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INTERVIEW

Kazatomprom CEO Pirmatov on Adapting to Covid-19

In April the world's largest uranium producer announced that it was reducing the workforce at its in situ recovery (ISR) operations in southern Kazakhstan for three months in response to the coronavirus pandemic, and that this in turn would force a downward revision in previous 2020 Kazakh production targets of 22,750-22,800 tons of contained uranium (NIW Apr.9'20). Kazatomprom, which is majority owned by Kazakhstan's sovereign wealth fund Samruk Kazyna, subsequently issued a revised 2020 Kazakh production target of 19,000-19,500 tU (of which 10,500-10,800 tU will be attributable to Kazatomprom), with plans to supply into all of its contracts via existing inventories (NIW May15'20). In an exclusive interview with Energy Intelligence, Kazatomprom CEO Galym Pirmatov discusses this response to the pandemic, and answers what Kazatomprom might do in the event of a second wave of Covid-19.

Q: You've communicated how the coronavirus has impacted Kazakh uranium production, but can you describe what human toll, if any, it has had on Kazatomprom's employees and their families? Has your workforce suffered from any positive Covid-19 infections or deaths?

A: Kazatomprom and all of its subsidiaries continue to take comprehensive measures to combat the spread of Covid-19 and protect employees, their families, and the local communities. We had two confirmed cases in April: both are employees in our service company subsidiaries from the same village in the Kyzylorda region and contracted the virus outside their work place (they were not employees at the mines, where the concern is that living in close proximity could result in an outbreak). Fortunately, both of our employees recovered and have been discharged from hospital, and in both cases, contact with others was minimal. Contact tracing was carried out to isolate anyone in contact with the affected employees, and full sanitary and disinfection measures were carried out at their places of work.

Q: Kazatomprom's current 2020 production target for Kazakh uranium output is 19,000-19,500 tU. What are the assumptions behind this target as to the size and severity of the Covid-19 pandemic and its response in southern Kazakhstan?

A: Well, production levels for the first half of the year will probably be fairly similar to the first half of 2019. That is due to the lag between when the stoppage of drilling and new wellfield development was implemented to minimize the risk of a Covid-19 outbreak, and when the impact is seen in head grades and flow rates from the wells. Think of it this way: what is coming out of the ground today is the result of what was done over three months ago. Therefore, the real impact to production numbers will only materialize in Q3 and Q4, when the wellfield development activity we have now deferred in Q2, was due to be completed. Overall, we expect Kazakhstan's production to be between 19,000 tU and 19,500 tU, assuming the stoppage of wellfield development activity lasts for only three months. It is also important to note that, while the reduction in production affects all our mines [in Kazakhstan], the lost production will not be equal at every site. The drop [in production] will depend on a number of factors, including the number of wellfields already in operation when staffing was reduced, and the geological characteristics of each deposit.

The geographical spread of Covid-19 in Kazakhstan is nonuniform, and the south of Kazakhstan experienced a later spread of the virus, starting in April — it is therefore correct to assume our mines will remain at lower staffing levels throughout the second quarter. Ultimately, no one knows how long this pandemic will continue to pose a health threat, so we must adapt accordingly, as the welfare of our people will always be our first priority when determining the right time to safely resume regular operations.

Q: At the moment the total number of cases in Kyzylorda and Shymkent appear to have leveled out, and are only growing very gradually. But what sort of localized outbreak or second

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wave of Covid-19 would cause you to rethink Kazatomprom's current operational response, and the current 2020 (and/or 2021) production targets?

A: President Kassym-Zhomart Tokayev has lifted the emergency situation, but the quarantines are still in place. Local governors and office of the chief sanitary doctor have significant powers to maintain measures designed to safeguard the local population. Our response was and will continue to be driven by government health experts. The initial spread of known cases beyond the major centers (Nur-Sultan and Almaty) was slow, resulting in a lag in the timing of the initial lockdowns of major cities as compared to the south regions around most of our operations. As a result, we immediately started to implement sanitary and protective measures at the mine sites, but you didn't see us immediately reduce staff levels. However, as the pandemic grew and the number of cases increased, it was the expansion of the lockdowns that determined our timing and the more aggressive measures that were taken. The number of cases in Kazakhstan is quite low, comparatively speaking, but it has increased tenfold since we imposed the lockdown at the mines on Apr. 7. I hope that we will manage to contain the spread and avoid a second wave, but this virus has so far been nothing if not unpredictable.

Q: Given that Kazatomprom is already "prepared to manage its supply with an inventory level below the target range" of six to seven months of production, additional cuts to output prompted by a second wave of Covid-19 or a hyper-localized outbreak — alongside continued fulfillment of your contractual supply obligations — could presumably absorb the remaining Kazatomprom inventory. If that happens, do you have a strategy for how you would refurbish your inventories?

A: We finished 2019 with an inventory of approximately 8,500 tU — representing eight months of planned attributable production (prior to the reduction in guidance). We therefore believe that we have sufficient inventory to cover our commitments in the near term. However, the nature of our business means that we cannot bring our inventory to zero or anywhere near that level, given that much of it is work in progress and inventory in transit. It takes up to two months to ship material to some of the converters, which is only the first step of the fuel cycle. Therefore, should we see a second spike in Covid cases, or if the current situation extends beyond three months, we cannot rule out the possibility that Kazatomprom will need to purchase material from the market. As I have said before, I believe that the company is well positioned to do so if needed, both technically through the use of its trading arm THK, as well as financially, being well capitalized with low debt levels and untapped lines of credit.

Q: Kazatomprom's all-in sustaining cash costs in USD have fallen in recent years, thanks largely to the weakening of the KZT against the USD. Setting aside the currency issue, what efforts has Kazatomprom been taking to keep these costs low? And you're currently projecting 2020 all-in sustaining cash costs $1-$2 per pound U3O8 higher than the 2019 figure of $11.94/lb. U3O8. What is behind this increase, and do you expect these costs to continue to increase in 2021 and 2022?

A: The cost profile of an ISR operation is fairly resilient and flexible, whereby changes in production levels do not have a significant effect on unit costs, unlike traditional mines that are best operated at maximum output. The recent weakening of the KZT had a modestly positive effect, which is why our weighted average C1 cost per pound across all operations is expected to remain within the conservative range established at the beginning of 2020 — and this is despite the forecast fall in production. [C1 cash costs is the JORC-compliant designation for almost all production costs, excluding capital costs.] The "all in sustaining cost" has been revised downward, reflecting the sharp fall in capital spending, related to minimizing site staff levels and the suspension of wellfield development.

Q: Since January 2019, Kazatomprom's dividend policy has committed the company to pay a minimum of 75% of free cash flow if the ratio of net debt to adjusted earnings before interest, taxes, depreciation and amortization is equal to or under 1.0. Does this commitment allow you enough cash to reinvest in growing your long-term resource base, particularly as costs of any new development will likely be higher due to the distance from existing infrastructure?

A: The company's focus remains on our core business of uranium mining and its value-chain components, with plans to continue investing in exploration and development of deposits, projects in front-end nuclear fuel cycle as a function of future expected market demand. We believe that our dividend policy allows us to retain enough funding to do so — the dividend formula ensures that an appropriate level of cash flow is available to deliver on our business plans.

Q: One industry source pointed to a sharp decrease in your spending on exploration and development, and argued that there aren't highly promising prospects beyond Inkai South. Is that a fair assessment? If not, what other prospects are most promising at this point?

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A: It is true that the south Inkai blocks are our most attractive advanced uranium exploration projects (not just for Kazatomprom, but I believe anywhere in the world), with around 125,000 tU of resources. Amid current market conditions, we don't talk much about those and our other prospects, but in actual fact, we do have several others, including Block 6 and 7 Budenovskoye, Togusken, and East Zhalpak, which are all located in the Shu-Sarysu Basin and have been explored for a number of years.

As our production profiles start to decline (we closed our first sizable mine last year) these deposits represent the future of the company for decades to come. When and at what size they come on line will of course depend on our view of future supply and our utility customers' needs. We have stopped thinking of these as resources, and we think of them as assets, for this and future generations. As such, we are in no hurry to bring them on line until the timing is right and the market requires additional supply.

Q: Kazatomprom currently plans for 2020 dividends of no less than the Tenge equivalent of $200 million. Is there any prospect of this being revised upward given the broader financial situation faced by Samruk Kazyna, your primary shareholder?

A: As a public company, and the first in the broader Kazakh privatization program, it is extremely important that we deliver on our commitments. Hence, the dividend policy sets out a plan for annual dividend payments, while leaving sufficient funds with the company for the delivery of the business plan. There is obviously a caveat that the board of directors does have discretion in making the annual recommendation, but strong corporate governance is a priority and we take the commitments we have made very seriously. For 2020 (payment on 2019 results), we committed to paying at least US$200 million to shareholders, and based on the actual 2019 results, our board has recommended shareholders approve a payment of KZT 99 billion based on the dividend policy. At the current exchange rate that is about US$235 million, so we are confident that even with the weakening of the KZT, we will exceed the US$200 million commitment.

Q: In 2019 some 40% of Kazatomprom's uranium products were sold by Kazatomprom and THK to customers in China. Has the impact of Covid-19 softened Chinese demand in the first third of 2020, or are you seeing steady (or growing) demand?

A: The pandemic brought certain changes to shipments to China, especially given the fact that China was going through its peak Covid-19 spread in January-February, while Kazakhstan was only seeing its first cases in March. While the border closed, some shipments had to be delayed. We have now resumed our deliveries to China and do not expect these temporary conditions to have an impact on the overall Chinese delivery picture.

Q: After years of operating a Washington, DC office and touting efforts to diversify your customer base, for the past three years your sales to customers in the US remain in the mid-single digits, on a percentage basis. How do you explain this lack of market share growth in the world's largest nuclear fuel market?

A: The United States is a very important market for us. It is the largest uranium market in the world, with more than 20 utility companies and 95 reactors providing reliable baseload electricity to US households and industries. However, it is a tougher market to penetrate because of its size and number of customers, when compared to other nuclear countries that typically only have one or a couple of nuclear-generating companies at most. It is a lot of geography to cover, with many different customer needs to understand — naturally it takes time to build up sales in new markets. Having said that, last year our sales to the US doubled, and this was in spite of the uncertainty among US utilities around Section 232, followed by the Fuel Supply Working Group deliberations. And I have to say it was really great to see how much support Kazatomprom received, both publicly and privately from the US utilities during the 232 review — I think this is a strong foundation for us to continue to build on.

I would agree that at 10% of our sales, the US is still underrepresented in our portfolio. In part, this is probably because US utilities have been very well covered contractually over the past few years in which we have implemented all the changes to our strategy and transformed our marketing and sales approach, both in Kazakhstan and with THK in Zug [Switzerland].

But overall, we have come a really long way; in the three years 2015-17 we were only able to sell about three-quarters of our annual production, and even then, significant volumes were not direct to our customers, but instead via traders. Beginning in 2018, we transformed the business to the point where we became not only the largest producer, but also the largest seller in the world. We no longer sell through traders, our sales are well above production levels every year allowing us to reduce our inventories, and in 2020 (for the first time), we were in a position where we had little free material to sell (even before the production impact of Covid-19). And that is why I feel very confident about our goal of being the supplier of choice to the global nuclear industry (including the US).

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