

## Old West Investment Management, LLC

October 5, 2020

Dear Investor,

With one quarter to go in 2020, this is by far the most extraordinary year I have experienced in my 67 years on earth. Just as we were hoping things might be settling down, the leader of the free world came down with COVID. Of course, that was just three days after the debate from hell. This year has brought us a worldwide pandemic, protesting and rioting in most of our big cities, political chaos in Washington and an economy attempting to recover from a shutdown the likes of which we have never seen. If there is one thing the stock market hates its uncertainty, yet despite all the aforementioned challenges the market is near its all time high. As you can see in your enclosed statement, we had a good third quarter and we are well ahead of the market in most of our portfolios year to date.

I continue to be concerned with the disconnect between the economy and the stock market. Our offices are located in downtown Los Angeles, and it looks like a ghost town during the middle of the business day. When I walk to get some lunch, homeless people outnumber business people on the sidewalks. I believe similar situations exist in most of our big cities. Yes, business professionals are able to work from home quite efficiently, but what about all the restaurants, hotels, airlines, ride-share companies, retail shops and health clubs.

How does the market shrug this off and keep climbing higher? As I have said ad nauseum in past letters, the Federal Reserve manipulation of interest rates is the market's best friend. The Fed has set the Federal funds target rate at 0% and they intend on keeping it there indefinitely. The Fed has been buying \$120 billion of Treasuries and agency mortgage securities each month, and this false demand suppresses interest rates at all levels. Low rates have led to all time high valuations in most every asset class including stocks and bonds.

We are definitely headed down a very dangerous road. This year's federal budget deficit will top a record \$3 Trillion, \$1.9 Trillion more than the previous budget deficit record. This deficit will bring our national debt to over \$27 Trillion. Government revenue (taxes) is flat this year, but expenses are up 50% year over year. As a result, 60 cents of every dollar now being spent by the government is being printed out of thin air. This is not sustainable, and these numbers only reinforce our belief that gold (in our case gold mining companies) is a fantastic long-term investment.

Where does the market go from here? Hard to say, but look at these eye-popping returns of certain stocks since January 1:

PAYPAL + 77%  
TESLA + 422%  
NVIDIA + 120%  
APPLE + 54%

These returns are for the first nine months of 2020. One has to ask: have these businesses improved that much in nine months, or is the market forming a bubble ala 1999? In determining whether the market is in bubble territory, I love a quote from legendary investor Sir John Templeton: “Bull markets are born on pessimism, grown on skepticism, mature on optimism, and die on euphoria.”

The returns shown above, in my opinion, smack of euphoria.

Buying stocks regardless of price is a dangerous speculation. Market speculators have little sense for what underlying businesses are actually worth, but instead buy stocks simply because they believe the price will go up. We refuse to overpay for a company and our first concern is always preventing permanent loss of capital.

As I have written in previous letters, our team feels strongly we have uncovered a fantastic opportunity in the nuclear energy/uranium mining industry. One of our largest holdings is Centrus Energy Corp, and Old West partner and portfolio manager Brian Laks writes the following:

### **Centrus Energy (LEU)**

Readers of our past letters will likely be familiar with the uranium investing thesis. A decade of low prices has led to severe supply destruction, and continued demand growth globally has created a large and growing shortage that can only be solved by higher prices and the development of new supply.

While our investments in the sector have mostly focused on uranium mining, which we view as most directly levered to this rising price environment, we are also involved in other areas of the nuclear fuel cycle where supply dynamics are similarly stressed. One of those critical areas is the process of enrichment, which increases the concentration of fissile material in natural uranium to higher levels for use as nuclear fuel.

The global enrichment market is highly concentrated with significant barriers to entry, and only a handful of companies control global capacity. The majority of these are state-owned or privately held, and as a result there are very few opportunities to invest in this crucial portion of the fuel cycle.

One such company is Centrus, which traces its origins back to the beginning of the nuclear age when the US government originally developed the technology for nuclear enrichment. Those enrichment assets, representing billions of dollars of research and development, were privatized in the 1990s and subsequently listed on the New York Stock Exchange. In 2013, due to market conditions and advances in technology, the company shut down the last of the legacy enrichment assets but maintained their relationships with fuel buyers and suppliers, in effect serving as a broker of enriched fuel into the US market.

The US is the world's largest consumer of nuclear fuel, powering 20% of its electricity supply, but has no domestic enrichment capacity. The only operating facility, in New Mexico, is owned by a consortium of foreign entities. The country is heavily dependent on imports from Russia, whose state-owned nuclear enterprise controls half of global supply. The US government has readily acknowledged that this is a serious problem, and a trade investigation in 2018 led to a cabinet-level Nuclear Fuel Working Group report that revealed strong bipartisan support for revitalizing the domestic industry.

The government set out to remedy the problem by awarding a contract to Centrus to build a new enrichment plant, and agreeing to fund most of the \$115 million cost. When completed next year, it will be the only facility capable of producing the advanced fuel (known as "HALEU") required by the next generation of nuclear reactors and satisfying the domestic origin requirements of the US government. With their first mover advantage and strong government support we believe Centrus will have a dominant position in HALEU fuel, a market that is expected to grow 100-fold this decade.

In addition to early demand from government, many advanced reactors are being developed to use the fuel. Last month TerraPower, a company founded and chaired by Bill Gates, announced a landmark agreement with Centrus to invest in commercializing the fuel. Gates himself is a strong supporter of nuclear power, committing \$1 billion personally to advance the technology.

In an era where high-flying tech companies with no profits (and sometimes no product!) are valued in the 10s and 100s of billions of dollars, it is remarkable that what will be virtually the entire nuclear enrichment capacity of the United States has a market capitalization of only \$100 million.

Meanwhile the company trades at 5x earnings with a billion dollar contract book extending out much of the next decade. They have over \$100 million in cash and \$1 billion in tax offsets that can be used against future profits. Enrichment prices have been steadily rising

leading to margin expansion from the low costs they locked into their supply contracts at the bottom of the cycle.

They also have a very tight share structure and low float, with over 40% owned by insiders and the two largest outside shareholders. The management team has strong ties to both industry and government, with the CEO previously serving as Deputy Secretary of the Department of Energy.

We believe it is one of the most underfollowed and misunderstood companies in the entire sector, and we plan to be a major shareholder for years as the thesis plays out. As always, we encourage clients to reach out if they would like to learn more about the idea or about the fund we launched specifically to capitalize on opportunities like this.

This coming fourth quarter promises to be exciting and possibly volatile in the markets. We believe we are ideally invested to watch our outstanding companies grow and reward shareholders. Thank you for your continued loyalty.

Sincerely,

A handwritten signature in black ink, appearing to be 'J. Boskovich', with a stylized flourish at the end.

Joseph Boskovich, Sr.  
Chairman and Chief Investment Officer