THE ENERGY REPORT
A STREETWISE REPORT

The Uranium Industry Is Alive and Well: David Talbot

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The Fukushima disaster cast a shadow on the uranium mining industry, but Dundee Capital Markets Vice President and Senior Mining Analyst David A. Talbot sees very strong fundamentals, especially in the absence of substitutes for nuclear generation. Such a premise suggests that uranium use will rise with growing populations and needs. In this exclusive interview with *The Energy Report,* Talbot lays out the demand picture in detail and shares the names of his best uranium mining ideas.

COMPANIES MENTIONED: AREVA - **BANNERMAN RESOURCES LTD.** - EXTRACT RESOURCES LTD. - **FISSION ENERGY CORP.** - HATHOR EXPLORATION LTD. - MANTRA RESOURCES LTD. - MAWSON RESOURCES LTD. - PALADIN ENERGY LTD. - RIO TINTO - ROCKGATE CAPITAL CORP. - **UEX CORPORATION** - **URANERZ ENERGY CORP.** - **URANIUM ENERGY CORP.** - URANIUM ONE INC.

The Energy Report: Dave, what is your post-Fukushima uranium thesis?

David Talbot: Post Fukushima, there are broader market issues that are also impacting the uranium equities. However, there is a little bit of danger that if we don't get a lot of this new build, uranium prices would increase.

TER: Lack of development would give rise to the classic market conditions that would ultimately force uranium prices up.

DT: Exactly.

TER: How does consolidation come into play?

DT: I don't think there is necessarily consolidation for its own sake. I think that there are some companies that are just so undervalued that larger companies that want to get into certain areas may jump at these opportunities. **Hathor Exploration Ltd. (HAT:TSX.V)** ended up being taken by **Rio Tinto (RIO:NYSE; RIO:ASX; Not Rated)** at almost an 80% premium to where it was trading before. The initial **Cameco Corp. (CCO:TSX; CCJ:NYSE; Not Rated)** offer of $3.75/share was certainly opportunistic. I'm not surprised at all that Cameco didn't win the bid at that level.

TER: Does this portend additional or future takeouts?

DT: I think we probably will see some, especially if we take a look at Canada's Athabasca Basin. Rio Tinto is the second-largest mining company in the world with a $100 billion (B) market cap and $7.5B in cash. So I don't think Rio is going into the Athabasca Basin for just 70 million pounds (Mlb) of uranium. I really think it is going to take a look at other opportunities there, first and foremost **AREVA (CEI:PAR; Not Rated)**. AREVA has a lot of assets in the basin and it is not spending a lot of money on exploration there this year. I think it's down to only two rigs at its Shea Creek joint venture (JV) with **UEX Corporation (UEX:TSX)**. So I think there's potential that Rio is going to go after some of the AREVA assets. No, I don't think it will get McArthur or Cigar Lake interests, which are the two best uranium deposits in the world, but it might get something like the McClean assets. There's also the Midwest deposits, which are immediately next door to the Roughrider deposit, and it makes sense for Rio to go after that. So that's the first thing. Then there are other projects in the basin. **Fission Energy Corp. (FIS:TSX.V; FSSIF:OTCQX)** or UEX are potential targets as well.

TER: Will we see the double-digit returns again in the uranium industry?

DT: I think we will come back to double-digit returns. The stocks actually had double-digit returns on three occasions this summer. But Fukushima put long-term viability of the sector in doubt for some time due to significant negative press, which kept coming, and often it was just wrong. Uranium and uranium equity markets now seem to be hypersensitive to negative news, and the spot price was declining due to supply concerns earlier this year, and the stocks were trading hand-in-hand with uranium prices. We think that Fukushima ultimately is responsible for only about 30–35% of the value lost in the uranium equities while many of the stocks are down by about half.

TER: I'm hearing you say there's value in the equities because of this 35% haircut that Fukushima gave the industry, but I'm wondering about revenue lines and bottom lines.

DT: For the producers, revenue is certainly tied to uranium prices and the rate of production. I think many of the uranium producers are also ramping up production: Cameco is touting its "Double U" program, doubling its production by 2018. We forecast **Paladin Energy Ltd. (PDN:TSX; PDN:ASX)** production to rise almost 90% to about 13 Mlb and **Uranium One Inc. (UUU:TSX)** production to rise by about 75% as well over the next four years. Whether uranium prices reach the bottom line really depends on the company. I think Cameco can be considered as almost a blue chip stock in the sector with excellent margins. On the other end of the spectrum, I think Paladin has some hefty general and administrative (G&A), exploration and financing costs that it's working to reduce. I think some companies like that actually need higher uranium prices than the $52/pound (lb) where we're trading at right now. We forecast uranium prices of between $65 and $75/lb over the next couple of years, especially once the HEU (highly enriched uranium) Agreement goes offline.

TER: What are some growth drivers in the industry?

DT: I think the main growth drivers are the expectations for higher prices given the strong fundamentals of the uranium space. We believe that demand will really outpace supply beyond 2013. Uranium demand continues to be strong. Nuclear build continues to increase despite Fukushima and despite that the reactors that are now offline in Japan and Germany. Today there are 12 more reactors in operation, under construction, planned or proposed than there were before the Fukushima incident. So that's about 997 reactors on the drawing board right now in one way, shape or form. We have seen uranium production increase about 28% over the past four years with almost all of that growth coming from Kazakhstan and Namibia. In fact, Canada and Australia are actually in decline over the same period. So despite this big runup in uranium prices from about $20 six years ago, we really haven't seen the mine construction that we had expected. Projects have been delayed, deferred or canceled for many reasons. We are estimating maybe just under 200 Mlb of production by 2020 if everything goes forward as planned.

Another important driver is the reduction in secondary supply resulting from the HEU Agreement, the downblending of the Russian nuclear weapons program and then selling that uranium for nuclear fuel. The HEU Agreement is expected to go offline by the end of year 2013, and the Russians continue to confirm this. The end of the HEU program would remove 24 Mlb from supply annually. That number is huge. It's about 18% of all uranium mining. I think Cameco CEO Tim Gitzel said it best on his Q311 conference call: "We absolutely believe it will happen that when the HEU agreement comes off, it will equal production from McArthur, Rabbit, Smith Ranch and Crow Butte all put together." That's about 1.4 times larger than the Cigar Lake production. So what do you think the market will do when it realizes this HEU Agreement is going offline? I think that's definitely positive for the fundamentals.

TER: Is China going to be the major global driver?

DT: Yes. I would say China is definitely the dominant growth driver. Along with India and Russia, China is going to account for about half of the new build in the world. While China has temporarily suspended approvals pending stress tests and further review in light of Fukushima, and rightly so, the country maintains strong support for nuclear power. The country is up to 15 reactors in operation from 11 just one year ago, and it has another 26 under construction, 51 planned and 120 proposed. So China is definitely leading the way.

TER: And utilities are in the game now.

DT: I think the Asian utilities are going to go out of their way to either purchase uranium in the markets through long-term contracts, but probably and most importantly, buy some of those large uranium mines around the world. This, potentially, leaves less uranium for the next country. The examples are China looking at **Extract Resources Ltd. (EXT:TSX; EXT:ASX; Not Rated)**, the Russians buying out **Mantra Resources Ltd. (MRU:TSX)** on behalf of Uranium One. The Chinese were even looking at **Bannerman Resources Ltd. (BAN:TSX; BMN:ASX; Not Rated)**. These are some of the world's largest deposits that are potentially disappearing.

TER: When you put it all together it sounds like a bullish scenario. What companies do you like?

DT: I would have to say our top pick right now is **Rockgate Capital Corp. (RGT:TSX)**. We have it rated as a Buy with a target price of $4 per share. This company hosts a growing resource at its 100%-

owned Falea project in Mali in West Africa. Right now, it has resources of 28 Mlb of triuranium octoxide (U3O8) with 41 Moz silver and some copper. So it is a polymetallic deposit. Exploration continues to extend the deposit in several directions. The assays it receives from drilling exceed the average resource grade of 0.11% uranium and 111 grams/ton (g/t) silver. The company is currently upgrading the resource area and expanding the zone in several directions.

TER: Dave, Rockgate has been weaker than most of these companies over the past three months. What has been the issue there?

DT: I think it has been weaker for the past three months because it actually outperformed almost everybody except Hathor in the preceding period. This company performed quite well through the summer. Even right now, Rockgate is trading at an enterprise value per pound (EV/lb) of $2.71. That's still a premium over its developer peer group average $1.54 EV/lb. We think with the quality of this project and the fact that there's a scoping study on the way, this premium is not only justified but we think it's also well below the current acquisition levels that are up to $9 EV/lb based on recent bids from Mantra and Hathor.

TER: What other companies are you telling your clients that you like?

DT: We would also recommend UEX Corp. as a Buy, and we have a $2.50 target price on this one. This has long been one of our favorite companies. Its growth potential is tremendous, particularly in the West Athabasca at its 49%-owned, 88 Mlb-Shea Creek deposit. This is a JV with AREVA. We have suggested that Rio Tinto is looking for other AREVA projects, and this might be one of them. Shea Creek has several areas that host over 20% U3O8, and more exploration is really needed to determine where the best potential mining area will occur. The company just last week announced a $6M-exploration program for 2012. It will target probably three areas, but right now we already assume that this project is beyond the 100 Mlb-level and likely to grow further following that drill program.

UEX also has an interesting project in the eastern Athabasca called Hidden Bay. It totals about 40 Mlb. A preliminary assessment assumes toll milling right next door at Cameco's Rabbit Lake mill located about 4 kilometers (km) away. Cameco already owns about 23% of UEX, and Cameco has also avoided replacing its retired UEX board nominee despite its right to do so. We're reading between the lines; maybe Cameco is just trying to avoid potential conflicts should it ever decide to take a run at UEX.

TER: Your UEX target price of $2.50 is an implied return of about 300% from here. Is that dependent on a takeover?

DT: A takeover is not baked into my target price. Through much of the summer this stock in particular had a single seller who wanted to get out, and UEX was sort of the victim of that. But our 10% discounted cash flow (DCF) model does not assume that there's going to be any takeover premium built in. We just think that the stock is vastly undervalued considering its potential for high grade. It's at a great location. Shea Creek is a world-class asset with over 100 Mlb of U3O8. That could be a companymaker mine. Right here the stock is trading at a mere $1.34/lb EV/lb again compared to that $1.54 EV/lb for its peer group. We believe that should be higher for this company.

TER: What other companies?

DT: **Uranium Energy Corp (UEC:NYSE.A)**. We have a Buy on the company right now with a $5.50 target price, and that's in U.S. dollars. It is an emerging in-situ recovery (ISR) producer in the U.S. Assets are based in South Texas. The company started mining uranium at its Palangana mine near the Hobson mill about a year ago. Initial production is still ramping up, but its operating costs have really declined to a point where it already has lower cash costs than most of its peers, large company or small. The company has also received a draft radioactive materials license for another project it has called Goliad. This project is expected to be the largest ISR project in Texas once it's at full capacity. Because it's a tabular sandstone deposit, not a linear roll-front deposit like Palangana, we think that Goliad should actually ramp up quicker than Palangana. Ultimately, we could see production of about 1 Mlb/year at very low cash costs in the $15/lb range coming from these two operations.

I would have to say another one we like is Fission Energy. Now here we are back to the Athabasca Basin where you have potential for high-grade uranium deposits. We recommend Fission as a Buy with a venture risk rating. We don't have a target price on this one because we're still waiting for that initial resource. We do believe this company is a prime takeover target in the Athabasca, probably more so now that Rio has won Hathor, which is located immediately next door. While we might expect Rio Tinto to first go after AREVA, it could next target Fission Energy, which has a market cap of about $80M, to gain not only its projects but also perhaps a partnership with the Korea Electric Power Corporation (KEPCO) (KEP:NYSE). We are assuming that Rio already has solid relations here, but that definitely is an idea. Plus, Fission has a potentially new discovery in the western Athabasca. A radioactive boulder field measures 5,000m by 900m and one third of all boulder and cobble samples taken assays at over 10% U_3O_8, and another third at between 1% and 10%. By the end of this year, we think that the Fission project next to Hathor's Roughrider might measure between, say, 11–18 Mlb. It might grade around 3%, according to our estimates. Upside is huge here.

TER: Dave, Fission's relative strength has been extremely high. Shares are up 14% over the past 12 weeks. Is this takeover premium we're seeing in this stock?

DT: For this stock right now, I would have to say yes there is takeover premium. As soon as that Cameco bid for Hathor came out, this stock popped in unison with Hathor. But with that said, I don't think that the takeover premium, even though it's in the stock right now, is the whole story. If we were to use the $10/lb takeover level where Hathor was finally taken out by Rio and then add Fission's cash that would suggest more like a $1.30 target price for Fission. It's trading right now at $0.81. We don't have a target price on the stock at this point, but there's an inferred upside based on where its neighbor was taken out.

TER: Another one you're recommending?

DT: **Uranerz Energy Corp. (URZ:TSX; URZ:NYSE.A)** is another company. We have a Buy on it with a $5-target price. This company is on the verge of becoming the next uranium producer in the U.S., and as of last week is now one step closer to realization with the signing of a uranium processing agreement with Cameco, which operates three ISR mines in the U.S., including two that are in the Powder River Basin of Wyoming near Uranerz. This agreement will allow Uranerz to deliver uranium-loaded resin from its Nichols Ranch area projects to Cameco's Smith Ranch-Highland uranium facilities for final elution and drying into yellowcake. Now what this should do for Uranerz is eliminate some of the growing pains that typically come with ISR plant commissioning. It also should benefit from years of Cameco's experience in operating in this area, essentially by tying its initial production into existing operations.

TER: Your implied return on Uranerz is 200%. Did you have another one that you'd like to mention?

DT: **Mawson Resources Ltd. (MAW:TSX; MWSNF:OTCPK; MRY:Fkft; Nat Rated)** is an exploration company with vast, but early, uranium and uranium-gold projects in Finland. It's likely going to be spinning out its gold and copper projects in Peru and other non-core uranium assets in Scandinavia. Now, we don't cover the stock and we don't have a recommendation on Mawson, but we visited its flagship project, Rompas in Finland this summer, and we were quite impressed. Dundee has visited about 60 uranium projects around the world, and we've actually never seen so much high-grade uranium outside the Athabasca Basin, let alone massive uranium with significant visible gold in the surface outcrop. So there are several reasons why we like Mawson right now. The stock is tightly held, and the story is relatively unknown. It has a very experienced exploration team. It deals in multiple commodities. It is an early-stage play but with huge potential. The kicker here is that it has extremely high gold and uranium grades. In an average of 171 grab samples there were 1,127 g/t gold. The uranium grades at an average of 4.25%.

TER: Does this stock trade on gold valuation or uranium?

DT: I would say a little bit of both. The stock certainly was impacted immediately after Fukushima, but that didn't last long. It quickly bounced back to where it was, and it traded sort of in line with a lot of the gold stocks recently, up or down somewhat. I think at the end of the day, probably gold is going to carry this one. But you just can't ignore 4.25% uranium.

TER: Can you mention one more company?

DT: Sure. Paladin Energy. We have a Buy and a $3.80 target price on it right now.

TER: That's a double from here.

DT: Yes, and it is in line with what I have for the rest of the producers at this point. Paladin's recent positive adjusted earnings will go a long way mending some fences with investors. I think it's been a long time coming, but the recent elevated uranium production and sales levels, particularly when combined with ongoing cost optimization should help Paladin cover its onerous corporate costs. The company has stressed that it would like to make more of a concerted effort to reduce its financing costs, G&A and exploration costs. It also plans to start creating some value from its project pipeline, which is dominantly located in Australia. The largest is Mt. Isa. This has the potential to produce about 5 Mlb/year. Paladin may have to spread the risk of what could be a significant capital requirement at this project. Incidentally, it was just announced that Australia will open itself up and be allowed to sell uranium into India. That's definitely a positive event for Paladin. I think the next step is getting that uranium mining policy overturned in Queensland but that might have to wait for an election later in 2012.

TER: Back in mid-November Paladin was your top pick. Now Rockgate is your top pick?

DT: I would have to say Paladin would be my top pick of the producers. Rockgate would remain my top pick of the developers. I segregate them that way.

TER: I have enjoyed speaking with you, Dave. Thank you.

DT: Thank you very much.

Dundee Securities *Vice President and Senior Mining Analyst* ***David A. Talbot*** *worked for nine years as a geologist in the gold exploration industry in Northern Ontario. His field experience included three years with Placer Dome and six years managing projects for Franco-Nevada Corp. and its successor, Newmont Capital. Talbot joined Dundee's research department in May 2003; in the summer of 2007 he took over the role of analyzing the fast-growing uranium sector, and has since launched the lithium sector. He is a member of the Prospectors and Developers Association of Canada, the Society of Economic Geologists and graduated with distinction from the University of Western Ontario with an Honors Bachelor of Science degree in geology.*

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