

L2 INTERNATIONAL OPPORTUNITIES FUND

September 2019

“What the wise man does in the beginning, the fool does in the end”

Howard Marks, Oaktree Capital

Dear partner,

We have reached the end of the third quarter of 2019 with many stocks in the uranium space hitting new lows.

Although we do not have a crystal ball, we are tranquil with the current situation, which represents, in our opinion, only a short-term movement, unrelated to the fundamentals of our Fund's assets or without any connection to the commodity's physical market. Short-term variations are common and affected by diverse, often exogenous factors, and in this case, we believe, represents investor capitulation and lack of knowledge of the nuclear cycle.

Economies and markets are subject to cycles. In the case of commodities, factors such as the length of time to bring a mine online and the high volume of capital involved lead to a temporal mismatch of supply and demand and, consequently, to extreme cycles. We see this as a great opportunity.

Obviously, cycles vary in intensity and duration and, for a sharpened investor, they tend to be extremely lucrative. The mismatch mentioned above causes commodity prices to rise several times and in the last uranium bull market, for example, there was a price increase of more than 10 times.

The companies that produce the commodity, in turn, have financial and operational leverage. Third-party equity participation and high fixed costs mean that variations in commodity prices are amplified in the company's net income. From the break-even point, *ceteris paribus*, virtually every change in sales price is flowing directly to the last line of the Income Statement.

The company's long-term stock prices, in turn, assuming investors are willing to pay the same price/earnings (P/E) multiple as before, rise to fit higher future profits. If investors become more confident with the sector's performance, there may be a re-rating and acceptance of a larger P/E multiple, further exacerbating the rise in stock prices.

In the last bull market in the uranium sector, we saw stocks rise by 10,000, 30,000 and 90,000% - as expected, this move did not happen in a straight line and was not free of volatility, quite the opposite. Shares of Paladin, the company with the highest share price return of the last cycle, plunged at the beginning by 90%, and displayed at least two 60% declines, several 40% or more declines and countless minor declines of 20% or 30% between the bottom and the top.

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Thus, we try to focus on the investment thesis and not on short-term variations, which mean nothing in the global context.

We believe we have already passed the lows in this cycle (as long as there is no cataclysm in the world financial situation) and we have seen uranium rise by over 40% since then. Evidently, we are aware of the impossibility of pinpointing the bottom, but we are comfortable investing right now due to the current situation, catalysts and inflections we have identified.

There was indeed an excess of uranium production at the time of the last bull market. It is worth remembering that the situation at the time was much better in terms of supply than it currently is, ie there was no deficit - anyway, uranium prices soared, largely due to the fear that utilities had to run out of uranium, the essential material for energy production. After all, what good is a nuclear reactor that costs billions to build without the input that will make it produce energy?

The investment thesis can be summarized quite simply in the end. As we have said many times, it is a commodity whose demand is increasing, production is decreasing, end buyers are practically indifferent to price they pay and the cost of production is well above the selling price. Added to this is the fact that uranium has no substitute and it is a niche market. Everything indicates to us that the price will have to rise.

THE QUARTER

This quarter was very busy, with President Trump's final decision on Section 232 in mid-July and the World Nuclear Association WNA Symposium in early September.

The next big event will be the result of the Working Group created by Trump to support the US nuclear industry. We will hear about the steps to be taken (if any) in October, and we did a podcast a few weeks ago mentioning the possible outcomes.

Shortly before President Trump's official announcement of Section 232, the shares of several US companies fell sharply. As some market participants expected benefits and protectionist measures for US companies and this benefit was not reflected in the S232 resolution, there was no shortage of sellers. Ex-post it was clear that there was strong speculative positioning in the direction of the decision, as if it were a binary event, which, as we have said several times, was not.

The selloff ended up affecting many companies. Some of them, solid companies that until recently produced the metal, fell by 40% the day before and in the days following the decision. We saw this movement as an exaggeration and took advantage of the bargains to increase (or start) our position in some of these names.

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THE MARKET

We noticed this quarter a lot of positive news regarding the sector. Starting with Brazil, which announced the construction of 6 more nuclear reactors by 2050, in addition to Angra 3, at a much lower cost than the recently built US reactors.

Slovenia has announced that its reactor, which was to be decommissioned in 2023, has been granted an extension for another 20 years. In addition, the prime minister is engaged in the project to build a second reactor in the country.

France will build two more reactors to replace older reactors, and in the US, Duke Energy, one of the world's largest utilities, is requesting the renewal of another 11 licenses for another 20 years. Duke alone consumes about 5 million pounds of uranium annually and if we imagine 5m for another 20 years, we will have 100m pounds of total consumption lined up.

Speaking of US, the Senate is discussing a bill to extend the life of other nuclear reactors in the country.

In addition to these, India and Russia signed an agreement to build 6 new reactors in that country and the Chinese also announced the start of construction of 3 new reactors and the approval of 6 more.

Rarely does a week go by without news of more demand coming into the sector, either through more extensions of operating reactors being authorized or new reactors being built and / or approved. It is a growth industry and no one is paying attention. And now it is not only L2 Capital and other investors in the sector saying it. For the first time since the Fukushima incident, the WNA report points to growing demand for uranium in all projected scenarios.

China has announced its intention to buy even more uranium from Kazakhstan. We already know about Russian influence in the country, so the "cheap uranium" is getting into the hands of the Russians and the Chinese, while the western world is still just watching.

It is also worth remembering that most utilities have as their usual practice to diversify uranium sources and some of them are getting very close to the limits allowed for buying material from a particular country.

Annual uranium production is well below demand and this discrepancy cannot go on for much longer, with inventories shrinking at alarming rates. Just a few days ago, Kazatomprom itself mentioned this. Last year we had the first significant deficit between production and consumption, which should persist at least until there is an incentive for miners to return to production.

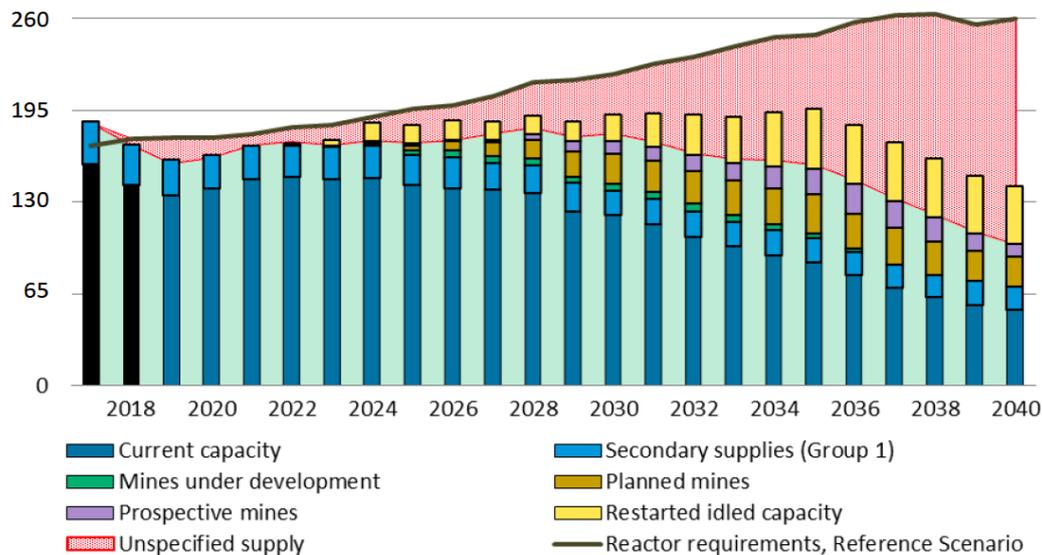
Just to give you an idea, using WNA's most likely scenario figures for 2030, 85,000tU will be consumed that year, while last year's annual production was only 53,500tU (and decreasing). Consequently, almost 4 mines similar to McArthur River (the biggest mine in the world) will have to be discovered, developed and come to production to supply the needed uranium. And it is a good idea to start immediately, because McArthur River mine took 11 years between its discovery and the start of production.

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2018-2040 Uranium Supply & Demand (WNA Reference Scenario, mln lbs. U₃O₈)



Source: WNA.

And the WNA numbers are not alone either. In the 85 scenarios projected by the Intergovernmental Panel on Climate Change (IPCC), nuclear power generation increases by an average of 2.5 times by 2050. In the most positive scenarios, this generation increases 5 times.

And there is recent precedent in history. We are already seeing the effects of the supply-demand relationship on the U308 to UF6 conversion market, which has risen 400% since the end of 2017, when ConverDyn decided to suspend its activities and buy more conversion. At the time, we could see what would happen to prices very clearly. Part of the supply came out and turned into part of the demand - it was obvious that prices would rise. ConverDyn accounted for about 12% of the conversion market - McArthur River mine accounts for 13% of production. The similarities are amazing.

As we all know, the largest mine in the world, McArthur River (18M lbs per year), operated by Cameco, has been suspended indefinitely. Kazatomprom, the world's largest producer, reduced its projected production by 20% from 2018 to 2021 (inclusive). Several other projects or mines have been mothballed or suspended. In addition, Cameco has reduced its production and will buy at least 10 million pounds of uranium (or 7% of all world production) between now and the end of 2019 to honor its contracts. This will happen in a very illiquid market.

The enrichment market (SWU) is going up and the conversion market is going up ... Now just wait for the new contracting cycle to start and we will see uranium prices rise and with it the share price of the miners.



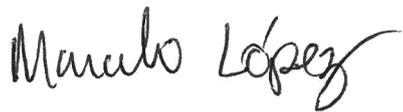
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We would like to end this letter with the same sentence we started the last one “**the big money is not in the buying and selling ... but in the waiting**”. We still believe this is the best investment opportunity we have ever seen and would like to thank you once again for your trust and prestige. The case of uranium is becoming increasingly clear and the risk-return ratio is even more inviting now than when we first became interested.

As always, we are investing alongside you, our partner, under the same conditions. In the last quarter, we invested more than the 50% previously announced and we will invest even more this quarter.

Sincerely,

A handwritten signature in black ink that reads "Marcelo Lopez". The signature is fluid and cursive, with the first name "Marcelo" and the last name "Lopez" clearly distinguishable.

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