

HOW TO CHOOSE A URANIUM STOCK

Ten Tips from Sprott Asset Management

Part One of a Two-Part Series



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Now that the uranium bull market has gone to a new level, a number of exploration stocks made spectacular percentage gains after the International Investment Conference held in San Francisco in late November 2005. We turned to Kevin Bambrough, Market Strategist, and Jean-Francois Tardif, Portfolio Manager, at Sprott Asset Management for their advice on how to navigate through the more than 250 uranium exploration, development and producing companies available across the global investment landscape. Who better to ask than a fund that has invested around reportedly invested about C\$175 million, of the firm's C\$3.3 billion under management, in the uranium sector? The Sprott team has bet heavily on a nuclear energy renaissance, and early indications confirm very strong returns on their investments.

Before our taped telephone interview, Kevin Bambrough emailed a few comments, "We would like to make the point about some incredible gains that have been had in the uranium sector. The list is growing but not the quality so investors

should use extreme caution. As the uranium price rises, and money pours into exploration, we can expect to see some sizeable discoveries coming down the road. It should be exciting times."

Prior to StockInterview.com's interviews with Mr. Bambrough and Mr. Tardif, they compiled a list of ten tips for investors studying uranium companies. The tips are listed below, followed by an extensive interview, first with Mr. Bambrough (in this installment) and a second installment with Mr. Bambrough and Mr. Tardif.

The Ten Tips Investors Should Know

1. One of the best indicators of a project's potential success could be past ownership. It's best to try to buy any mining stock early in the cycle. Try to pick up properties that were worked by majors during the last bull market but which eventually dropped during the lows of the bear market. During the last uranium boom of the 1970's, many majors decided to completely exit the uranium sector.
2. Study the value of ore body with regards to its value per tonne, or its recoverable metal. Estimate the "all in" costs and feel comfortable with what you are paying. Risks-to-reward doesn't favor pure exploration. Typically, we avoid pure exploration plays unless management is excellent, they have a large prospective land package, and the company is well financed.
3. Look for good, proven management, which has been successful in the past.
4. Look for solid shareholders. It is always nice to see that management has a large stake in the company. Often, this makes them value their paper more, and they will be less likely to engage in reckless stock issuance. If not management, I get comfort seeing that successful fund managers have large holdings. It is even better to see that a major company in a related industry has taken an interest in the company.
5. Look at the property's infrastructure. Find out about electricity and water costs required for exploration, development and production. Find out about roads, rail, trucking, access and proximity to a mill.
6. Look for hidden value in the company. We always consider the value of existing infrastructure. From time to time we have been able to buy companies where existing facilities, perhaps a mill or shafts more than justify the entire market cap of the company. Past drilling for uranium will save money. Some companies have properties with very expensive shafts and/or mills. There are also companies with large extensive databases like Energy Metals Corporation (TSX: EMC) and Strathmore Minerals (TSX: STM). These databases of past drilling on various properties can be used to continue to acquire good prospects as well as sold in pieces. I would expect that they will also be able to use the data to farm in on other properties or sell other property owners valuable drill-hole data.
7. Buy emerging stories. It is great to find a company before it has any analyst coverage or even covered by letter writers.
8. Find out if the property is in a pro-mining environment. Ultimately, you need to mine. It's best to have a property in a location where government is pro-mining. We will still invest, though, as long as this factor is discounted in the stock. Some countries are so hungry for investment they will offer favorable tax rates and other incentives. Permitting can be costly and take a long time so this is very important.
9. Study the capital costs for the project and the currency in the country where the project is located. Typically, the lower the capital costs, the less risk in the project. The less a company risks, in time and money, to find out if the mine is economic, the greater its chance of success. Larger capital intensive projects usually take longer to bring on, and you could risk missing an important part of the cycle. I also like to consider currency moves and their possible impact. A strengthening local currency can drive up costs and destroy margins. A falling currency can dramatically improve the economics of the project
10. Funding can improve the story or outlook. Make your cash work. It's not really an option for a small investor but as an institution we love to invest in companies when we think our cash is going to make a huge difference. Examples include when Aflase (now SXR Uranium One – TSE: SXR) had cash problems and was being deeply discounted, or our recent Tournigan (TSX: TVC) funding to pay for confirmation drilling and exploration on the Jahodna uranium deposit in Slovakia.

To further clarify some of Mr. Bambrough's tips, StockInterview.com discussed his advice in greater detail. Below is the first part of the interview with Kevin Bambrough.

An Interview with Kevin Bambrough, Market Strategist for Sprott Asset Management

StockInterview: What do you look for in an exploration play before you even consider it?

Kevin Bambrough: There's different things you could do. With some exploration plays, you focus on management history. A lot of it is a belief in management. With exploration plays, sometimes you're looking at your belief in a region, the success of a region, what is called "closeology." Somebody's staked around an area where there was a recent strike by another. Or, a major dropped a bunch of land that was prospected around an existing deposit, which another company picked up that land during a market low and is now going to explore.

StockInterview: When you say a good management team, are you referring to the geological team?

Kevin Bambrough: Typically yes. I typically get more comfort from guys that have worked for some of the larger companies. For example, some of them have been employed with a larger company for a long period of time in a prominent role. Then, they decide to go on their own because they feel that they can. They're excited to go and try to develop their own company. They think that they can go and hopefully strike it rich.

StockInterview: Aren't there, however, a lot of failures in that area?

Kevin Bambrough: A lot of successes, too. It's a risk-to-reward ratio.

StockInterview: Because the last uranium boom was thirty years ago, aren't many of the exploration companies having a tough time finding talented experts?

Kevin Bambrough: There are not a lot of people out there. There are some people who have been trained. The Altius (TSX: ALS) people were fortunate enough to work with Cameco and have access to their lab back over last decade and are very close in that area. A lot of different people out there have skills, and people are developing them. Some would argue there's still a lot of people that are going to retire over the coming years and this skilled labor could get somewhat

worse. But at the same time, there's a lot of new interest moving into this sector.

StockInterview: How do you uncover the "hidden value" during a company in which you consider investing?

Kevin Bambrough: When we first started look at uranium companies at the start of this bull market, we looked at different things they had. With a company like Western Prospector (TSX: WNP), it had a mine shaft. An existing shaft costs huge dollars to build today. Their market cap was less than the value of the shaft when we first started investing in it. Another company might have a database with drill data they can use. They just have to drill a few holes to be able to qualify their resources and bring things forward. So, it's a huge considerable cost and time savings. When you have access to that data, it's a type of hidden value. Sometimes, there are companies which have a mill that can be rehabilitated. In comparing the value of an explorer, in terms of one who's got a very little bit of drilling done on their property, you find out what it costs for the average drill hole. Depending upon where you are, it can be quite expensive. That also helps put a baseline value in the company.

StockInterview: What about exploring in a remote area, such as Namibia, where Paladin Resources (TSE: PDN) has had success?

Kevin Bambrough: It really depends upon your distance from infrastructure. In Namibia, there is a real shortage of water. It can be an extreme problem. It can be an extreme cost to get access to water that's required in the mining process. It doesn't kill the exploration, it just means you're going to have to find a lot more uranium in order to justify the capital costs. If you believe there's some uranium in this remote area, well there better be a lot of uranium. That's because the cost to build a mine there is extreme. It's not like you can truck the ore out, because it's out in the middle of nowhere. So you're going to have to build a mine and a mill, and it becomes a lot more difficult. You also have to make sure there is a long enough reserve life so you can spread the capital cost of the infrastructure out over time.

StockInterview: Do you still believe we can find strong price appreciation in the uranium sector?

Kevin Bambrough: Personally, I think there's a lot of speculation going on in the sector and some things maybe of lesser quality are... well, the access to capital seems quite easy right now in the sector. Some of these stocks have already had 30-50%, like Paladin, on the year. It's a little staggering and obvi-

ously you get a little uncomfortable when things move up so fast. For certain stocks whose projects I believe are real, they can move forward, go into production and generate profits. We think they're going to do really well. At the same time, I'd caution people that investing in mining is difficult and is a risky business. For us, we get comfort in investing in more of the known projects where we consider the economics and justify the price we pay.

StockInterview: You mentioned that "access to capital was easy right now in the sector"?

Kevin Bambrough: The money is just pouring into this sector with all of the financings. In some ways, it's good for the industry as a whole. It may not be the best thing for the uranium price long term, but the investments that have come in recent months are going to help the find, or might find, new deposits and solve the (supply) deficit at some point. We're talking way off here, because it still takes a long time to find new deposits.

StockInterview: Sprott Asset Management has invested heavily in the uranium exploration sector, and many have done well. Will you continue to support these companies?

Kevin Bambrough: What we have been doing is basically sticking with our winners and helping to finance them to take their project forward. We still believe we were fortunate enough that most of the projects we found and invested in early are the ones that are still the most likely to come on in the future. We feel we're backing the right horses, and we're going to sort of stick with that philosophy.

StockInterview: How do you keep everything balanced in your funds with each of these investments?

Kevin Bambrough: We try to stay close to the stories that we follow. We always evaluate and try to make sure we can justify the prices. Sometimes, one stock may get ahead of itself relative to another, and we'll look to move money from one

to another for awhile. Maybe one of the plays catches up, and the other one has a setback, so we can move in. That's basically what we've been doing for the longest time now, mainly moving money around in the sector. Every now and then, some new prospective play comes along, or we see some drill results. Or something like Tournigan (TSX: TVC), which was a fairly recent new one that we got onto. I believe that one has great exploration potential so that is one that we're following. We're helping to fund them to do more exploration in the area.

StockInterview: Many companies approach you with presentations to fund their exploration or development programs. What red flags show up that make you shy away from their projects?

Kevin Bambrough: There have been a number of presentations, where a lot of the uranium companies just come in right away and say, "We're in the Athabasca Basin or whatever and we hope to find ... Or, they don't really have anything to talk about in terms of why we should believe that their properties are that prospective. It makes me nervous when I see people that are very promotional like that. They just think that they're going to go and find one of these things. They just seem to be such optimists. I prefer to go with guys that are more conservative and say, "This is our plan." And, they seem to have a very well thought out plan of how they're going to try to find something. We want to see some drill holes with results that really give us some encouragement that there is something there.

I'd rather get away from them trying to tell me about the history of the Athabasca Basin. Typically, we've shied away from investing in just pure land plays in the Athabasca Basin. It would be interesting to know - and I'm not aware of - how many conductors have been drilled in the Athabasca Basin that have found nothing. There has been a lot of exploration over there, over time. It's tough, it takes time, and it takes a lot of money. All these guys that have tried to find it and don't find anything? The stocks just get crushed, and they keep having to come back to get more money to drill more.