A LIKELY RISING PRICE OF URANIUM

Yellow Cake is a quasi market listed fund.

The business model is super straightforward. YCA from time to time raises external capital (*fortunately equity-only*) to buy uranium on the open market.

It got listed in summer of 2018, just at the right time, shortly after the low in uranium prices.

YCA bought its 18 million pounds of uranium for an average price of around 31 USD. This means, they are already 50% in the green zone!

It stores the bought uranium mainly in Canada, but also to a lesser extent in France at special facilities of local producers.

The capital allocation approach is important to understand:

Management raises capital when the own share price is higher than the calculated NAV. The other way around, they buy back some stock when the share price is – like currently – under the NAV.

With Yellow Cake, you don't have the super upside like with more speculative miners or even explorers. But what counts for me more than that, is that you also don't have the ultra high risks.

Not only of a potential bankruptcy, but also concerning not unlikely operating challenges like rising costs that would have a negative impact on margins.

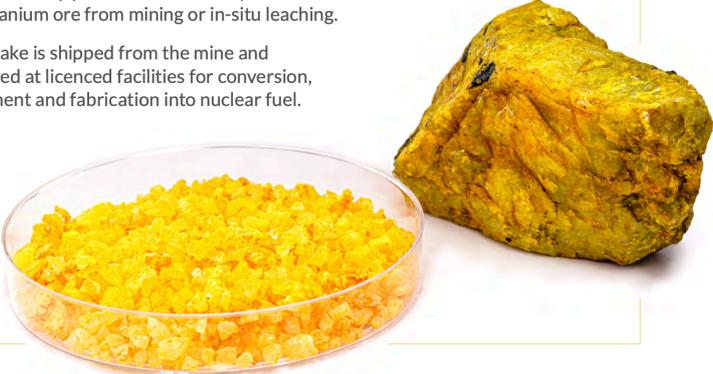
As a big plus, you can currently buy the stock of Yellow Cake around 10% under NAV while for example the big well-known Canadian miner

YELLOW CAKE AT A GLANCE
STRATEGIC REPORT
GOVERNANCE
FINANCIAL STATEMENTS

🏠 ⏪ ⏩ 🔍

### What is Yellowcake?

- Yellowcake is a solid form of mixed uranium oxide that is generally yellow in colour. It is produced from uranium ore from mining or in-situ leaching.
- Yellowcake is shipped from the mine and processed at licenced facilities for conversion, enrichment and fabrication into nuclear fuel.



*Source: Yellow Cake  
Annual Report 2022*

*(and favored play of many retail investors)* Cameco already has a high valuation.

This is pure play on rising uranium prices. Don't expect any dividends, at least not for the foreseeable future.

[Read on for the whole story...](#)

# Brief overview of the stock

## Key facts and longterm chart



### Yellow Cake

<b>ISIN / ticker</b>	JE00BF50RG45 / YCA
<b>Home bourse</b>	London (UK)
<b>Share price (as of 16 December 2022)</b>	3,60 GBP
<b>Market Cap / enterprise value</b>	0.6 bn. GBP / 0.6 bn. GBP
<b>Average 3 month daily volume</b>	0.9 million shares / ~3.3 million GBP

Yellow Cake plc (YCA)

GBP USD

**3,60 £**  
-0,01 £ (-0,17 %)  
16. Dezember 2022 Close



# The business model

## What is the company doing?

**T**HE BUSINESS MODEL IS SO STRAIGHTFORWARD, YOU CAN EXPLAIN IT IN ONE SENTENCE.

Yellow Cake (YCA) buys physical uranium on the open market, stores it at third parties' facilities and just waits for the price of the yellowish commodity to appreciate.

Its bought uranium is stored at facilities in Canada and France. It can buy or sell whenever it wants.

**Yellow Cake**

- Buy and hold strategy** → We purchase uranium and hold for the long-term
- Pure exposure to the uranium commodity price** → No exploration, development or operating risk
- Ability to purchase in volume, at the spot price** → Ability to purchase US\$100m of U<sub>3</sub>O<sub>8</sub> from Kazatomprom per year
- Inventory stored in safe jurisdictions** → Uranium stored in Canada (Cameco) and France (Orano)
- Low-cost structure** → Outsourced operating model  
Annual operating costs of <1% of NAV

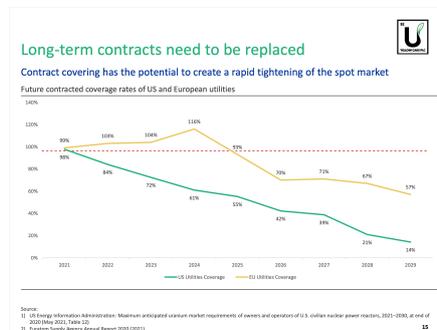
Source: Yellow Cake  
Investor Presentation August 2022

Is it too good to be true or where is the catch? This is indeed the entire business model. Together with another and way bigger competitor, Sprott Physical Uranium Trust, YCA pursues the goal to „help“ the price of uranium on its way up.

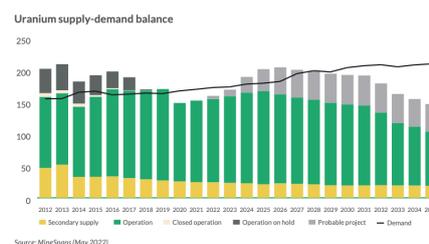
How so?

Both companies are buying physical uranium on the market and thus take it out of circulation. This way the supply for utilities gets reduced.

Coverage of the needed physical amount of uranium by utilities is shrinking already now. In the graphics below, you see why buying pressure will likely increase, soon.



Source: Yellow Cake  
Investor Presentation August 2022



Source: Yellow Cake  
Annual Report 2022

Why not invest in one of the following choices, you might ask:

- **nuclear power plants:** they belong to utility companies that are heavily regulated, capital intensive, have barely any free cash flow if any, are highly leveraged and often not allowed to even sell electricity at market prices. Higher uranium prices will increase costs primarily, not necessarily revenues. French nuclear plant operator EdF gets nationalized, because the company is over-indebted and at the same time must keep electricity prices artificially low.
- **Smaller uranium explorers / miners:** the key factor are operating risks. I expect cost and

maybe even time overruns and way higher CAPEX requirements for the companies. The longer mines stay on maintenance or exploration takes more time, the higher these cost overruns will be. This significantly increases the risks of shareholder dilution, because these smaller companies will need to raise fresh capital at all costs, just to stay alive. Also after production kick-off, operating costs (OPEX) will be higher which will put pressure on margins.

- **big miners:** There are two, **Cameco** not only seems to have already priced in way higher uranium prices with a current PE of 94x, it also invests into Westinghouse – the American nuclear reactor builder. Cameco dilutes shareholders, takes on debt for this transaction and stops being a pure-play uranium mining company (*higher complexity*). **Kazatomprom** has too many geopolitical risks that just make me feel uncomfortable. Both will likely also experience higher costs.
- **ETFs with many miners:** These can spread individual company risks, but don't solve the main problems described above. You must also look into the holdings of such funds, as some can be named uranium funds when in fact they're mainly investing in utilities, not miners.

Miners can also be taken hostage by labor strikes, increasing labor costs or taxes, volatile energy costs, regulatory changes and also floods or other environmental disasters.

YCA doesn't have all these pitfalls.

# Leadership & capital management

## What is the company doing with stockholders' money?

**M**ANAGEMENT PURSUES THE RIGHT CAPITAL ALLOCATION APPROACH.

On the last page, you saw the ongoing dynamics visualized. For the investment thesis, the implications are clear: The more physical uranium is taken from circulation, the earlier price pressure should come up.

Let's have a closer look at YCA's capital management approach.

On the chart on the right, you see that the share price of Yellow Cake as well as the price of uranium are going most of the time hand in hand. Not only in the same direction, but also the relative moves are quite similar.

YCA issues shares from time to time when the NAV trades above the market price of uranium. The other way around, they repurchase shares – like currently during 2022 – when the NAV is below the market price.

Thus, management can effectively limit shareholder dilution. Or in other words: They get active when there are discounts in the market.

It requires discipline, but so far management has done a good job.

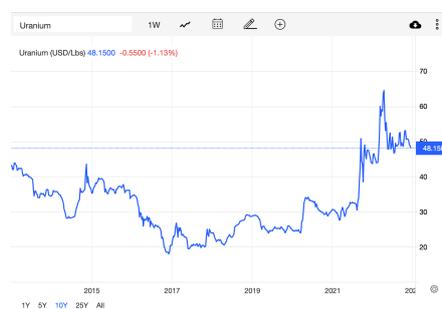
As of 30 September 2022 (*the last reported numbers*), YCA holds 18.8 million pounds of uranium for a paid average price of 31.1 USD / pound. Uranium currently is priced at around 48 USD on the spot market. Good deals so far!

The smaller chart shows the price of uranium over the last ten years. Yellow Cake was listed in July 2018, i.e. quite at the right time after the low, as it seems. Since then, the price already more than doubled.

**GBP share price and uranium price<sup>(1,3)</sup>**



Source: Yellow Cake – *Investor Presentation August 2022*



Source: *Trading Economics*

We already have seen close to 65 USD / pound this year due to fear of a serious supply disruption. Kazakhstan (*mining*) and Russia (*enrichment*) play key roles here.

This could happen at any time, again. I lack the imagination of why the price should fall to its lows again on a sustainable basis, given the current circumstances and many igniting sparks.

Yellow Cake buys most the uranium from Kazatomprom.

As to the management team, both the CEO and the CFO are working from home out of Jersey in the Channel Islands where YCA is also incorporated.

Both are also shareholders of Yellow Cake. And: These are the only employees the company has!

Speak of a lean management!

Self-explanatory, the company does not pay any dividends and likely won't do so for the next several years, because the business model pursues an appreciation of the held assets.

There will be a time in the future, where Yellow Cake could take some chips of the table and maybe then pay a special dividend out of realized capital gains.

But I would leave these thoughts aside for now.

# The financials

## Cash flow statement, balance sheet, income statement

**T**HE FINANCIALS ARE NOT THE TYPICAL ONES, HOWEVER, NOT THAT DIFFICULT TO UNDERSTAND.

Because the company is only buying and holding assets (*physical uranium*) from raised capital, it lacks a „normal“ revenue-generating business model.

You are only asking the question: *“Have the held assets moved up in value in accordance with market prices or have they gone down?”*

This has implications for the financials, but not necessarily negative ones, if understood.

The P&L (*see the example on the right from the current half year report*) has no revenues. It starts somewhere in the middle of a „traditional“ P&L statement and only shows investment gains or losses, costs and a bottom line profit or loss, roughly speaking:

- Starting atop, gains or losses are the appreciating or depreciating results of the held uranium assets (*“fair value movements“*). They get valued by volume times the spot market price. Don't be surprised to see very big gains when the price of uranium rises and also the other way around. By the way, Warren Buffett is annoyed every single quarter by these big swings he also has to report for his held investments.
- operating costs are not that high; besides salaries and some uranium handling or storage costs, there is nothing worth mentioning; however what should be mentioned is that management holds enough cash in the bank to enable operations to go on for at least three years on average. This is especially of

### Condensed Statement of Comprehensive Income

		1 April 2022 to 30 September 2022 (unaudited) USD '000	1 April 2021 to 30 September 2021 (unaudited) USD '000
	<i>Notes</i>		
<b>Uranium investment (losses)/gains</b>			
Fair value movement of investment in uranium	3	(142,035)	175,892
Uranium swap income		-	100
Premium to spot price on disposal of uranium		-	10
Fair value movement of uranium derivative liability		-	(3,193)
<b>Uranium investment (losses)/gains</b>		<b>(142,035)</b>	<b>172,809</b>
<b>Expenses</b>			
Share-based payments	6	(18)	(204)
Commission on uranium transactions	8	(452)	(1,188)
Uranium holding fees and storage incentive fees	8	(1,619)	(777)
Other operating expenses		(1,350)	(1,116)
Equity offering expenses		-	(149)
<b>Total expenses</b>		<b>(3,439)</b>	<b>(3,434)</b>
Bank interest income		35	11
Loss on foreign exchange		(37)	(274)
<b>(Loss)/profit before tax attributable to the equity owners of the Company</b>		<b>(145,476)</b>	<b>169,112</b>
Tax expense		-	-
<b>(Loss)/profit and total comprehensive income for the period after tax attributable to the equity owners of the Company</b>		<b>(145,476)</b>	<b>169,112</b>
<i>Basic (loss)/earnings per share attributable to the equity owners of the Company (USD)</i>	10	<b>(0.79)</b>	<b>1.19</b>
<i>Diluted (loss)/earnings per share attributable to the equity owners of the Company (USD)</i>	10	<b>(0.79)</b>	<b>1.18</b>

Source: Yellow Cake – *half year interim report 2022 / 2023*

interest, should the price of uranium not rise or should there be no discounts to be taken advantage of.

That's it, because the bottom line is more or less the same like the changes in fair value of the held investments.

Yellow Cake has no debt and only uses equity financing, which I like to see.

This confirms the defensive nature of the business.

There isn't really any more to say, except that you can expect the gains or losses to be in line with the price movements of uranium.

Some quarters will be positive, others negative. What counts is the difference.

So watch it from time to time.

# Valuation and what to expect

*Valuation always matters!*

**T**HIS PART IS REALLY EASY. YOU JUST NEED A FEW THINGS TO BELIEVE IN AND TO MONITOR.

First, of course you need to believe in the whole investments thesis to play out and a further advancement of the price of uranium to occur.

If so, then you just need to look at the NAV calculation that the management frequently presents. Not only in their earnings reports, but also in their investor presentations that are updated every two months or so.

Usually, the management shows a NAV per quarter's end and one that is the most current, like in the screenshot on the right from their most recent interim report.

As of writing this research report, the valuation has even become cheaper since 5 December 2022.

Then, the stock of YCA changed hands for around 3.95 GBP apiece or just below the NAV of 4.09 GBP (see picture below).

YCA is trading now for 3.60 GBP per share or a market cap of 660 million GBP.

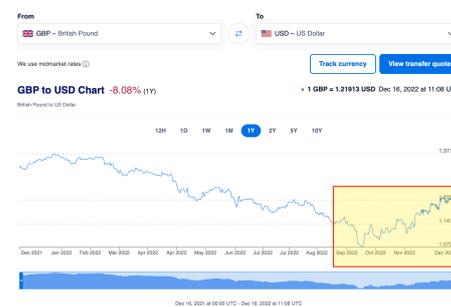
Yellow Cake Estimated Net Asset Value as at 5 December 2022			
			Units
Investment in Uranium			
Uranium oxide in concentrates ("U <sub>3</sub> O <sub>8</sub> ")	(A)	lb	18,805,601
U <sub>3</sub> O <sub>8</sub> fair value per pound <sup>(7)</sup>	(B)	USD/lb	48.00
U <sub>3</sub> O <sub>8</sub> fair value	(A) x (B) = (C)	USD m	902.7
Cash and other net current assets/(liabilities) <sup>(8)</sup>	(D)	USD m	13.2
<b>Net asset value in USD m</b>	<b>(C) + (D) = (E)</b>	<b>USD m</b>	<b>915.9</b>
Exchange Rate <sup>(9)</sup>	(F)	USD/GBP	1.2218
Net asset value in GBP m	(E) / (F) = (G)	GBP m	749.6
Number of shares in issue less shares held in treasury <sup>(10)</sup>	(H)		183,104,399
<b>Net asset value per share</b>	<b>(G) / (H)</b>	<b>GBP/share</b>	<b>4.09</b>

Source: Yellow Cake half year interim report 2022 / 2023

This is slightly more than 10% below the last NAV valuation. That means that the valuation gap simply widened.

Neither the price of uranium nor the GBP / USD exchange rate have moved in these one and a half weeks (which both could have an influence).

The currency is important to understand. A weaker pound (or stronger US-Dollar) leads to an



Source: xe.com

appreciation of the USD-held uranium investments.

Thus, you have also a currency play.

Bottom line is, when the price of uranium rises, so will Yellow Cake. With a stronger US-Dollar, you have a second component that helps rising the NAV valuation in GBP terms.



Source: TIKR.com

# Investment risks

*Important to think about – what could go wrong?*

**A**LTHOUGH YELLOW CAKE IS A VERY DEFENSE PLAY ON A RISING PRICE OF URANIUM, IT IS NOT ENTIRELY WITHOUT RISKS.

However, we can make it rather short at this point:

- the purchased uranium is stored mainly in Canada and to a lesser extent in France; theoretically it could be confiscated for „national security reasons“ or so by the government, e.g. in case of a supply crunch, but I don't think these amounts, especially in France, to be enough
- The price of uranium could not appreciate as thought due to nuclear energy being phased-out again – I don't think this is likely, at least not over the next 1–2 decades
- The recent headlines about the breakthrough in nuclear fusion technology reads well, but realistically does not present any imminent danger to the uranium play. In my latest Weekly, I quoted an Austrian physicist who wrote his assessment about the results and further implications.
- Natural disasters and subsequent nuclear catastrophes could turn the mood against the usage of nuclear power; however, if most Western countries want to abandon coal and oil, I don't see how this should function without going back to the stone age
- Management could do wrong decisions with their transactions; until now, the moves were rather transparent, understandable and management did not show any weaknesses in their capital allocation



source: Drew Rae on Pixels

One could also think of any kind of disruption in the mining or transportation or also enrichment processes.

Every single one of these should rather propel the price of uranium higher to the benefit of Yellow Cake. I wouldn't be so sure that the uranium miners would automatically benefit from such problems, on the other side.

I think, now you see why my choice fell on Yellow Cake to play this trend.

Better safe than sorry.

One more hint: The stock is not ultra-low in liquidity with around 3 million GBP on average daily volume, but nonetheless also not highly capitalized. Some days, the trading volume is only 1 million GBP or even less!

Should you consider buying (*and also selling!*), then always use a predetermined limit.

Just in case...

# Sources

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- <https://www.youtube.com/watch?v=bWM70w5oGRg>
- [https://www.yellowcakeplc.com/wp-content/uploads/2022/08/Yellow-Cake-Investor-Presentation\\_August.pdf](https://www.yellowcakeplc.com/wp-content/uploads/2022/08/Yellow-Cake-Investor-Presentation_August.pdf)
- [https://www.yellowcakeplc.com/wp-content/uploads/2022/07/Yellow-Cake\\_IAR\\_2022.pdf](https://www.yellowcakeplc.com/wp-content/uploads/2022/07/Yellow-Cake_IAR_2022.pdf)
- [https://otp.tools.investis.com/clients/uk/yellow\\_cake/rns/regulatory-story.aspx?cid=2392&newsid=1640080](https://otp.tools.investis.com/clients/uk/yellow_cake/rns/regulatory-story.aspx?cid=2392&newsid=1640080)
- [https://otp.tools.investis.com/clients/uk/yellow\\_cake/rns/regulatory-story.aspx?cid=2392&newsid=1650058](https://otp.tools.investis.com/clients/uk/yellow_cake/rns/regulatory-story.aspx?cid=2392&newsid=1650058)

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