Cameco Corporation

Q3 2017 Results

Conference Call Transcript

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Presenter: **Rachelle Girard**
Director, Investor Relations

Tim Gitzel
Chief Executive Officer

Grant Isaac
Senior Vice President and Chief Financial Officer

OPERATOR:

Welcome to the Cameco Corporation Third Quarter 2017 Results Conference Call. As a reminder, all participants are in listen-only mode and the conference is being recorded. After the presentation, there will be an opportunity to ask questions. To join the question queue, you may press star, then one on your telephone keypad. Should you need assistance during the conference call, you may signal an Operator by pressing star and zero.

I would now like to turn the conference over to Rachelle Girard, Director of Investor Relations. Please go ahead.

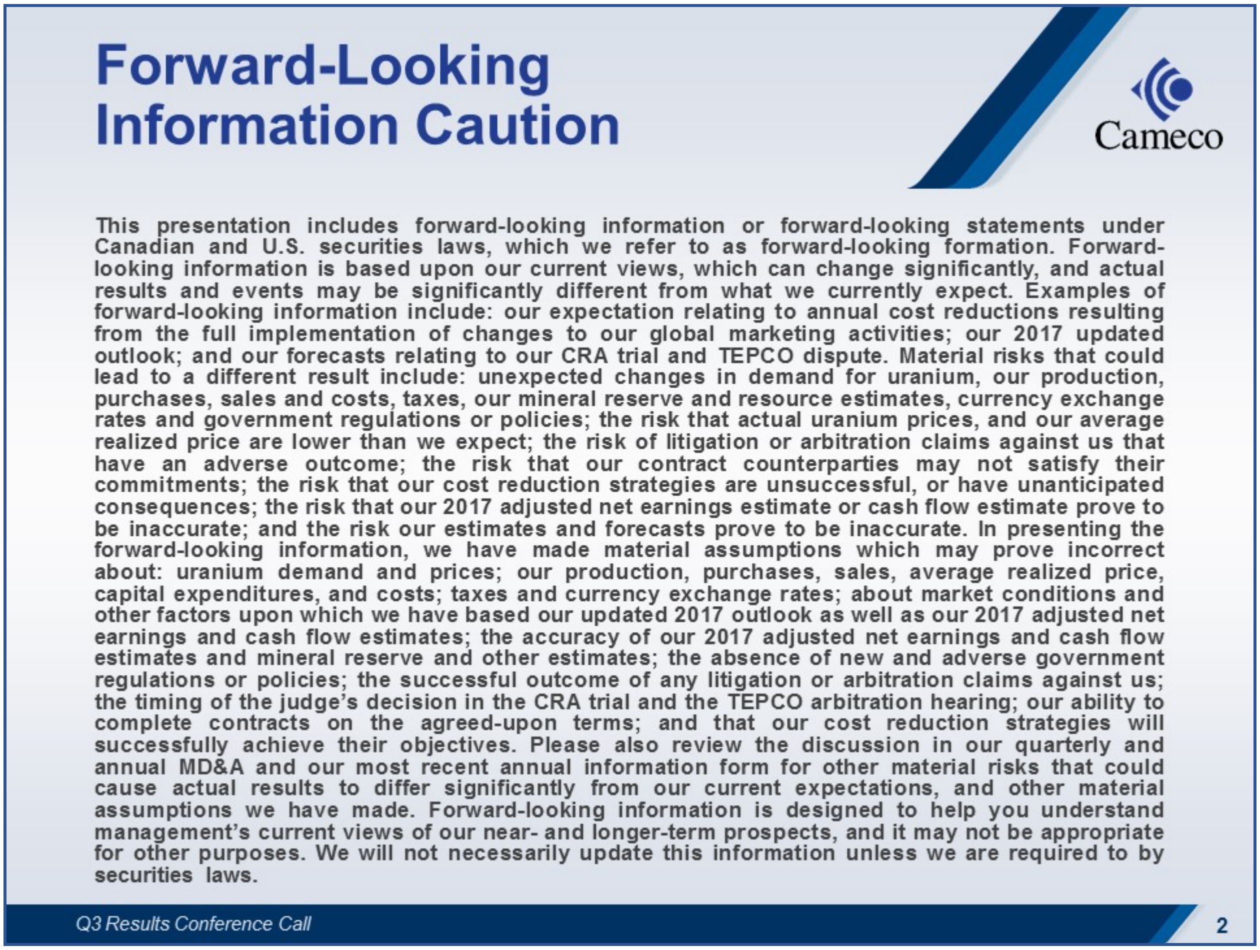
RACHELLE GIRARD:

Thank you, Operator, and good day everyone. Thanks for joining us. Welcome to Cameco's conference call to discuss the third quarter financial results. With us today on the call are Tim

Gitzel, President and CEO; Grant Isaac, Senior Vice President and CFO; Brian Reilly, Senior Vice President and Chief Operating Officer; Alice Wong, Senior Vice President and Chief Corporate Officer; and Sean Quinn, Senior Vice President, Chief Legal Officer and Corporate Secretary. Tim will begin with comments on our results in the industry. Then we'll open it up for your questions.

If you joined the conference call through our website event page, you'll notice there will be slides displayed during the remarks portion of this call. These slides are also available for download in the PDF file called Conference Call Slides through the conference call link at cameco.com.

Today's conference call is open to all members of the investment community, including the media. During the Q&A session, please limit yourself to two questions, and then return to the queue. For those on the webcast, if you have questions, please select the Submit a Question feature to submit your question by email, and we will follow up after the call.



Please note that this conference call will include forward-looking information, which is based on a number of assumptions, and actual results could differ materially. Please refer to our annual information form and MD&A for more information about the factors that could cause these different results and the assumptions we have made.

With that, I'll turn it over to Tim.

TIM GITZEL:

Well, thank you, Rachelle, and welcome to everyone on the call today. We appreciate you taking the time to join us to discuss Cameco's third quarter results, which were as anticipated, and in line with the outlook we provided last quarter.

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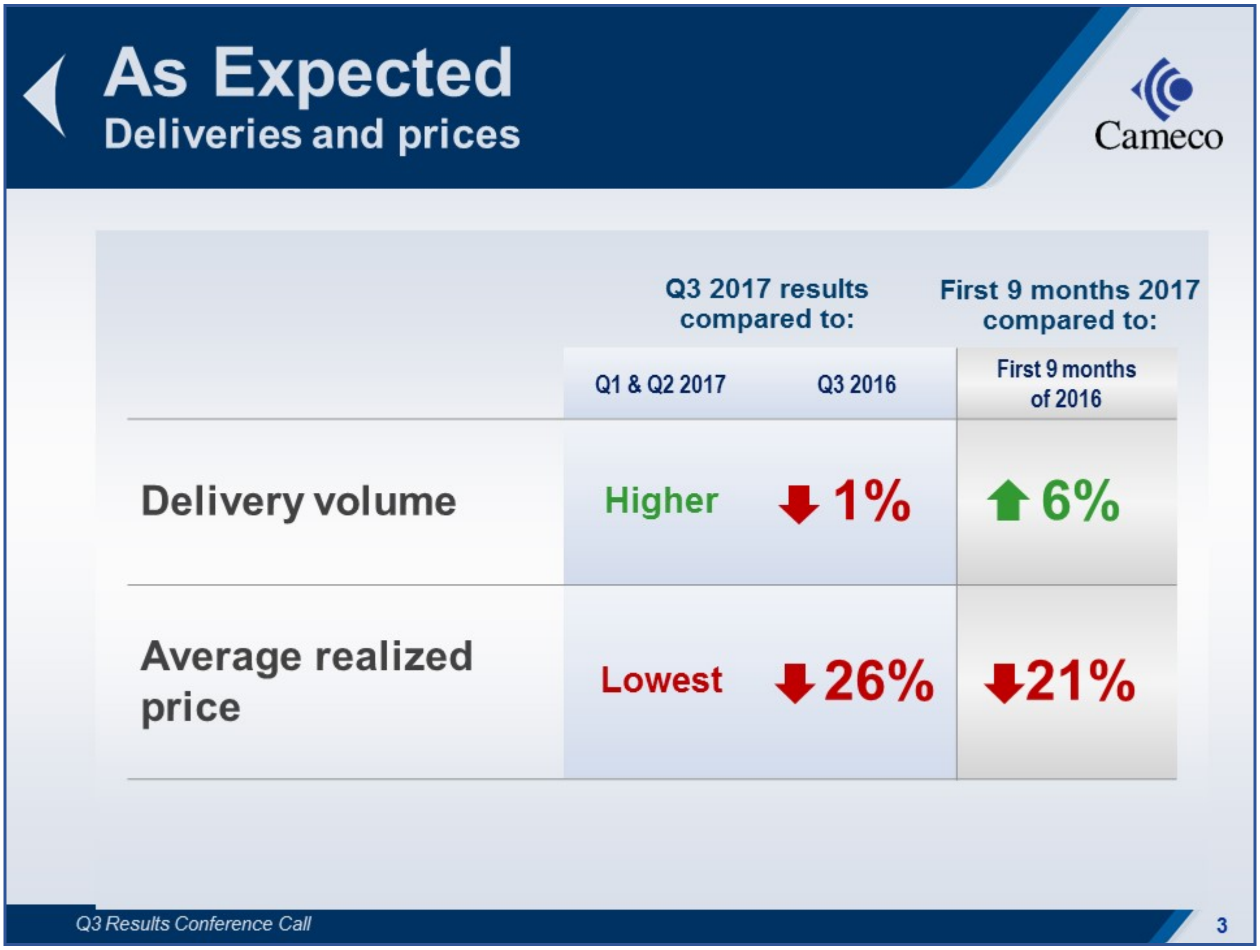

You will recall that in Q2 we highlighted a number of items that led us to expect the third quarter to be the weakest quarter this year. First, although the delivery volumes in our uranium segment were higher than in Q1 and Q2, the realized price for the quarter was the lowest expected this year, again, as we guided to last quarter. This is a result of the pricing terms in the contracts we made deliveries under during the quarter, and the weaker uranium price.

Given the recent strengthening of the Canadian dollar, we have updated our assumption for the U.S. dollar exchange rate. As a result, we have lowered our expected annual average realized price to CA$47.50 per pound, which points to an expected Q4 average realized price higher than the annual average. Of course, the actual results will depend on exchange rates and uranium market prices. However, you can see from the sensitivity analysis we provide that a further weakening of the uranium price is not expected to impact revenue, adjusted net earnings, or cash flow. This is, of course, due to the very deliberate way we have structured our contract portfolio and the protection it affords us.

We have also updated our expected delivery volume range to between 32 million and 33 million pounds, largely as a result of some portfolio optimization opportunities we undertook. This means we will deliver between 11 million and 12 million pounds in the fourth quarter. This assumes that all deliveries are made as scheduled in the quarter. As you know, it's not unusual for delivery to slip over the year-end.

As Expected

Costs trending down

	Q3 2017 results compared to:		First 9 months 2017 compared to:
	Q1 & Q2 2017	Q3 2016	First 9 months of 2016
Cash production costs/lb	Higher	↑ 50%	↓ 10%
Avg. COS/lb	n/a	↓ 10%	↓ 13%
Direct administration	n/a	↓ 3%	↓ 20%

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Unit costs of production were significantly higher than in the first two quarters and compared to Q3 last year, due to the lower production resulting from the implementation of a mandatory summer vacation period, followed by planned maintenance shutdowns at our northern

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Saskatchewan operations. Again, this was not unexpected, and despite the impact on quarterly production costs, these measures are designed to reduce overall operating costs for the year. Despite the quarterly fluctuation in production costs, the average unit cost of sales was 10% lower for the quarter and 13% lower for the first nine months compared to the same periods last year. We have lowered our expectation for the average unit cost of sales, including depreciation and amortization, to be between CA$35 and CA$36 per pound, a reduction of 11% to 13% from 2016. The reduction is driven by the deferral of some purchases and the revised U.S. dollar exchange rate assumption.

In the second quarter, we announced that we were pleased to have settled our tax dispute with the United States Internal Revenue Service, and as we expected, the financial impact was not material. In the end, we had to pay about US$198 thousand to resolve the dispute related to the 2009 through 2012 tax years, which represents $122,000 in taxes owing plus interest of about US$76 thousand. Based on the adjustments proposed by the IRS for this period, our potential exposure was a tax expense of US$122 million. As we noted, we had to make the payment in the third quarter and record the associated tax expense.

The final item affecting the third quarter that we disclosed previously was receipt of the 2011 transfer pricing penalty from the CRA of $78 million. Although we disagree with this penalty, we are required to pay half of it in cash while the matter is in dispute, which we did in the third quarter.

Direct administration costs were down about 3% compared to Q3 of last year, and 20% for the nine-month period.

During the quarter, in line with the other disciplined actions we have taken, we made changes to the way our global marketing activities are organized, resulting in one-time admin costs of about $5 million. Excluding these one-time costs, direct admin would have been down about 15% for the quarter and 23% over the comparative nine-month period in 2016, continuing the downward cost trend.

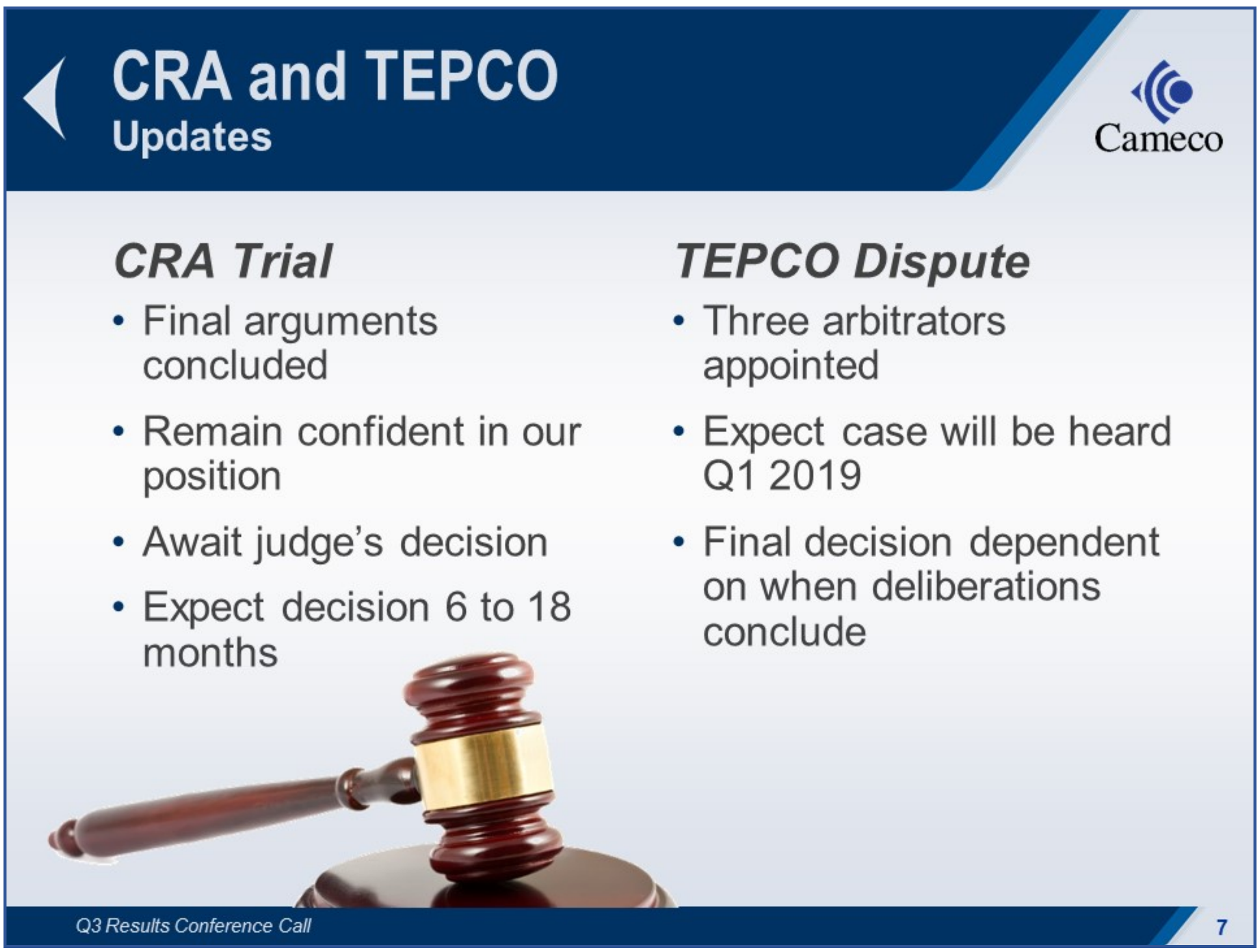
The changes to our marketing activities required a write-down of the full carrying value of goodwill associated with our purchase of Nukem. As such, we recorded a non-cash expense of $111 million in the quarter. We needed to make these changes because current market conditions do not support the level of resources and personnel deployed under the previous structure. Going forward, all Canadian and international marketing activities will be consolidated in Saskatoon. Marketing has always been a strength at Cameco, and that will not change.

Existing purchase and sales contracts will remain in place, along with Cameco's European and U.S. subsidiaries that perform under these contracts. Once fully implemented, we expect the changes will reduce costs by $8 million to $10 million per year. The changes we are making are intended to position the Company to deliver increased shareholder value over the long term, no matter what the market conditions. Unfortunately, they do affect people.

On the operational front, you will see that we have lowered our production outlook by 1.2 million pounds for the year. The reduction is due to production delays at Key Lake caused by work required on the existing calciner circuit, and lower production than expected at Smith Ranch-Highland as head grades continue to decline. Given our inventory position and the market environment, we are willing to accept some production variability as long as we don't compromise safety, the environment, or the long-term health of the Company.

We continue to expect adjusted net earnings for 2017 to be lower than the $0.36 reported in 2016. However, despite lower adjusted net earnings than in 2016, we continue to expect 2017 cash flows will be higher than the $312 million reported last year. The increased cash flow is a result of progress made in decreasing our operating, general and administration, and exploration costs, as well as a reduction in our purchasing activity, resulting in less cash tied up in inventory.

In addition, we've pulled back our capital expenditures by almost 26% since last year, which has a positive impact on free cash flow. So, while we have had some weaker results, they were anticipated, and reflect a very deliberate strategy to strengthen the Company in the long term. Cameco remains a solid Company financially, generating strong cash flows.



Before I leave the quarter, I want to give a quick update on the CRA trial and TEPCO dispute. Final arguments in our CRA trial wrapped up on September 13, and now we await the judge's decision, which is expected to take 6 to 18 months from the conclusion of the trial. We have provided an overview of appeal possibilities in our MD&A, which I won't go into detail here, except to say either party has the right to appeal the decision of the Tax Court of Canada. However, if neither party pursues an appeal, CRA would issue reassessments for the 2003, 2005, and 2006 tax years to reflect the decision, and the corresponding payments or refunds, including interest, would then be made. The total tax amount reassessed for the 2003, 2005, and 2006 tax years was $11 million, and we remitted 50% at the time the reassessments were issued.

On the TEPCO file, the three arbitrators have now been appointed, and based on the current schedule set by them, we expect the case will be heard in the first quarter of 2019. However, timing for a final decision will be dependent on how long the arbitrators deliberate following the conclusion of the hearing. In both the CRA and TEPCO cases, we remain confident in our position and expect favourable outcomes, but the resolution timelines could still be a ways off.

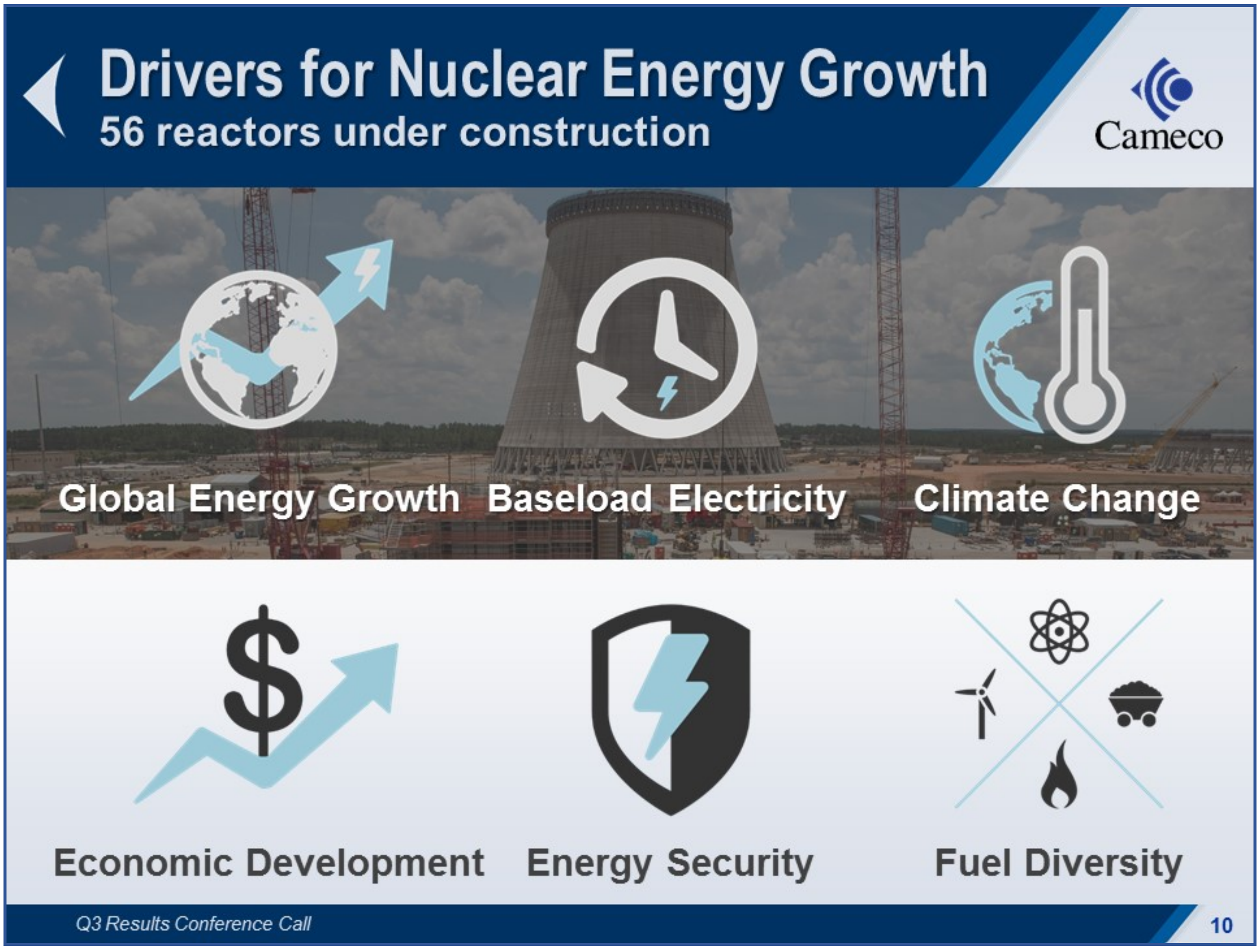
Turning to the market, there was some good news on the construction front last week. Nearly 60% of people polled in South Korea voted in favour of resuming construction of the two reactors halted following the election of a new president, whose plan is to phase out nuclear power, and I was just in India and the United Arab Emirates, and they continue to move forward with their nuclear plans. Of course, China continues to be the bright spot, with 19 reactors under construction.

However, we remain cautiously optimistic. Cautious because we continue to face difficult market conditions and have seen global demand expectations come down, while the industry works its way through supply that was incented in previous price runs. Yet optimistic because today's uranium price is too low to incent the investment required to ensure that adequate uranium production is in the market; uranium needed to support the reactor construction program, as well as the return of idle reactors to the grid, and utilities uncovered requirements.

Our strategy to curtail higher-cost production, and focused on our best margin assets, restructure various aspects of our business, and generally reduced cost, is driven by these market conditions. We have consistently acknowledged the near to medium-term challenges on both the demand and supply side. However, we are a bit frustrated by the reliance on supply-side forecasts that fail to account for the economic factor that distinguishes a uranium reserve from a uranium resource.

For example, we've seen forecasts that show our McArthur River Mine, where cash operating costs are among the world's lowest, increasing production in 2019 at a uranium price of US$25 per pound. While we can't speak for the behaviour of other producers in the $25 market, I can tell you this is not a rational assumption. At $25, we won't be investing a dime to increase production at MacArthur River. In fact, expect there could be further variability in existing production beyond what we announced for 2017 if these conditions continue, and we certainly won't be undertaking the work required to extend the 18 million pound per year mine life at Cigar Lake, which we should be starting tomorrow if we want to extend production beyond 2027.

At today's prices, or the prices used in those reports, apart from making sure we have uranium to fulfill our contract commitments, our supply is better left in the ground. Experience has taught us that success in our business requires patience and discipline. Progress is not measured in weeks or quarters, but in years, and that's how we manage our business. Our decisions are deliberate, driven by the goal of increasing long-term shareholder value.



Global population is on the rise, and with the world's need for safe, clean, reliable baseload electricity, nuclear remains an important part of the mix. Just last week, the Lancet Commission confirmed that pollution causes nine million premature deaths each year. That's the equivalent of a country about the size of Sweden or Austria every year. Clearly, there's an urgent need to address air pollution, and nuclear offers a ready solution. The good news is that many recognize this. Around the world there are 56 reactors under construction, the majority of which will be online over the next three years if start-ups occur as planned, and more reactors means more uranium will be needed.

We can't control the timing of a market recovery, but we are taking action on the things we can control. We are focused on our strategy to produce from our Tier 1 assets those that are the lowest cost and provide us with the most value. We're restructuring our organization to be as efficient as possible. We're responsibly managing our production, inventory and purchases, protecting and extending the value of our contract portfolio and maximizing cash flow, while maintaining our investment-grade rating. Ultimately, our goal is to remain competitive and position the Company such that we have the ability to be among the first to respond when the market calls for more uranium.

Thanks for joining us today, and with that, I'll turn it back over to the Operator.

OPERATOR:

Thank you. We will now begin the question-and-answer session. In the interest of time, we ask you to limit your questions to one, with one supplemental. If you have additional questions, you're welcome to rejoin the queue. To join the question queue, you may press star, then one on your telephone keypad. You will hear a tone acknowledging your request. If you are using a speakerphone, please pick up your handset before pressing any keys. To withdraw from the question queue, please press star, then two.

Webcast participants are welcome to click on the Submit a Question tab near the top of the webcast frame and type their question. The Cameco Investor Relations Team will follow up with you by email after the call.

Once again, anyone on the conference call who wishes to ask a question may press star, then one, at this time.

Our first question comes from Ralph Profiti of Eight Capital. Please go ahead.

RALPH PROFITI:

Good day. Thanks for taking my question. Tim, you touched on this in your comments about price sensitivity, and I've been looking at the uranium realized price sensitivity table, and have been looking at it post TEPCO, and if you take into account the changing contract mix, there's still been this slippage of about $1 or $0.75 per pound per quarter. Is this something that, irrespective of prices, if they were to stay the same, you'd expect this slippage to continue to occur? I'm just trying to find a point where this stops and that contract books becomes more reflective of price protection, irrespective of where current spot prices and long-term prices are.

TIM GITZEL:

Yes. Thanks Ralph. Thanks for the question. Grant and I were just talking about this before the call, and Grant, you've got the pieces on that.

GRANT ISAAC:

Yes. Sure. Hi, Ralph. We have a bit of an explanation here that really has two factors to it. One is just the methodology behind the table, which is just a rounding effect, so when we round to the nearest dollar—and so you're seeing a bigger jump, if you will, in the early years with respect to the prices that are coming off, but really what it's about is the—it pivots around the assumption under the table under deliveries. Deliveries include best estimates of requirements, contracts, and contracts with volume flex provisions, and so what we do as we construct this table, looking at our customers, looking at their requirements, looking at their behaviours in a market that's this price, we have an estimate and we make conservative judgments on whether they would exercise, for example, flex provisions, or if it's a requirements-based contract, that might be a judgment on where that reactor operator is going to be in, say, a market where there are challenges to operating a nuclear plant, so what you're seeing there is just a filtering through of mostly assumptions around flex, which is why, in the outer years, you see that value coming back into the table, because the assumption is they might flex down a higher-priced contract in a low-priced market, but eventually you have to catch up to that quantity, so it'll have to come back at some point.

The other feature that I think is important, Ralph, is that, as we've seen in the past, when the market begins a demand transition and contracting begins and price pressure picks up, then we don't assume the flex behaviour will occur, and then the value comes back to the table in that form as well, so that's really what you're picking up there. It's just the variability within the contracts and our best estimate on how the utilities will behave.

RALPH PROFITI:

I've got it. You're making assumptions on discretionary behaviour, which is—which can be difficult. I understand. Yes. If I can ask a follow-up, you're coming off one of the key investors symposiums for the industry last month. I'd like to get your thoughts on any changes in your assumptions on where we are and the amount of oversupply in the uranium market.

TIM GITZEL:

Well, Ralph, it was the WNA conference, so it was mid-September. I haven't missed it for about 30 years, I think. It's a bit of a bellwether as to how things are going in the space, and this year was really a bit of a mixed bag, I would say. Coming off a South Korean election. South Korea, a country really strong in nuclear, elected a president that kind of starts going the other way, and then we find, just recently, that they take a bit of a poll in the country to see if they should finish building those Shin Kori 5 and 6 reactors, and the population wants them to go, and so you've got that out there.

Post symposium, you've got the Japanese election. That was a good news piece, I think, Shinzo Abe re-elected. We hope that will be good news for the restart program. On the supply side, I think during the symposium we heard from the Kazakhs. The Minister of Energy, I think, mentioned that they might be looking at some more supply discipline, so we're waiting to hear how that's going. Then you've got the other side, the U.S. kind of struggling along. It looks like they're going to finish two of the four reactors there, which is a good news, not good news story, so it's just really a mixed bag of information right now.

As far as supply goes, we're seeing—we launched our own supply discipline last year, in April of '16, at Rabbit in Wyoming, and in Nebraska. We pulled back at MacArthur. AREVA, we're seeing pulling back out of Niger last year, and then next—or this year and again next year. Paladin, we're not sure where that movie's at these days, Peninsula Husab, so it's a real mixed bag. Secondary supply, still—the Russian black box still feeding material in. I think the enricher underfeeding and the tails re-enrichment still producing, so it's a bit all over the map right now, but the piece we take and we watch closely is on the supply, and we've said for years, keep your eye on supply. That's the big piece, and we saw the Kazakhs make a declaration in January of this year saying 10%. We think they're somewhere near there. I heard 9%, I think, from the Minister not long ago, and we know our own JV, Inkai, is down that much and more right now. We expect to be down 10% at the end of the year, so, really watching the supply side. Demand is kind of behaving as expected: 56 reactors under construction. You know the whole story. I think we're looking at a percent to percent and a half growth. That's a good news story. If we didn't see growth or reactors under construction, that wouldn't be good news. We do, and if we could see some supply discipline, we think eventually we'll get back to more of an equilibrium point.

RALPH PROFITI:

Great. Thanks, Tim.

TIM GITZEL:

Thanks, Ralph.

OPERATOR:

Our next question comes from Orest Wowkodaw of Scotiabank. Please go ahead.

OREST WOWKODAW:

Hi. Good afternoon. Just following up more on Ralph's question about your realization table, in the assumptions there, it shows that the sales volume average over the '17 to '21 period has actually gone up by one million pounds, I guess, from 25 million to 26 million, and then when we look at your realized prices, in the next couple of years they've come down. Is it correct to assume you've been, then, signing new contracts that have lower pricing in them that's effectively adding to the volume, but lowering the expected realized price?

TIM GITZEL:

Thanks, Orest. I'll get Grant to carry on with that one.

GRANT ISAAC:

Yes. That would be incorrect, Orest. The factors that are changing the price sensitivity table are the ones that I outlined with Ralph. You know that we have had some long-term contracting success. We talked recently about a Bruce Power contract, but that was under the types of terms and conditions that we're interested in, which is market exposure going forward. We don't think these are rational nor sustainable prices, so we want that market exposure going forward. That was the type of contract we signed. What's driving those changes is not layering of volumes at base escalated prices around today's fixed. We have not changed our long-term contracting strategy.

OREST WOWKODAW:

What's driving the higher sales volume number then?

GRANT ISAAC:

Bruce Power would be an example.

TIM GITZEL:

That was a large contract for us, Orest. That was, I think, a 10-year deal, about a $2 billion value contract, so that was a big ticket to add to our portfolio.

OREST WOWKODAW:

Okay, so the British contracts added pounds, but can you—the pricing would be more at—on your kind of traditional sort of mechanism?

GRANT ISAAC:

Yes. With Bruce Power in particular, we were looking at a contract that gave us market-related exposure, and of course you know in most of our market-related contracts, they tend to be a bit of a hybrid, if you will. In markets like this, the customer might ask for a certain ceiling, and of course we would then ask for a floor, but it was a very—it was arranged where there was market exposure we were very comfortable with, all consistent with what has been our long-term contracting strategy in the past and what it is going forward. In other words, I don't want you to take away an assumption that we're panicking in this market and layering in fixed-price volumes at today's prices. That's just not the case. We don't feel we have to right now, and therefore, we're not chasing down this market.

OREST WOWKODAW:

Okay, and in terms of when we look at the next couple of years, when—at what year would your contract book kind of drop below, say, 20 million pounds?

TIM GITZEL:

Well, we talk about the next five years, and I think we said we have 26 million pounds on average over those years, more in the early years, and I think that's about as much as we've said about that, Orest.

OREST WOWKODAW:

Okay. Thanks very much.

TIM GITZEL:

Good. Thank you.

OPERATOR:

As a reminder, we ask that you limit your question to one, with one supplemental question. The next question comes from Fai Lee of Odlum Brown. Please go ahead.

FAI LEE:

Thanks. Just wondering, in terms of the additional disclosure around the appeal process on the tax court decision, in terms of the timing, is there any particular reason why you've decided to provide the additional disclosure about the appeal process at this point in time?

TIM GITZEL:

Fai, it's Tim. Obviously, we're waiting for the initial decision to come out. I think we just wanted to make everyone aware that there is appeal rights on this. I think we'll see when we get the first decision, and then each side has the right to appeal, and I think that—looking at Sean Quinn here—but that was just kind of our best estimate, and I think we just wanted to make sure people understood that once that initial decision comes out might not be the end of the ballgame yet. If we're not happy or they're not happy, it could go to appeal. I think that's why we put that in there, just to, maybe, temper the expectations that it's all over when that first decision comes out.

FAI LEE:

Okay, so it's not like there's an expectation that you're expecting to appeal, or they've given an indication that they're going to appeal.

TIM GITZEL:

Yes. We don't know. We have no idea, and obviously, we're waiting with bated breath for the decision because it's such a big ticket for everyone, but we just wanted to make people aware that there is a right to appeal on both sides, and that it could happen.

FAI LEE:

Okay, and in the MD&A, there is this little blurb about industry consultants and uncovered requirements of about 600 million pounds over the next decade, and that's come down from 800 million pounds; obviously, forecasting to shift with the winds. I'm just wondering, how does that reconcile with your own internal views?

TIM GITZEL:

Yes, so Fai, that was a U.S. number. We obviously look at the trade publications who are watching this, TradeTech, UX, and that number just moved in the 10-year window. If you spread that window out a little longer, I think you'll get those pounds back. We didn't want to do that. We wanted to be true to the numbers we've been putting out, and the window we've been using, so just has to do with some delays in construction, some shutdowns prematurely that are being announced. We'll see if they happen, and so that's what that's about.

FAI LEE:

Okay. Thank you.

TIM GITZEL:

Thank you.

OPERATOR:

Our next question comes from Yi-Jeng Huang of S&P Global Platts. Please go ahead.

YI-JENG HUANG:

Thank you very much. Your net assets this quarter looks like it's—sorry, the net losses this quarter looks like it's due largely to the $111 million impairment of NUKEM goodwill ticket item. Could this be considered a one-time write-down of that asset or will there be more in the future? I guess from a layman's perspective, could you explain the factor that caused you to buy NUKEM in the first place, and why Cameco has decided to shelf that for now?

TIM GITZEL:

Yes, Yi, thanks a lot for the question. That is indeed a one-time write down of goodwill associated with NUKEM. Let me just back you up and say I'm not sure anybody anticipated now a seven-year slump in the uranium business. When we took NUKEM, we took it—there was strategic reasons for us to take it. It was in the market. Someone was going to take it. It brought along some good people and good assets, good contracts that we've benefitted from, quite frankly, over the years.

This seven-year run now—or almost seven years of a slump—you see us—read our MD&A. Across the board, we're pulling back, and including Grant Isaac this last couple of weeks and his Marketing and Sales Team; we had to make some really tough decisions there to consolidate. We couldn't afford all of that infrastructure in this market, and so that's part of it. It was to downsize the NUKEM piece. We continue trading. We continue selling long term, but that was a move we had to make with NUKEM, and that write-down of goodwill came with it.

YI-JENG HUANG:

As a follow-up question, would this be kind of the first time that you put a price tag to the, I guess, the magnitude of the impairment of NUKEM?

TIM GITZEL:

Grant?

GRANT ISAAC:

Yes. I'm not sure I understand the question.

YI-JENG HUANG:

Is this the first time that you've sort of publicized and put a number to the write-down of this asset?

GRANT ISAAC:

Well, if I understand your question, it would be yes because this is the first time we've impaired the goodwill on the asset. Yes.

TIM GITZEL:

We adjust the inventory on a quarterly basis, but on the asset itself, this is the first time, Yi.

GRANT ISAAC:

And only time.

TIM GITZEL:

And only time.

YI-JENG HUANG:

Thank you very much.

TIM GITZEL:

Thank you. Thanks for your question.

OPERATOR:

Our next question comes from Alex Pearce of BMO. Please go ahead.

ALEX PEARCE:

Hi. Thanks for my question. I know you touched briefly on the purchase commitments, and overall, they have gone down, but I see in 2017 it's actually up by about 37 million. Maybe you could just tell us what's driving the increase this year.

TIM GITZEL:

Just on our purchases, for this year I think we're at about three million pounds to the end of September. We're holding an inventory, I think, of about 27 or 28—just over 27 million pounds.

Obviously we're always watching for opportunities that can be profitable and provide us with additional flexibility, and I would just say we've seen some of those, and that would explain the difference.

ALEX PEARCE:

Okay. Thank you.

TIM GITZEL:

Thank you.

OPERATOR:

The next question comes from Greg Barnes of TD Securities. Please go ahead.

GREG BARNES:

Thank you. Just wanted to follow up on the CapEx. You've brought that down quite a lot this year to $160 million. Guidance that you have out there right now is '18 and '19, you're looking at $200 million to $250 million in each year. I assume there's downward pressure on those numbers as well.

TIM GITZEL:

Greg, I think you're probably right. The numbers we put out we put out some time ago, and I'm looking over at Brian Reilly, and we've been working hard with he and his teams on our CapEx. Our CapEx is considerably lower for that—for this year, and we'd be, I think, looking to replicate that in the future, but we just haven't put those new numbers out yet.

GREG BARNES:

But the 160 million issue would be sort of where you'd like to be.

TIM GITZEL:

Well, that's where we are this year, and we'd like to be. We just haven't got through that exercise yet, but we'll certainly be looking to drive those down, Greg. Yes. Yes.

GREG BARNES:

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Okay, and just following up on Orest's question about the legacy portfolio, I think we've talked before on conference calls about that 2020/2021 timeframe is when that starts to really fall off. Is that still the case, or have you been able to layer in contracts now beyond that, notwithstanding Bruce Power?

TIM GITZEL:

Yes, it did. Obviously when you have an average in the 26 million pound range for the five years, and we have more, obviously, in the near—in the next couple of years, it starts to fall off there. We've found a few opportunities. There have been a few. I think there's been about 60 million pounds traded on the long-term market this year. We're obviously always in there looking to find those that might meet our conditions. Bruce Power was one of them, and so we'll be looking, if we can find the right conditions, to keep layering in, but we don't feel big pressure to do a lot now unless it meets with what we're looking for.

GREG BARNES:

Just a quick follow-up if I may, when do you think you'll start to feel that pressure, though, Tim?

TIM GITZEL:

Well, Greg, we're watching every day. I'm not sure how long this market can last. We're closing in on seven years now, but we get a bit enthused by that 600 million pounds—800, 600, pick your number—that's out there that has got to come to the market at some point. We're seeing a little bit of a supply discipline as I outlined a little earlier. That's kind of the first we've seen from the suppliers in a long time, and that tells you that we're probably not the only ones that have a declining curve on our sales commitments, that have more in the next few years and declining over time. That tells you that if we're, as suppliers, not—our books aren't full, then there's some buyers that are out there that are going to have to come to the market, and so we think we're in a good shape right now. We have a good commitment. Twenty-six million average a year is not a bad position for us when we're producing 25-ish, and so we've got some inventory to use up as well, so we're comfortable where we're at, and we'll just watch how the market turns out.

GREG BARNES:

Okay. Thank you.

TIM GITZEL:

Thank you.

OPERATOR:

The next question comes from Robert Reynolds with Credit Suisse. Please go ahead.

ROBERT REYNOLDS:

Good morning guys—or sorry, good afternoon. My question relates to the inventory or the uranium purchase commitments that you have left. I saw during the third quarter, the average price paid for purchases was CA$36.83 a pound. Of the 23 million pounds or so of purchase commitments that you guys have disclosed, how much are still in the sort of higher-priced legacy purchase contracts that you entered into to secure when you were having the Cigar Lake start-up challenges?

TIM GITZEL:

Yes, Robert. Thanks for the question. Indeed, it is still morning here, but I'll turn that one over to Grant.

GRANT ISAAC:

Yes. Thank you. We really abandoned an aggressive purchasing program in 2015, so we really have not been purchasing—layering in new purchase commitments, except for when we see the right opportunity, and of course, those would be linked to the markets those right opportunities are in. We have a bit more of the legacy-type purchases, as you describe them, to work out, but ultimately you're seeing the transition down to our inventory costs. So, also in the MD&A, just in front of the uranium segment there on Page 18, you see quite a significant reduction in the cost of our inventory, and that really is just as we utilized those purchases that were at a higher price and benefit from the Tier 1 pounds coming into the inventory portfolio, and any purchases that we've layered on since have been reflective of these kind of markets, so really, we're working through those legacy purchases and don't expect a big impact on those going forward.

ROBERT REYNOLDS:

Then, just as I follow up, what is a normalized inventory level that Cameco would like to hold?

TIM GITZEL:

We'd like to usually hold, Robert, about five to six months forward sales, so that would be our position.

ROBERT REYNOLDS:

Great. Thanks.

TIM GITZEL:

Good. Thank you.

OPERATOR:

Our next question comes from Greg Smith who is a Private Investor. Please go ahead.

GREG SMITH:

Okay. Thanks for taking my call. I was just trying to figure out some kind of valuation here based upon how much it would cost to build the whole place, like that—the mines, the whole shooting match. How much does that cost?

TIM GITZEL:

Well, it would depend, Greg, where you're talking about, and whether you're in a in situ recovery situation or underground. I can give you some numbers that we know of. Cigar Lake is our most recent foray into the mining business, and by the time that was done, we were somewhere in between $2.5 billion and $3 billion for the mine, so I would just say it's not cheap. In Saskatchewan, it's not cheap. Uranium's not cheap, so just keep your eye on the—when you see numbers coming out for new projects going forward. We've got a lot of experience, some good, some not as much, but it's expensive, and Cigar Lake would be an example where we were in the $2 billion to $3 billion range just for the mine.

GREG SMITH:

Okay. Thanks for your help.

TIM GITZEL:

Thank you.

OPERATOR:

Our next question comes from Fai Lee of Odlum Brown. Please go ahead.

FAI LEE:

Thanks. Tim, I just want to make sure I understand this correctly. You've indicated that the increase to your sales volume guidance for the year, and not this quarter—was predominantly due to Bruce Power, I guess, and...

TIM GITZEL:

No, no, no, no, no, not for this year. That's going forward, Fai.

FAI LEE:

Okay, so these portfolio optimization decisions that's affecting this year, what is that about? Can you shed more colour around that?

TIM GITZEL:

Yes, absolutely. It's some contracts we've brought forward, but Grant, you know the specifics.

GRANT ISAAC:

Yes. I wish I had a really short answer for you, Fai. I don't, so you'll have to bear with me. When we look at our contract portfolio, obviously there's a lot of value in it, and when we have customers who are looking at their own requirements going forward, and if there's any doubts or concerns about their portfolio going forward—they might want some future relief for example—and for us, if it's valued out into the future where we have uncertainty about the demand of that customer; might be technological, it might be regulatory, it might be licensing, it might be just straight economic where we have doubts about a customer out in the future, we'll entertain a conversation with them about their future uranium requirements, but it's all on the principle of converting uncertain future value into certain present value, and so we've had a few opportunities there where we've been able to bring forward some value, offset it with more exposure out into the future, but we're okay with that.

For the reasons that Tim described earlier, we don't believe that this is a market that's sustainable, and having exposure out into the future when that demand transition—when that 600 million pounds of uranium demand has to come to the market, some of it's going to come our way, and we want to be exposed to that. So, it's just a way for us to optimize our portfolio, and we were able to bring some value in the form of cash flow and earnings into the near term, and that conversion works for us right now in the market that we're in.

FAI LEE:
Sorry, maybe I'm not clear. I was referring to the last quarter. The outlook for sales volume was 30 million to 32 million pounds, not 32 million to 33 million, and I'm just wondering what that delta is referring to.

GRANT ISAAC:
Yes, sorry. I did, obviously, a horrible job of trying to explain it. That is the delta. We have some opportunities to work with some customers and bring forward volumes into this period, volumes that would have been out into the future, and then that's reflected in higher guidance on our sales delivery volumes, all within our committed portfolio.

FAI LEE:
Oh, okay, so you've brought forward sales and you're going to sell more this year, but they'll be offset, maybe somewhere in the future then.

GRANT ISAAC:
Yes.

TIM GITZEL:
You got it.

FAI LEE:
Thank you.

OPERATOR:

As a reminder, if you have a question, please press star, then one. Our next question comes from Orest Wowkodaw of Scotiabank. Please go ahead.

OREST WOWKODAW:

Hi. Thanks for taking the follow-up. You mentioned earlier that with the production cuts at MacArthur this year, you kind of alluded to the fact that you might consider more moving forward. I'm just wondering, I mean given the state of the market, would there be any possibility that—or would it make sense to shut down one of either Cigar or MacArthur in order to get the market closer to equilibrium, and basically help pricing?

TIM GITZEL:

Yes

OREST WOWKODAW:

Can you go for that?

TIM GITZEL:

Well, Orest, that'd be a nice question that you could ask the Kazakhs at some point. I would just say that we're always looking at our operations, our balance of production and purchases and inventory to see what the optimal space is there. Today we have contracts to fill. We have the 32 million to 33 million pounds to fill this year, and so our production is down a bit, about a million pounds due to some technical issues coming out of our summer shutdown, so it's something we look at all the time, Orest. That's all I can say.

OREST WOWKODAW:

Okay. Thank you very much.

TIM GITZEL:

Thank you, Orest.

OPERATOR:

Our next question comes from Anang Majmudar of General American Investors. Please go ahead.

ANANG MAJMUDAR:

Good morning. Thank you for taking my question—or questions, actually. I had, please. Given the restructuring in the last two years, would you mind reminding us please—let's say if we look at this year—what costs are running through the P&L that are, let's call them temporary or one-time in nature, and where they belong, whether it's cost of goods sold or its operating expenses, and then what expenses related to restructuring might be a little stickier in nature, such as the care and maintenance on Rabbit Lake, and if there might be room for those to moderate over time?

TIM GITZEL:

Anang, that's a great question, and I look to the CFO for an answer to that one.

GRANT ISAAC:

Yes, and my apologies. I don't have the full list sitting in front of me, but you highlighted some of the examples, Anang. When we curtailed at the—in the U.S., for example, that's still a producing asset on a declining basis, so you would have the cost of that running through cost of sales, so hanging in that cost of sales line a lot longer. You would have had some cost of sales burden from the Rabbit Lake care and maintenance for a period of time once production and building was completely ceased, converting then over into just a straight care and maintenance expense. When we do any restructuring on the G&A side, in order to get those A-base sustainable reductions, of course, they carry with them one-time restructuring costs, so we've tried to break those out. We've also had some costs associated with things like our tax dispute that we've talked about, so that was not one time; it was occurring over a period of a couple of years, but now that the case is in the judge's hands, that falls off. We had some costs associated with some collaboration agreements. As we looked to shore up the support that we get from communities in which we operate, those collaboration agreements carried some costs which aren't—parts of it are ongoing, but some of it was one-time as well, so it is a basket of costs in there. We try to track them for you and lock them into either the administration table or in the uranium segment. But, if you look through all of that, you see that it is a story about fundamentally cost of sales coming down.

We work through higher-cost purchases. We work through higher-cost Tier 2 production. Tier 1 is filling up that bucket, so you see the cost coming down fundamentally, or the core costs coming down. You see direct administration coming down on a run-rate G&A basis quite substantially—20% so far in the nine months—added to the work we've done in the past. You see the core exploration program coming down, and then on a free cash flow basis, you see the CapEx coming down, so there is a—what we hope is a very clear, and in our minds, compelling story about reducing the run-rate costs of the Company to deal with these markets in order to ensure we have good cash flow, good cash flow that gives us the ability to continue to navigate by an investment-grade rating, and an investment-grade rating that, in fact, makes sure that we can weather a deep cycle in the uranium space with no awkward lurches to the capital markets. That is the path we've been on for the last couple of years, and continue to be on, and we would just say it's paying dividends.

ANANG MAJMUDAR:

Thank you. I appreciate that, and maybe if I could ask one question about capital expenditures, just to follow up on the previous question about capital expenditures, would you be able to speak to—of the $160 million, would you be able to speak to what amount you would consider to be maintenance CapEx?

TIM GITZEL:

Oh, I was just looking at that this morning. We have it broken out in our MD&A into the different categories, but I'm not sure I have a sharper answer than that. Grant, do you have anything, I mean other than the breakdown we have in our MD&A?

GRANT ISAAC:

Yes. With the $160 million that is forecast for this year, and if we just look at the Tier 1 assets and what's required, you see that there's a bit in the categories of both replacement and growth. To really focus in on what that sustaining piece is, or that maintenance piece is, it really is a combination between sustaining and replacement categories, so it is some mine development, which might be picked up in replacement versus just the good old-fashioned sustaining capital you need to keep those operations going. I don't have a new number for you. We're in the midst of that process right now. We're in the budgeting cycle. We'll be coming out with new capital numbers like we talked about.

As Tim indicated to Greg a bit earlier, this is an area where we continue to look, so unfortunately, I can't give you a precise number, other than yes, we're looking at honing in on exactly what that maintenance number is. It will be a combination of sustaining and replacement that allows us to benefit from these assets, to put them into our committed sales portfolio where the average realized price is higher, but ultimately not expose any of this Tier 1 production to the spot market.

TIM GITZEL:

I think, if you take a look at the investor handout on the website, there's some detail on there as well, Anang, so you may want to look at that.

ANANG MAJMUDAR:

Terrific. Thank you. I will do that. Appreciate the time.

TIM GITZEL:

Super. Thank you very much.

OPERATOR:

Our next question comes from Anton Hugo of Prima Research. Please go ahead.

ANTON HUGO:

Hi. Good evening. I was looking at your inventory of 27-odd million pounds of uranium oxide, and I was surprised that you increased the valuation on a per pound basis by 4.5% quarter-on-quarter. That's out of line, seemingly, with the changes in the actual underlying long-term contract price, which is down almost 8% for the quarter, and the only about 1% increase in the spot price for the quarter. Can you give a sense—because it's quite marked in terms of the picture—your inventories are more than a quarter of your market cap at your valuations, so it's quite a serious number?

TIM GITZEL:

Yes. Anton, we're sorry. We're looking at each other, trying to understand, maybe, the question. I'm not sure we increased the value of our inventory. Can you point us to some numbers?

ANTON HUGO:

Yes. If you take the actual inventory value, it went from CA$40.33, so CA$40 odd, to CA$40.54 on a per pound basis quarter-on-quarter, and during this—and during that time, the Canadian dollar strengthened by almost 4%, so on a U.S. dollar basis, there is a 4.5% uptick in the valuation on a per-pound basis of your inventory, whereas the actual spot price only went up 1%, and the long-term price went down 7.5% on the quarter, so I don't understand what drives the actual valuation figure.

GRANT ISAAC:

Yes, Anton. First of all, let me just say I'd love to take this offline because I think there's a lot of detail we need to work through, and you're picking up kind of an everything all-in number. What I would instead do is point you to Page 18 of the MD&A where we break out specifically the cost of the inventory, and actually, you see it declining, declining from $34.69 per pound to $31.56 per pound. That's the disclosure that, really, I think gets at your question about where is that inventory value going, so I'd love to get into a little more detail on the bigger number, but that's where I point you to.

ANTON HUGO:

I mean, simplistically, if one looks at September quarter of last year, the valuation per pound in dollars was $34.10 a pound, and the long-term price was $37.50. Now you're talking $32.50, but the long-term price has since then declined by 19% to only $50.50, so in other words, you've gone from a discount to the long-term price to premium to the long-term price, and it seems incongruous.

TIM GITZEL:

Anton, let me suggest that we take this offline. We're thumbing through papers. We obviously know who you are and where you are. We will be in touch with you and we will get the answer to your question. Thank you, Anton.

ANTON HUGO:

Thank you. I appreciate that.

TIM GITZEL:

Yes, no problem. Thank you, sir.

ANTON HUGO:

Okay. Thanks.

OPERATOR:

This concludes the question-and-answer session. I would like to turn the conference back over to Tim Gitzel for any closing remarks.

TIM GITZEL:

Well, thank you, Operator. With that, I just want to say thanks to everybody who's joined us on the call today. We certainly appreciate your interest and support, and hope you have a wonderful day, and go Riders. Thanks.

OPERATOR:

This concludes today's conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.