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Radioactive-asset manager

Evan Lorenz writes:

Things came together last year for fissile uranium, the kind that feeds a nuclear reactor. Grace Stanke, crowned Miss America 2023, promoted nuclear energy, of all things, while touring the 50 states. Governments worldwide granted extensions to nuclear reactors they had previously scheduled to shut down. And at the United Nation's COP28 climate powwow in December, a group of 20-plus countries, including the United States, France and the United Kingdom, promised to triple global nuclear-generating capacity by 2050.

The good news is unmistakable in the prices of uranium and the major uranium miners, such as Cameco Corp., which have more than doubled since year-end 2022 (*Grant's*, June 1, 2018). However, not every nuclear-powered investment train has left the station. In preview, *Grant's* is bullish on Sprott, Inc. (SII on New York and Toronto), the resource-focused Canadian asset manager.

In 1981, Merrill Lynch alumnus Eric Sprott founded Sprott Securities, Inc. with the idea of producing not commissions (though they would come) but ideas. Twenty years later, the founder, conceiving an interest in asset management, sold the employees the legacy brokerage business, today called Cormark Securities, Inc., and created Sprott Asset Management. The year was 2001.

"Sprott had an amazing track record, with a focus on small-cap value originally and then on technology in the 1990s, and then he pivoted to precious metals and mining around 2000," current CEO Whitney George tells me.

An inauspiciously timed IPO and an unrequited devotion to gold led to a rocky public debut. Within six months of the initial offering, in spring 2008, Sprott's shares had fallen by 75%. One might have supposed that the Lehman failure would be bullish for gold, the legacy monetary asset that lives outside the leveraged financial system, but people sell what they can when they must sell fast. A resurgent bullion price—$1,900.20 by 2011—lifted the Sprott shares almost back to their IPO price, but the subsequent crash in bullion and the related mining stocks sent Sprott into a long-term funk. Attempts to refocus proving unsuccessful, Eric Sprott retired as chairman in 2017 and sold his stock.

no Artificial Intelligence required

Prior to joining Sprott in 2015, George was the co-chief investment officer of Royce & Associates, LLC, and the evident CEO-in-waiting to succeed founder and eponym Chuck Royce. However, George tells me, "it started to become apparent to me that Mr. Royce really didn't want or need a successor. He's still running Royce today."

Royce became America's preeminent small-cap investment manager by hiring proven, but cyclically unfavored, investment managers, including Charlie Dreyfus and Buzz Zaino, in the dot-com boom. "Essentially, we scooped up all the talent that was unwanted in the 1990s," George says. "I saw an opportunity in precious metals and mining to do the same thing."

In 2018, Sprott bought the Central Fund of Canada Ltd., a manager of physical gold and silver funds, and announced the acquisition of the gold strategies of Tocqueville Asset Management, LP in 2019. The purchase of the Uranium Participation Corp., which managed a physical uranium trust, followed in 2021 and then that of North Shore Group Uranium Mining ETF, an assembler of uranium-mining exchange-traded funds, took place in 2022.

"We have all this mining expertise, a lot of it with experience outside of precious metals," says George. "In many cases, you can see these commodities all come out of the same hole in the ground. So we have used that expertise to start to build out, on the back of our uranium products, the energy transition funds, and that would include copper and the battery metals like nickel, lithium, cobalt. We launched a bunch of ETFs last year. Some are still

Hitting on one cylinder

source: The Bloomberg

small and haven't gotten scale yet…"

Has Sprott considered cryptocurrencies in addition to tangible commodities? "Yes, under prior leadership," George replies. "We made a number of unsuccessful venture investments in digital gold concepts, all but one small one written off. I believe there is a future for digital gold, but we lack the technology and balance sheet to develop it. Perhaps our brand and physical expertise can bring some value to the project.

"We were approached on several occasions to create products that combined cryptos and gold," George continues. "My personal view is the best use case for cryptocurrencies is criminal activity, followed by casino speculation. Given their volatility, I don't believe they can be seen as a store of value. Our expertise is in metals and mining. I think we have plenty of opportunity in our chosen lane."

Last year Sprott finished divesting non-core assets, including a Canadian broker-dealer and a sub-scale Korean asset-management business, thereby making itself a pure-play asset manager. As of Sept. 30, 2023, assets under management totaled $25.4 billion. Exchange-listed products (both physical metal trusts and the funds that invest in miners) accounted for $20.3 billion, managed equities (precious-metals funds and managed accounts for high-net-worth individuals) for $2.5 billion and private strategies (a mix of private funds that lend to, or acquire streaming rights from, miners) for $2.6 billion.

To align better the employee and shareholder interests, George has changed Sprott's incentive pay structure. "They had a compensation structure that basically paid discretionary bonuses based on 25% of the Ebitda no matter whether that was grown organically or acquired," he says. "The first thing I did was, I went to the senior management team and said, 'Look, whatever you expect to earn in bonuses for the next five years, I want you to take in stock that will vest over that period.' We're now two-thirds of the way through our second program, and all senior executives, portfolio managers—anybody at the higher end of the pay scale—takes a disproportionate amount of their compensation in long-term stock awards, most of which they've kept."

Uranium makes the Geiger counters chatter, but it's Sprott's gold-equities strategies that, to many investors, are truly radioactive. Bloomberg reported last week that the ratio of the VanEck Gold Miners ETF to the S&P 500 "breached support (August 2022 trough) to form a new all-time low, which might spur more underperformance."

Uranium is a very different story. Assets under management in the Sprott Physical Uranium Trust and in a pair of uranium-miner ETFs stand at $8.5 billion today, up from $7.6 billion at year-end 2023 and $3.7 billion at year-end 2022. Fourth-quarter data on Sprott's managed-equities and private-strategies units won't be available until the Feb. 23 earnings report. If, however, assets in these divisions wind up registering no increase from Sept. 30, 2023, company-wide AUM, measured year over year, would nonetheless balloon by 23.5%.

Needless to say, nuclear power, too, has had its ups and downs. When *Grant's*, anticipating Miss America 2023, made its opening bullish pitch on uranium in June 2018, the 2011 Fukushima nuclear accident still haunted the market. Never mind that nuclear power, from a carbon point of view, is as green as grass. In the wake of Fukushima, Japan and Germany shut down 54 and 8 nuclear reactors, respectively. The sudden decline in demand exac-

Sprott, Inc. at a glance
all figures in $ millions except per share data

	TTM*	2022	2021	2020	2019
revenue	$164.4	$145.2	$164.6	$121.8	$73.5
adj. Ebitda	71.9	72.1	67.7	48.7	29.8
net income	39.5	17.6	33.2	27.0	10.2
earnings per share	1.51	0.67	1.28	1.05	0.40
shares outstanding	26.2	26.2	25.9	25.8	25.7
cash	23.9	51.7	49.8	44.1	54.7
debt	34.4	54.4	29.8	17.0	15.3
total assets	375.9	383.7	365.9	377.3	324.9

* Trailing 12 months ended Sept. 30, 2023.

source: company reports

erbated a bear market that had already knocked down the price of a pound of yellowcake, the familiar uranium concentrate powder, to $36 in the 2010s from a peak of $136 in 2007.

Last year, utilities consumed an estimated 187 million pounds of uranium while miners dug up only 147 million pounds. The supply deficit, a longstanding feature in uranium, was met by secondary inventories, largely held by governments.

"Well, those shock-absorbers are gone," Cameco CFO Grant Isaac warned on Oct. 5 at a TD Cowen investor conference. Production problems at Cameco and Kazatomprom (the two largest uranium miners in the world), a coup in Niger and Russia's invasion of Ukraine have further tightened supplies. On top of this, legislation is wending its way through Congress to prohibit American companies from buying Russian uranium.

The surging uranium price, to $106 today from $47.75 at year-end 2022, has catalyzed a rally in several *Grant's* names. Since mid-year 2018, Cameco's share price has compounded by 370%, the Sprott Physical Uranium Trust by 272% and the Global X Uranium ETF by 164%; in comparison, the S&P 500 has scratched out a gain of 98% (all figures in U.S. dollars and include reinvested dividends).

Interestingly, the leap in the price of uranium has hardly impinged on the economics of operating a nuclear reactor. For one thing, most utilities buy the mineral with long-term contracts, which are typically struck below the spot price. For another, "only about 20% of your nuclear-power costs come from fuel, and only about 40% of that 20% is uranium," as Arthur Hyde, a portfolio manager at Segra Capital Management, LLC, which invests in uranium equities, tells me. "This is unlike natural gas- or coal-fired generation, where your feedstock can be 70%–80% of your total cost structure. Uranium prices can move quite a bit without impacting long-term demand from utilities."

Similarly, while the pickup in price has called forth announcements about new projects and the restart of mothballed mines, "none of that is sufficient to really cover all the future demand," according to Jonathan Hinze, the president of research boutique UxC, LLC. "So, at the moment, price signals have yet to lead to firm commitments on production that will cover that demand by 2030 and beyond. Until you see a stronger supply response, I don't see prices retreating heavily."

Sprott's own financial reporting counts just the net fees that its funds earn; subadvisor fees and other fund expenses are subtracted from the total. Thus, in the case of its physical uranium trust, Sprott reports a 0.3% fee rather than the gross 0.72% fee that the fund charges. As there are few incremental costs to this income stream, more than 80% of additional fee revenues fall directly to the bottom line. In the case of the physical uranium fund, each additional $1 billion in assets results in $0.09 per share in extra Ebitda.

While uranium should provide a short-term earnings uplift, the "bull case on Sprott is that if you ever get a secular rotation out of risk assets and into commodities, then Sprott would be a huge beneficiary of that," Mike Kozak, who rates the company a buy for Cantor Fitzgerald, LP, tells me. Technology-focused ETFs continue to attract large inflows while Sprott's precious-metals portfolios have languished. The NYSE Arca Gold Miners Index has declined by 43% since year-end 2010. "If even a fraction of [the money flowing into tech] ever rotates into commodities, it would be a huge tailwind for Sprott," says Kozak.

As of Sept. 30, 2023, the asset manager's balance sheet showed net debt of $10.6 million versus trailing Ebitda of $71.2 million. In the third quarter, Ebitda covered interest expense by 20.2 times.

At a dividend yield of 2.8% and a valuation of 13.8 times enterprise value (market cap plus net debt) to trailing Ebitda, Sprott appears neither cheap nor expensive compared with the other asset managers that do daily battle with the devouring force of passive investing. Thus, T. Rowe Price Group, Inc., Franklin Resources, Inc. and Invesco Ltd. trade at an average of 13.6 times, while Cohen & Steers, Inc. commands a multiple of 17.1 times Ebitda, despite its heavy presence in real estate.

In the third quarter, commodity funds like the Sprott Physical Gold Trust and the Sprott uranium fund delivered 72% of company-wide AUM. Their high incremental margins make Sprott somewhat akin to the precious-metals streaming companies, which earn a royalty on gold and silver production but bear no risks of mining operations. Streamers like Franco-Nevada Corp., Sandstorm Gold Ltd. and Triple Flag Precious Metals Corp. trade at an average of 20.8 times trailing Ebitda.

Size has its advantages. The fact that Sprott Physical Uranium Trust oversees 63.6 million pounds of uranium—triple the holdings of the second-largest exchange-traded product, Yellow Cake plc—constitutes a kind of radioactive competitive moat. As there aren't millions of pounds of uranium sitting around for other fund managers to buy, a Blackstone, Inc. could not easily recreate the Sprott Physical Trust.

Yet, the bulls contend, Sprott's small market cap and narrow focus make it an ideal takeover candidate. "It's just too easy and inexpensive to buy Sprott," Sy Jacobs, the managing partner and eponym of Jacobs Asset Management, LLC, which is long Sprott, tells me. "You can name big asset managers who can easily digest Sprott for the bargain price of $2 billion—double the current market cap—and instantly become the world's biggest gold, silver and uranium manager."

The verdict of the analysts who cover Sprott consists of one buy and two holds. The consensus of the three viewpoints projects flat Ebitda between 2024 and 2023 despite the aforementioned rapid growth in AUM. Let us say that the analysts' minds appear to be elsewhere, perhaps because, as George observes, Sprott doesn't "generate a lot of investment banking fees. We don't issue stock."

Sprott's insiders, though, do buy it. They purchased a net 22,970 shares over the past 12 months at a cost of $799,268. Over the same span, George himself bought 57,970 shares at a cost of $1.9 million. In aggregate, the CEO has accumulated 1.39 million shares, or 5.4% of the total outstanding, primarily through open-market purchases; he is Sprott's second-largest shareholder.

Of course, there are risks, including a sustained decline in the price of gold, silver and uranium. As most of Sprott's AUM is tied to physical commodity trusts, a decline in these prices would lead to lower net asset values for Sprott's funds and, therefore, lower fee income.

The abrupt run-up in the price of uranium poses its own short-term risks. According to press reports, Anchorage Capital Group, LLC and other hedge funds have accumulated millions of pounds of the radioactive mineral. The thin uranium market might not easily accommodate a mass exit of those substantial holders.

Besides, the physical uranium fund's net asset value increases when the price of the metal rises or when Sprott buys more material in response to investor inflows. "The question now that all the easy uranium pounds have been acquired is," Kozak muses, "'How are you going to scale that business going forward?'"

"Nobody's paid any attention to mining of any kind for two decades," says George, summing up the bullish case. "The world is going to wake up and discover that they're huge deficits in things like copper, lithium and nickel. They're all volatile, but as contrarians I think we have the ability to move in when others are going the other way."

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Important Disclosures

Performance: Average Annual Total Returns as of 12/31/2023* Fund	1 YR	5 YR	10 YR	Since Inception	Inception Date
Sprott Physical Uranium Trust (NAV)**	86.30%	--	--	49.72%	1/16/2018
Sprott Uranium Miners ETF (NAV)	56.88%	--	--	43.47%	12/3/2019
Sprott Junior Uranium Miners ETF (NAV)	--	--	--	20.05%	2/1/2023

*Returns less than one year are not annualized.

**The NAV performance calculation is based on the USD NAV and the market price performance calculation is based on the USD closing price on the NYSE Arca.

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