

GOT FUEL?

SLX.ASX | SILEX SYSTEMS LIMITED

PRICE
A\$ 2.58

TARGET PRICE
A\$ 4.40
(FROM A\$ 4.30)

RECOMMENDATION
SPECULATIVE BUY
(FROM SPECULATIVE BUY)

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Event

We recently attended a non-deal SLX roadshow; key takeaways are highlighted below.

Impact

Nuclear fuel cycle prices are at 10-year highs, primarily reflective of western utilities weaning off dependence on Russia's nuclear fuel supply chain. Spot SWU prices lifted US\$31/SWU (+33%) across Nov'22 to US\$125/SWU (+123% YoY), while term SWU prices remain elevated at a decade-high of US\$135/SWU (+121% YoY). Uranium conversion prices have also materially raterated subsequent to the Russian invasion of Ukraine, with spot and term conversion prices currently at all-time highs of US\$40/kgU and US\$27/kgU respectively (+150% and +50% YoY).

Supply anxiety continues to provide a highly supportive backdrop. An immediate global enrichment supply deficit of ~15m SWU/yr is expected in the absence of Russian enrichment supply. This potential supply gap is equivalent to 100% of the U.S.' current annual enrichment requirements, or ~7.5x the capacity of SLX's proposed Stage I Paducah Laser Enrichment Facility (PLEF I). GLE (SLX 51% / Cameco (TSX: CCO) 49%) continues to engage with U.S. nuclear utilities with respect to the domestic deployment of the SILEX technology, with the acceleration of commercialisation efforts currently being evaluated for initial production from PLEF I in CY27.

U.S. DOE funding awaited as a material catalyst. The U.S. government has appropriated US\$700m to the U.S. DOE's HALEU Availability Program under the Inflation Reduction Act of 2022 to support the establishment of domestic HALEU production capability. We continue to highlight a limited pool of western enrichers vying for funding under the HALEU Availability Program (consisting only of European enrichers Urenco and Orano ex-GLE), which both employ comparatively more capital-intensive and less efficient centrifuge enrichment technologies. We highlight that several other legislative initiatives are currently working through Congress that could provide up to ~US\$4bn of funding in support of establishing domestic LEU/LEU+/HALEU enrichment capacity.

Cameco able to close the 'gap' from Feb'23 onwards. Cameco holds an option to acquire an additional 26% equity interest in GLE from SLX at fair market value, which becomes exercisable from Feb'23. We highlight that subsequent to the acquisition of a 49% stake in Westinghouse, uranium enrichment is a notable final gap required for complete vertical nuclear fuel chain integration on Cameco's part. Noting significant macro tailwinds and recent bullish commentary from Cameco on GLE's prospects, we continue to assume this option is exercised in H1 CY23 at an assumed fair market value of A\$160m, which we think may prove overly conservative.

Action

Speculative Buy rating maintained, Price Target increased to \$4.40/sh (1.1x NAV, prev. \$4.30/sh).

Catalysts

Ahead of the potential election of Cameco to exercise its option to increase its stake in GLE to 75%, Requests for Proposals (RFPs) regarding U.S. DOE offtake under the HALEU Availability Program are due in Dec'22 per timelines recently guided by the U.S. DOE.

Silex Systems Ltd		
Share Price	2.58	A\$/sh
Price Target (1.1x NAV)	4.40	A\$/sh
Valuation	3.92	A\$/sh
Issued Capital		
Ordinary Fully Paid	205.3	m
Options & Perf. Rights	4.7	m
Dil. FP Ordinary	210.0	m
Market Capitalisation		
Enterprise Value	492	A\$m
Cash (Nov'22e)	38	A\$m
Debt (Nov'22e)	Nil	A\$m
Directors		
Craig Roy		Chair
Michael Goldsworthy		MD
Christopher Wilks		NED
Helen Cook		NED
Substantial Shareholders		
Jardvan Pty Ltd	15.0%	
Board & Management	4.5%	

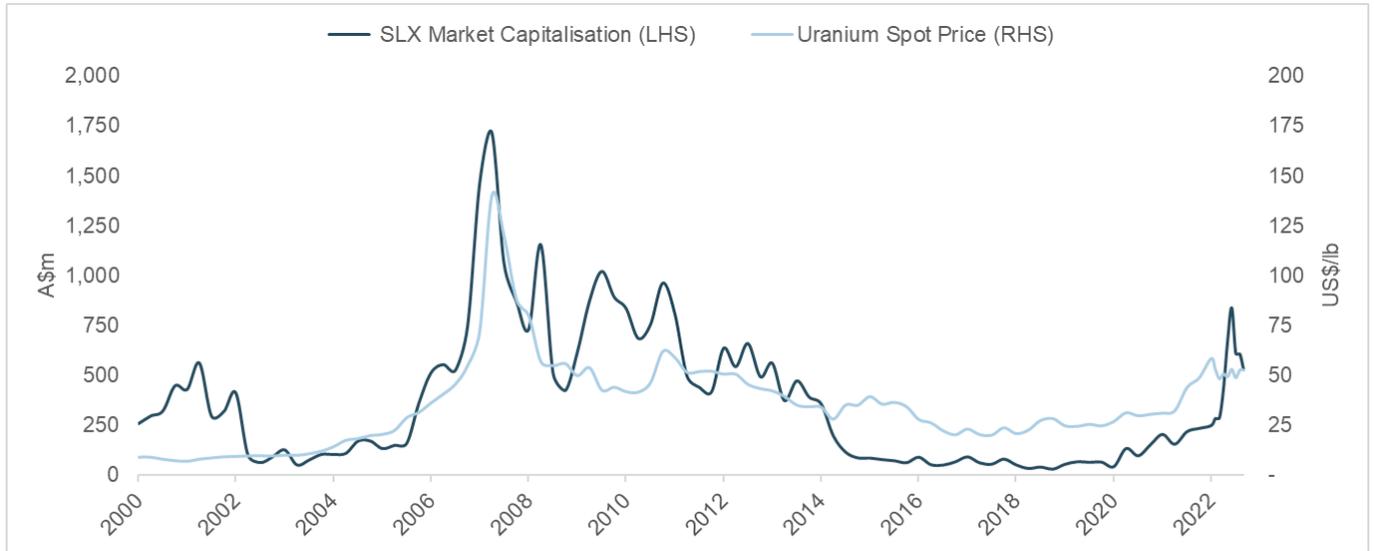
Performance



Source: IRESS

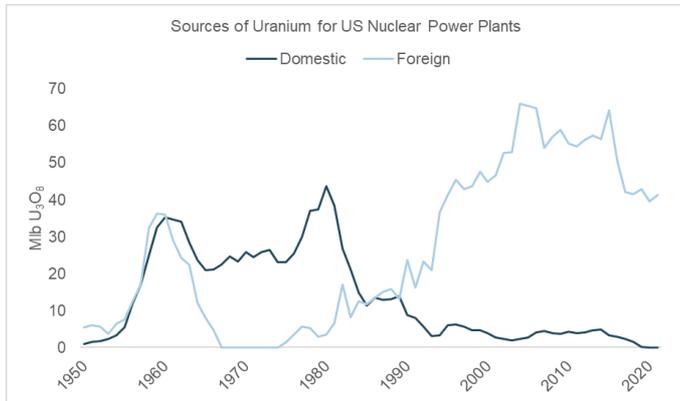
Investment Thesis

Figure 1: SLX has previously carried a market cap of >A\$1.7bn prior to holding i) an equity stake in GLE and ii) access to Paducah tails.



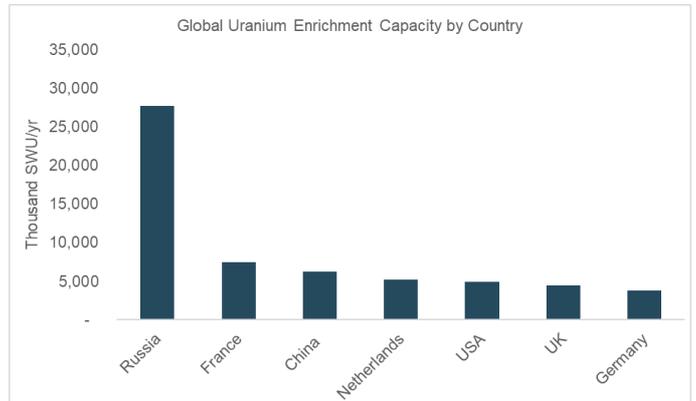
Source: Bloomberg

Figure 2: U.S. nuclear power plants are heavily reliant on foreign-origin U₃O₈; Paducah UF₆ tails hold significant strategic value.



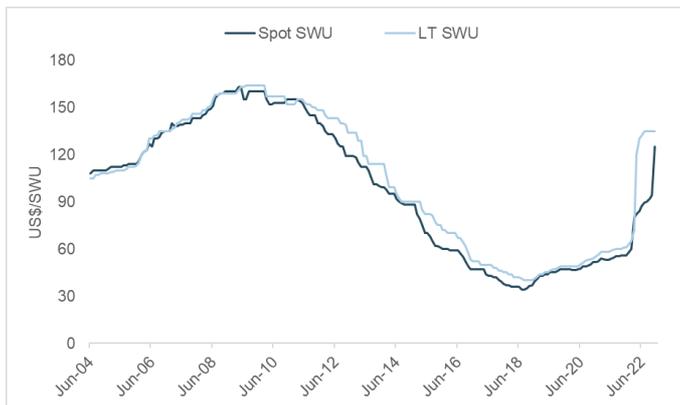
Source: U.S. EIA

Figure 3: Russia accounts for ~43% of global enrichment capacity, domestic U.S. capacity of ~5m SWU/yr = ~1/3 of annual demand.



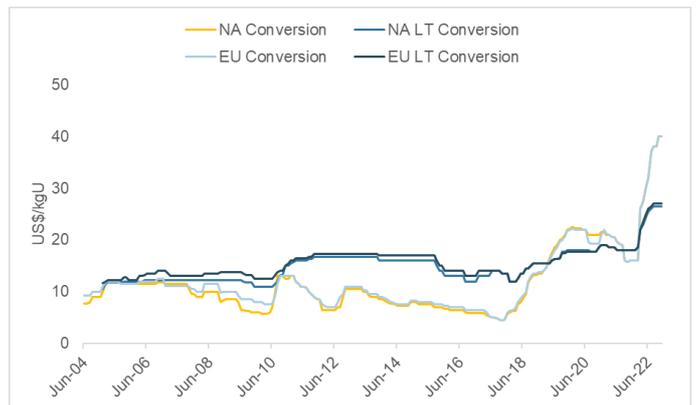
Source: WNA (2020), Urenco

Figure 4: Enrichment (SWU) prices are currently at decade highs, largely necessitated by the Russia-Ukraine conflict.



Source: UxC, LLC (adapted from SLX)

Figure 5: Uranium conversion prices are also at decade highs; the Paducah UF₆ tails capture the value of dormant U₃O₈ conversion.



Source: UxC, LLC (adapted from SLX)

Valuation

Our valuation of the Paducah UF₆ Tails Project reflects total SWU capacity of ~4m SWU/yr (combined PLEF I & II capacity) and LT U₃O₈ conversion and SWU prices of US\$80/lb, US\$25/kgU and US\$150/SWU respectively. We continue to conservatively ascribe no value to the HALEU opportunity at Paducah via a third-stage facility (PLEF III), although we look to ascribe value on the potential award of U.S. DOE funding to establish HALEU production capacity.

Figure 6: PLEF I Valuation Assumptions

Variable	Rationale	Units	EH Assumptions
Annual natural uranium production	U.S. DOE production cap	MTU in the form of UF ₆	2,000
Natural uranium production	1kg U in UF ₆ = 2.61285 lbs U ₃ O ₈	Mlb U ₃ O ₈	5.2
Avg. U ₃ O ₈ contract price	EH Price Deck (LT)	US\$/lb	80
Avg. uranium conversion price	EH Price Deck (LT)	US\$/kgU as UF ₆	25
Initial capex	~0.5x centrifuge plant capex	US\$m	750
Cameco option fair market value	Cameco acquired a 24% stake in GLE for US\$124m in 2008	A\$m	160
Steady state revenue	100% basis	US\$m	547
SLX royalty revenue	7% of total GLE revenue	US\$m	38
Unit operating costs (equivalency in lbs)	Published cost guidance	US\$/lb	25
Annual operating expenditure	US\$25/lb x 5.2mlb U ₃ O ₈	US\$m	130
NPV _{10%} (75% risk-weighted)	Combined PLEF I & II facilities (SLX 25% GLE equity stake)	A\$/sh	3.78

Source: Euroz Hartleys estimates

Our nominal PLEF II valuation assumes annual SWU capacity of 2m SWU/yr and an avg. product assay of ~5% U²³⁵, reflective of the view that longer-dated domestic U.S. LEU requirements will more than underpin the second-stage opportunity at Paducah.

Figure 7: PLEF II Valuation Assumptions

Variable	Rationale	Units	EH Assumptions
Annual SWU capacity (ex-Stage 1)	Urenco SWU calculator (refer below)	SWU/yr	2,000,000
Initial capex	US\$750m per 2m SWU capacity, aligned with PLEF I	US\$m	750
Avg. SWU contract price	EH price deck, current term price: US\$135/SWU	US\$/SWU	150
EBITDA margins	Aligned with Urenco EBITDA margins (Fig. 9)	%	60%
Steady state revenue	100% basis	US\$m	300
Steady state EBITDA	100% basis	US\$m	180

Source: Euroz Hartleys estimates

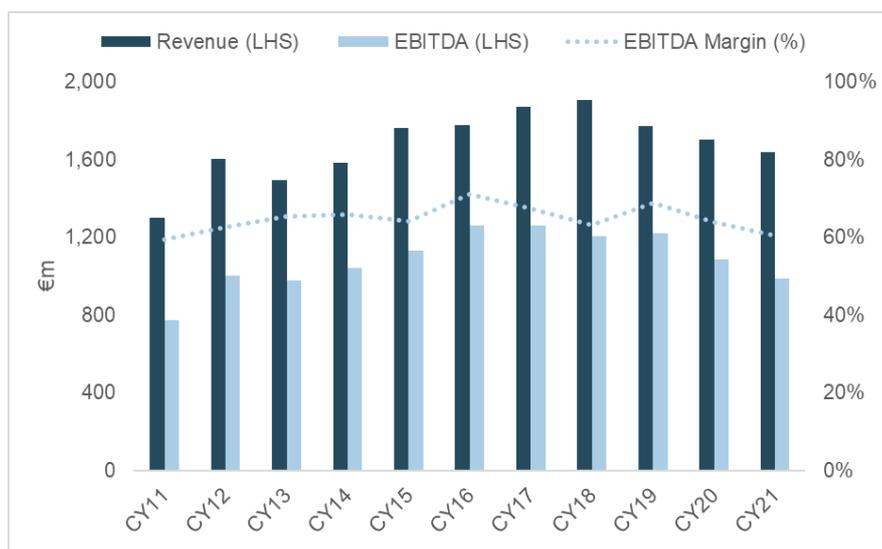
Figure 8: PLEF II SWU Capacity Assumptions

Variable	Rationale	Units	EH Assumptions
Plant Feed	U.S. DOE production cap	MTU in the form of UF ₆	2,000
Tails assay	EH estimate	% U ²³⁵	0.18
Feed assay	Natural grade	% U ²³⁵	0.71
Product assay	Upper end of LEU grade required for PWRs/BWRs	% U ²³⁵	5.00
EUP quantity	Urenco SWU calculator	kgU	220,337
Implied SWU capacity	Urenco SWU calculator	SWU	2,050,017

Source: Euroz Hartleys estimates

Although the existing uranium enrichment market is highly concentrated and opaque, the annual reports of Urenco provide a reference point for margins achieved on current gas centrifuge enrichment technologies. Urenco operates four uranium enrichment facilities located in Germany, Netherlands, UK and New Mexico with a global enrichment capacity of ~18m SWU/yr as at CY21 (global capacity: ~66m SWU/yr, *WNA 2020*). Urenco has achieved stable EBITDA margins from its enrichment business over the last decade (avg. ~65%, Fig. 9), which we highlight employs relatively less cost-effective second-generation gas centrifuge enrichment technologies.

Figure 9: Urenco Enrichment Segment EBITDA Margins



Source: Urenco

We highlight that SLX still trades below historical market capitalisations previously seen prior to SLX's acquisition of a 51% equity stake in GLE (Fig. 1), at which point in time SLX's exposure to the commercialisation of the SILEX technology was limited to a 7-12% revenue royalty stream, albeit admittedly without any exposure to technology commercialisation funding requirements. Further to which, GLE obtained the exclusive right to access the Paducah UF₆ tails in CY16, which we consider to carry significant strategic value given the Paducah Project is akin to a Tier 1 uranium resource capable of producing >5mlb U₃O₈ pa over a 30-year project life at avg. all-in costs of <US\$25/lb.

Consequently, we continue to look at our assumed fair market value of Cameco's option to acquire a further 26% equity stake in GLE from SLX (EHe: A\$160m) with an upward bias, particularly considering i) Cameco's initial US\$124m investment to acquire a 24% interest in GLE in 2008 and ii) market conditions have significantly improved over the last 18 months, with the enrichment term price increasing by ~US\$65/SWU to US\$135/SWU in response to the Russia-Ukraine conflict and nuclear fuel supply uncertainties. The potential exercise of Cameco's option to acquire a further 26% interest in GLE from SLX (exercisable from Feb'23) will provide an important yardstick for valuation under improved market conditions.

Our revised SOTP valuation is detailed below:

Figure 10: SOTP Valuation

	Risk-weighting	A\$m	A\$/sh
Paducah Laser Enrichment Facility - Stage 1	75%	628.4	3.06
Paducah Laser Enrichment Facility - Stage 2	75%	150.9	0.73
Zero-Spin Silicon Project		25.0	0.12
Overheads		(46.0)	(0.22)
Listed Investments		6.0	0.03
Cash (Nov'22e)		38.0	0.19
ITM Options		3.3	0.02
Total		805.6	3.92
Price Target	1.1x NAV, Rounded		4.40

Source: Euroz Hartleys estimates

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Silex Systems Limited (SLX.ASX) | Price A\$2.58 | Target price A\$4.40 | Recommendation Speculative Buy;

Price, target price and rating as at 08 December 2022 (not covered)*

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