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UNITED STATES
NUCLEAR REGULATORY COMMISSION
WASHINGTON, D. C. 20555

September 19, 1988

MEMORANDUM FOR: Leland C. Rouse, Chief
Uranium Fuel Licensing Branch
Division of Fuel Cycle and Material Safety
Office of Nuclear Material Safety and Safeguards

THRU: Darrel, Nash, Section Chief
Policy Development Financial Evaluation Section
Policy Development and Technical Support Branch
Program Management, Policy Development and Analysis Staff
Office of Nuclear Reactor Regulation

FROM: Robert S. Wood
Policy Development Financial Evaluation Section
Policy Development and Technical Support Branch
Program Management, Policy Development and Analysis Staff
Office of Nuclear Reactor Regulation

SUBJECT: PROPOSED TRANSFER OF OWNERSHIP OF KERR-MCGEE'S GORE FACILITY TO SEQUOYAH HOLDING CORPORATION

As you requested, I have performed a financial evaluation of the proposed transfer of ownership of the Gore facility of the Kerr-McGee subsidiary, Sequoyah Fuels Corporation, to Sequoyah Holding Corporation, a subsidiary of General Atomics Corporation.

I. BACKGROUND

This evaluation is based on material submitted by officials of and counsel to Sequoyah Holding Corporation, with emphasis on the balance sheet dated May 31, 1988 and the balance sheet and income statement dated June 30, 1988. The June 30 statements were not part of Sequoyah Holding Corporation's original submission to NMSS but rather were telefaxed directly to me on August 25, 1988. Information for this financial evaluation was further supplemented by a conference call on August 29, 1988 among me, Chuca Meyer, an attorney for Winthrop, Stimson, Putnam and Roberts, counsel to Sequoyah Holding Company, and Reau Graves, Jr., President of Sequoyah Holding Company. The purpose of this conference call was to answer questions on and clarify the May 31 and June 30, 1988 financial statements cited above. (See Appendix A for a list of questions asked by me in the conference call.)

II. ANALYSIS

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A. Balance Sheets

1. Reau Graves indicated that the purchase of the Gore and associated facilities would be financed by a $5,000,000 direct stock purchase

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[redacted]

plus a $10.5 million ten-year note payable to Kerr-McGee at an interest rate within the range available in international financial markets. This would have the effect of increasing the long-term debt liability on future balance sheet statements and, in effect, increasing the ratio of capitalization of debt to stockholders' equity to approximately one to one. That is, other things being equal, long term debt would increase to approximately $10.8 million and stockholders' equity would decrease to approximately $13.4 million. This is a reasonably acceptable debt-to-equity ratio, and is consistent with similar ratios of net worth-to-total liabilities (less decommissioning reserves) proposed elsewhere in NRC regulations and guidance for use in parent company guarantees.

2. The current-asset-to-current-liability position reflected in the balance sheets is quite strong. As an indication of short-term solvency, current assets should exceed current liabilities. The minimum acceptable ratio in NRC's parent company guarantee requirements is 2:1. The May 31, 1988 balance sheet for Gore and related facilities showed a current ratio of nearly 4.5. For the June 30, 1988 balance sheet the current ratio improved to over 5.0. In absolute terms, current assets exceed current liabilities by nearly $12,000,000.

   As part of current assets, the Gore and related facilities maintain a strong cash position, although this in part appears to reflect a stipulation by buyers as part of the purchase agreement that cash position be improved.

   Another primary component of current assets, accounts receivable, also appears to be strong. Reau Graves indicated that a recent CitiBank evaluation of the facility's accounts receivable indicated that they were all from utilities and had a 30-35 day average maturity term. Further, there has never been an instance of a bad debt write-off for a delinquent customer account.

   Product inventories account for nearly 30% of current assets. Apparently, this line item represents work already under contract and is analogous to unbilled accounts receivable with a 60 to 90 day term.

   Materials and supplies are shorter term assets used in the production process. Of all the current assets these are the least liquid (i.e., would be the most difficult to convert to cash on short notice.) Materials and supplies represent only about 17% of total current assets and, according to a recent audit by Arther Anderson Co. as indicated by Reau Graves, are accurately valued. Thus, the overall current asset position of the Gore facility is strong and demonstrates good liquidity.

3. Longer-term assets are carried at book value (which normally means original purchase price) less depreciation. Because of the limited number of UF6 conversion plants extant, it is difficult to determine the

salvage value of existing fixed assets. Mr. Graves indicated that a plant recently built in Canada using similar processes and of similar capacity cost nearly $100,000,000. This suggests that, in the event of a liquidation of the Gore facility and assuming a market for its equipment, there would be some salvage value obtainable. The fixed assets appear to be fairly valued according to audits performed during the purchase agreement negotiations.

B. Income statement

An income statement for the period (unspecified) ending June 30, 1988 was included with material telefaxed on August 25, 1988. A net income of approximately $1.48 million was realized on operating revenues of $11.1 million. However, a significant component of operating expenses for the period, the cost of product and material, is shown as a negative operating expense (i.e., as a received asset rather than expense requiring cash outlay). Reau Graves explained that this included a transfer from Kerr-McGee as part of the conditions of sale and would not be a recurring item. (However, I also understand that the material is generally owned by utilities and thus may not be reflected as a cost per se. I will have to clarify this point with Reau Graves when he returns to his office.) If this negative expense is eliminated (i.e., if cost of product and material required cash outlay), and other items were equal, a loss rather than a profit would have been realized.

Depreciation as a non-cash expense contributed nearly $2.4 million to cash flow during the period ending June 30, 1988. Although significant, it might not be sufficient in future years to compensate for possible cash outlays for cost of product and material. Of course, an effective management could increase revenues or reduce other expenses to improve both income and cash flow.

III. Conclusions and Recommendations

The balance sheet for the Gore and related facilities appears quite strong. The excess of current assets over current liabilities appears sufficient to cover the decommissioning and reclamation reserves carried on the liabilities side of the balance sheet. Additional protection is afforded by the likelihood that significant value still resides in the salvage value of the fixed assets of the facility. Another positive indicator is the relatively strong proportion of stockholders' equity in Sequoyah Holding Corporation's overall capital structure.

The income statement is less positive, if my understanding of cost of product and material is correct. Nevertheless, there appears to be sufficient leeway for improvement and limited potential for losses that would significantly impair the ability of Sequoyah Holding Corporation to perform necessary decommissioning and reclamation activities. (This assumes that the $11.7 million figure given on the balance sheet reasonably represents decommissioning and reclamation costs.)

Therefore, I conclude that, based on the information provided, Sequoyah Holding Corporation is financially qualified to assume the license to operate the Gore facility. Notwithstanding this conclusion, you may wish to consider the following additional safeguards:

1. Require Sequoyah Holding Corporation to provide annual balance sheets and income statements certified by a corporate officer. A statement that these financial statements meet generally accepted accounting principles should also be required from a Certified Public Accountant. The first statements should be required at the time the license is transferred.

2. Ask for a guarantee from Sequoyah Holding Corporation's parent, General Atomics Corporation, for decommissioning and reclamation expenses. You indicated that General Atomics would probably be unwilling to do this. If they refuse, we shouldn't make an issue of it, given the relative strength of Sequoyah Holding Corporation's financial statements; but it does not hurt to ask again. I don't believe this is essential, given the information provided to date; but it would provide an added degree of assurance.

/s/

Robert S. Wood
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cc: R. Fonner, OGC

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Appendix A

Questions Asked in Conference Call of August 29, 1988 among Chuca Meyer, Reau Graves, Jr., and Robert Wood

1. Are the June 30, 1988 and May 31, 1988 balance sheets indicative of Sequoyah Holding Company's asset/liability/net worth structure after the proposed ownership transfer?

2. How will the purchase be financed? What proportion of the purchase will be financed by debt and what proportion by stock purchase?

3. Is the valuation of inventories reasonably accurate? What is their liquidity?

4. Is the valuation of accounts receivable accurate? What is the estimated percentage of bad debts in receivables?

5. Is the decommissioning reserve offset by a segregated sinking fund or is it simply a reserve account?

6. What is the estimated salvage/market value of net property, plant and equipment?

7. Would the new owners consider putting more than $750,000 in an escrow/trust/surety bond for decommissioning?

8. Why is cost of of product/material a negative expense (i.e. a net increase to revenues)?

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