ENERGY FUELS NEWS ANALYSIS

Energy Fuels is potentially the company that has had the wildest year out of all our holdings in the portfolio. Not just from a price action perspective, but from a news flow perspective as well. There was good reason for us to double down on the position in Q2 of last year as we headed out of the worst of the tariff sell-off, because part of what drove said sell-off had to do with the leverage that China still has on global REE flows given they control the vast majority of REE processing capacity. Well, Energy Fuels of course did exceptionally well coming out of that correction as the stock and the call options we bought at the time went up ~640% and 2955% respectively from trough to peak, which tells you something about how the view of the market on this company has shifted in that period. While the profits we took on that were exceptional, at least I thought so, this is not the end of the story and there is a reason they are still a cornerstone portfolio holding for me when it comes to both uranium and critical materials. Now that story has gotten another page added to it and as many of you will have seen, it's quite the page and as a result I have a lot of thoughts on it.

The company fired off two very noteworthy pieces of news over the past few days (and today of course), first a conditional government loan that I will get to in a bit, and now a definitive agreement to swallow a century-old German magnet maker for the better part of $2 billion. No, I did not think I would ever be writing that sentence either, but here we are so let's just roll with it and as you can imagine, there is a lot to this deal and I have had to put some of my newsletter research and writing on pause to get through it all. The target is Vacuumschmelze, or VAC if you would rather not wrestle with the spelling every time like me even if you speak a bit of German, a Hanau-based outfit that has been making magnets since the 1920s and has passed through the hands of Siemens, then OM Group, then Apollo, and most recently the private equity firm Ara Partners, who are the ones cashing out here. Energy Fuels is paying somewhere around $1.9 billion for the whole thing, structured as roughly $718 million in cash and about 65.8 million newly issued shares, and on top of that they are assuming something like $140 million of VAC's net debt, so the all-in number creeps a bit above the number you will see on your screen if you're just quickly glancing at the news release.

VAC is not some pre-revenue science project either, this is a real business with over 400 patents, more than 1,000 customers, and a track record of having shipped over a billion rare earth magnets in the past decade, with something like 85% of its output built to customer specification under relationships that in some cases go back 30 years. The crown jewel from Energy Fuels' point of view is a recently built facility in Sumter, South Carolina, capable of churning out 2,000 tonnes a year of permanent magnets and engineered to scale all the way to 12,000 tonnes if the demand shows up. So, why do they want a German magnet maker? For those of you who may have missed it, Energy Fuels has spent the past couple of years assembling the pieces of a rare earth supply chain and the whole pitch has been about building the first Western company that can take a rock out of the ground and follow it all the way to a finished magnet without ever touching a Chinese facility. They have the separation piece they are building at their White Mesa Mill in Utah (more on that later), they have potential future feedstock coming from heavy mineral sands projects in Australia, Brazil and Madagascar (there are still hurdles there, but it's on the books), and they are in the middle of buying an Australian outfit called Australian Strategic Materials that brings an operating metals and alloys plant in South Korea plus plans for a similar plant on US soil. What they did not have, until this week, was the very last link in that chain, the bit where separated oxides and alloys actually get turned into the magnets that go into electric motors and missiles and data centers and all the rest of it. VAC is that last link it seems, and buying it turns a PowerPoint slide labeled "mine to magnet" into something that, on paper at least, spans the whole journey.

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And the backdrop could hardly be more favorable to a story like this, which is sort of the point. As I mentioned at the start of this piece, China sits on roughly 60% of the mining for the magnet rare earths, something like 91% of the separation and refining, and somewhere around 85 to 90% of the world's permanent magnet manufacturing, which is a stranglehold by any definition. Over the past year or so Beijing has been tightening the screws, first with export controls on the heavy rare earths and the magnets themselves back in the spring of last year, which had carmakers in the West cutting production and in some cases idling plants, and then with a broader set of restrictions that swept in more elements and, more alarmingly, parts and components and assemblies. Prices outside China shot up to as much as 6x what they cost inside China, because of course they did when supply gets choked like that. And the saber-rattling has only escalated, because just this week China added the two American champions, MP Materials and USA Rare Earth, to its own export control list, a fairly pointed way of saying that the very companies Washington has been propping up are now in the crosshairs. So Energy Fuels is buying its way deeper into a sector where the West is desperate, governments are writing checks and the strategic premium for any pound of non-Chinese material is real and widening and in my view will continue to widen. The timing, the way I see it, is hard to fault.

Now, this is not a pure ‘plug and play’ scenario of course, as there is a lot that needs to be done before Energy Fuels gets to receive the title of the ‘go-to western REE producer’ (I need to think of something more catchy to be fair). Let me give the bull case its due before I start poking holes though, because there is a lot to like here. The first thing, and I cannot stress this enough, is that VAC throws off cash, which makes it almost a unicorn in a sector stuffed with pre-revenue dreamers burning money on the promise of production five years out. The legacy business did around $29 million of adjusted EBITDA last year with an order book growing more than 20% heading into this year, and the Sumter facility on its own is penciled in for something like $65 to $75 million of annual run-rate EBITDA once it hits its current 2,000 tonne capacity, with management flagging that the building was designed to double to 4,000 tonnes without disrupting what is already running, which would push that Sumter number toward $130 to $140 million. Stretch all the way to the 12,000 tonne ceiling and they are talking about roughly $400 million, though I would file that last figure under "lovely if it happens" rather than anything to bank on today for obvious reasons, even though I am enthusiastic about the prospect given the US need for critical REE products. The practical effect is that Energy Fuels would have a downstream business generating at least a bit of cash that can help fund the rest of the empire, rather than leaning entirely on the uranium segment, grants and the equity market to pay for everything.

The defense angle is the second pillar that we need to discuss and for those of you who have seen my modeling of every US military system that requires various form of REE related materials, you will know how important that pillar is. VAC is the only commercial producer in Europe and the US with the full spectrum of qualified magnet grades, including the high-coercivity neodymium-iron-boron and the samarium-cobalt magnets that go into the mission-critical stuff like fighter jet actuators, missile guidance and submarine motors, where you cannot just swap in a cheaper magnet and hope for the best. They have already secured a contract with the Defense Logistics Agency to supply magnet blocks for the national defense stockpile, and they carry an existing $41 million grant from what is now the Department of War for a US metal-making facility. When you sit that alongside the government loan I am about to discuss, you start to see a company that the US national security apparatus appears actively keen to see succeed, and in this sector that kind of official backing is worth its weight in, well, neodymium (get it? Because gold has been dropping a bit? Right)

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Now for the cold water part of the equation, because as compelling as the strategic story is, I am not here to write the company's marketing copy and there are real reasons to keep both feet on the ground. My single biggest concern, and I suspect it will be yours too once you see it written out, is just how much this company is trying to do all at once. Pause and count the plates spinning folks, it's like a REE circus act. They are running a uranium mining and milling business, they are mid-way through a roughly $410 million expansion of the separation circuits at White Mesa, they are closing the acquisition of the Australian metals company and its Korean plant while planning to build an American metals plant from scratch, they are taking an Australian mining project called Donald toward a final investment decision and a 2028 commissioning, they are developing two more heavy mineral sands projects on two other continents, and now they are bolting on a German magnet manufacturer with plants spread across North America, Europe and Asia that needs integrating. That is a staggering amount of simultaneous construction, acquisition and integration for a company with somewhere around 1,000 employees that posted a net loss last quarter, and every single one of those projects carries its own budget, its own timeline and its own way of going wrong. Execution is the name of the game here, and the more plates you have in the air the more likely it is that you drop one.

That feeds directly into my second worry, which is that an integrated chain is only as strong as its weakest link, and this chain has a lot of links that all have to come good more or less on schedule for the story to hold together. The Sumter magnets are supposed to be fed by oxides from White Mesa, which are supposed to be fed by monazite from Donald, which does not get a final investment decision until early in the coming quarter and does not produce until 2028 if all goes well (this is mining folks, keep that in mind), with the White Mesa upgrades themselves not due to wrap until late next year and the metals plants somewhere in between. If any one of those slips, and in mining and heavy industry something almost always slips, then either Sumter runs short of domestic feedstock or Energy Fuels ends up buying material on the open market, which rather defeats the entire purpose of escaping the Chinese supply chain in the first place. There is a real risk that the company ends up owning a fully integrated platform on the org chart while still running it on bought-in inputs for years, and that gap between the vision and the plumbing is why I would urge people to stay grounded.

Then there is valuation and dilution, which I will take together because they are joined at the hip. Paying $1.9 billion for a business doing $29 million of EBITDA is, on the trailing numbers, a frankly eye-watering multiple of something north of 60 times, and the only way to make that math look sane is to believe in the Sumter ramp and the demand behind it, which is to say you are paying a strategic premium for a future that has not arrived yet and you are paying for it partly in stock. The 65.8 million new shares land on a base of roughly 250 million, so they swell the count by about a quarter and water existing holders down by something like a fifth of their stake from this deal alone, before you even count the stock going out the door for the Australian acquisition. There is also a clause that if Energy Fuels' shares are below $20.93 at closing, and they are sitting closer to the $15-16 range as I write this, the seller picks up as much as $135 million in preferred shares on top, so the dilution could get a touch worse and when the dust settles Ara Partners and those involved walks away owning close to 20% of the whole company plus a board seat and a one-time veto over an independent director nominee, which is a meaningful chunk of influence to hand a private equity firm that is, after all, the one selling you the asset. There are more thoughts one could have on this particular dynamic, but I have been writing for a few hours now and we need to wrap this up before it turns into a newsletter.

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The cash side is no small thing either, since $718 million in cash is a big swing for a company that finished last quarter with around $108 million of actual cash and another $800 million or so in marketable securities, so paying for this means leaning hard on those securities and on VAC's own cash flow, with a $250 million term loan from Goldman lined up to refinance VAC's existing debt on top. The balance sheet that emerges from all of this is going to be a good deal more complicated and more leveraged than the one they started with, and it is easy to lose sight of that when you get swept up in the mine-to-magnet romance. Which brings me to that government loan, which deserves its own look and is one of the more interesting pieces of the whole picture as it looks like they finally received some of that highly anticipated government support. They disclosed a conditional commitment for up to $725 million of senior secured debt from the Department of War's Office of Strategic Capital, a 20-year facility earmarked for expanding the processing at White Mesa and building that planned American metals plant. The market liked it a great deal and I agree even without considering the price action, and it should be liked in my view, because 20-year senior secured debt is about as patient and cheap as capital gets for a buildout this heavy, and crucially it funds a big chunk of the upstream and midstream expansion without printing yet more shares, which matters enormously when you have just seen how much stock is already going out the door for VAC and the Australian deal. The signal value is real too, since the government effectively saying it wants this built tends to grease the wheels with other lenders and customers. There could be more support available for them down the line, but we will cross that bridge when we get to it as trying to model in government support is a fool's endeavor in my opinion.

But I would gently push back on anyone treating this as a done deal or a panacea, because a couple of things require nuance. It is conditional, first of all, still subject to due diligence and definitive documents and the usual closing conditions, so it is a commitment to lend rather than money in the bank, and government programs move on government timelines and can shift. More importantly, it is a loan, and a senior secured one at that, which means it sits ahead of equity holders in the capital structure and it is money that has to be paid back, so it de-risks the financing of the buildout without doing a single thing to de-risk the operating economics underneath, the harder questions of feedstock and margins and whether they can actually sell separated rare earths and finished magnets at a decent profit if China decides to flood the market. Energy Fuels, in comparison to MP for example, got a loan, and a very good loan, but a loan all the same, with no price floor and no blanket offtake guarantee behind it. The difference between "we will lend you the money to build it" and "we will lend you the money, guarantee your price, and buy everything you make" is pretty big.

So where does all of this leave us? More or less where I started, which is impressed by the ambition and the strategic logic while distinctly wary of the execution mountain in front of them. The VAC deal is, I think, the right acquisition in the right sector at the right moment in history, and it hands Energy Fuels something no other Western platform can claim today, a credible path from the mine all the way to a defense-grade magnet, backed by a real cash-generating business rather than another promise. But it also stacks one enormous undertaking on top of three or four others that were already underway, at a valuation that demands almost everything go right, paid for with a meaningful slug of dilution and a balance sheet that is about to get a lot busier. The government loan helps, and I am glad to see it, but it doesn't see them all the way home yet. The way I see it, this is a company that has identified where the puck is going and is skating very hard to get there, and the prize at the end is large, but anyone buying the story here is also buying a multi-year execution gamble. Can they do it? Well, I wouldn't be a shareholder if I didn't back them to do so, but it won't be easy. I hope that thisupdate proved to be informative and that you have a good and healthy rest of your day! ~Mart

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