

We see the nuclear industry and the uranium market as set for a revival. Following the disaster in Japan in March 2011, uranium prices have been depressed and nuclear-generated power has fallen out of political favour. Our view is that uranium miners leveraged towards an increasing uranium spot price will be ripe to take advantage of the revival which, in our view, is inevitable.

We recommend that investors have exposure to uranium stocks in expectation of the resurgence in nuclear-powered energy generation.

Our most preferred stock is Uranium Energy Corp. (UEC.US)

Fukushima and the impact of the disaster on the global nuclear arena

On 11th March 2011, a magnitude 9.03 earthquake struck off the coast of Japan, triggering a powerful tsunami that unleashed destruction along Japan's eastern coastline and caused a nuclear disaster at the Fukushima Dai-ichi Nuclear Power Plant, the largest nuclear disaster since the Chernobyl disaster in 1986. The resulting negative effect on the global outlook on nuclear energy has depressed the price of physical uranium – currently around two year lows of \$42.50 per lb. – and dragged the value of publicly traded uranium mining companies down with it. We believe that nuclear energy is likely to experience a resurgence over the medium-term as governments realise the environmental and cost efficiencies of nuclear power.

The global 'love-hate' relationship with nuclear

One only has to watch a James Bond movie or an episode of The Simpsons to understand popular opinion on nuclear energy; Bond villains are often trying to obtain highly enriched uranium to create a world-dominating nuclear weapon while The Simpsons portrays its town's decrepit nuclear power plant as an environmental disaster run by an aging megalomaniac. We have highlighted four clear examples of the global 'love-hate' relationship with nuclear which demonstrate the elastic nature of opinion:

Germany

Following the disaster in Fukushima, Germany immediately shut down eight of its 17 operating nuclear reactors and put plans in place to shut down the remaining nine by 2022. According to industry sources, the eight reactors shut down represented c.5% of global uranium consumption prior to Fukushima and the German utilities' disposition of large amounts of their inventory has helped the downward pressure on the price of uranium. These same industry sources expect German utilities to now sit on the majority of their inventory over the next few years as the chances of the policy taking a U-turn are highly likely – Germany's nuclear policy has switched back and forth between extension and shutdown five times since 1986.

However, Germany's economic activity is already being affected by increased energy costs associated with the mothballing of the nuclear reactors as its metals industry association, WVM, estimates that Germany's electricity costs are 50% higher than those faced by metals producers in France, Spain and Scandinavia. Such increases in energy prices have already taken their toll on industry in Germany as May 2012's insolvency of the aluminium producer Voerde Aluminium proved; the company cited rising electricity prices as a reason for its bankruptcy.

Somewhat ironically however, Germany is now importing nuclear-produced electricity from the Czech Republic, Holland and France having self-imposed its own energy shortfall.

Uranium Energy Corp.

Rating	BUY
Current Price	\$2.38
Target Price	\$7.00

Pre-Fukushima, Germany supplemented power deficits in France via their coal production plant but this energy is now being utilised domestically. Also, despite Germany touting itself as the poster child for alternative energy, it is currently constructing 25 new coal-fired power plants as concern grows over its increasing domestic electricity prices; political rhetoric claims that the country's new energy policy will emit less carbon dioxide than previously but research suggests that a new 2,200 MW coal-fired plant that was started in the summer of 2012 is actually 20 million times more pollutive than Germany's entire nuclear industry. Could this lead to yet another policy U-turn? We believe that it is not out of the realm of possibility.

Japan

In the wake of Fukushima, Japan shut down all of its nuclear reactors to undergo safety checks and in September 2012 announced that it would look to phase out the country's reliance on nuclear power by retiring all 50 of its operational reactors by 2040 and looking towards renewable methods of energy production. Unsurprisingly, the announcement was popular with the public yet distinctly unpopular with business leaders (where there are clear parallels drawn with the case outlined in 'Germany' above) and, in an abrupt turnaround, the Japanese government promptly stopped short of adopting this goal and said it would merely "take [the 2040 goal] into consideration". In our view, this move merely pushed the Japanese nuclear issue to the back burner.

As further evidence that Japanese nuclear energy could quite easily stage a comeback, the country recently struck a joint venture deal with Uzbekistan to secure uranium supplies for the coming decades. In our opinion, this is proof that the government is trying to hedge its bets by both trying to appease the electorate – who are 47% against nuclear power – and committing to its legacy nuclear energy strategy. Also, the recently set up Nuclear Regulation Authority (NRA) is in the process of implementing a strategy whereby nuclear reactors will only require approval at a local prefecture level with no need for a green light at federal level.

Although this may take a few months to work through, we believe that these signs collectively point towards a re-start of Japanese nuclear reactors at some point in 2013 which will be a major catalyst for the sector.

The number of reactors being built globally

As of writing, there are 62 nuclear reactors being built globally with 26 of those being built in China, ten in Russia, seven in India and one in Brazil. These emerging/developing market economies are one of the key drivers to nuclear energy as they seek a method by which to provide a reliable, cost efficient and environmentally responsible method to meet the increasing energy demands of their burgeoning economies. Despite the unfortunate events at Fukushima Dai-ichi, the resulting loss of momentum in the nuclear arena and the somewhat abrupt U-turns from Germany and Japan, the World Nuclear Association's current estimate of planned and potential reactors is actually higher than it was pre-Fukushima in April 2011.

What is perhaps the starkest endorsement of nuclear energy however, is the Middle East's drive for the power source. Saudi Arabia plans to construct 16 nuclear power reactors over the

The number of reactors being built globally signals that nuclear energy is not out for the count

next 20 years at a cost of more than US\$80 billion to provide a sixth of its power by 2032 and the United Arab Emirates has recently awarded contracts worth over \$2 billion to a conglomerate of companies to provide, convert and enrich uranium. We see this investment by two of the world's leading oil exporters as a particularly bullish sign for the energy source and the raw material used to power the reactors: uranium. Saudi Arabia in particular recognises that, by investing in nuclear, it can transform its economy by providing a cheaper source of power than is provided by fossil fuels; the kingdom is using increasing amounts of its own oil for domestic electricity generation which, in turn, saps revenue for the country as there is less crude for export.

The environmental implications of nuclear power

Despite popular misconceptions, nuclear energy is very much a clean source of power that does not use fossil fuels or add greenhouse gases to the atmosphere. Statistically, it also has a far better safety record than gas and coal-fired electricity generation and has a low risk of environmental hazards. The biggest problem associated with nuclear power – and the 'demon' seized upon by many countries' media – is the difficulty of disposal of the radioactive by-product of nuclear energy. Currently, we do not possess the technology to dispose of this waste and it has to be stored at the nuclear facilities that produce it. However, with global investment in nuclear power generation and the clear benefits associated with such energy production, an increasing amount of capital is being spent on researching methods of radioactive waste disposal. By comparison, a 1,000 MW coal-fired plant produces 1.5 million tons of highly toxic ash which is typically disposed of in shallow landfills that can easily affect water sources. In addition, there are significant quantities of carbon and sulphur dioxide released into the atmosphere. Nuclear energy is actually the only major industrial technology which has no gas, ash or smoke emissions.

The effectiveness of nuclear power versus other major technologies

When looking at the benefits of nuclear power, it is important to make comparisons with other available technologies. There are certain conceptual – and potentially very interesting – new methods of energy generation being researched which attempt to satisfy both the world's increasing demand for energy and the desire to reduce the carbon footprint of the global population. Nearly every one of these technologies is currently not economically viable as the cost of producing the power is just too high.

In terms of currently available energy sources, nuclear power is both commercially viable and relatively environmentally sound. Ignoring the difficulty of disposing of the radioactive by-product (as mentioned earlier), direct emissions from nuclear power plants are the lowest of any type of major power generation, with only hydro-power as a rival in terms of emissions. Emissions from natural gas and coal-fuelled power generation are 20 and 30 times higher respectively and, in terms of British Thermal Units, the equivalent amount of power generated by six barrels of uranium (U3O8) would take 220,000 barrels of oil to produce. Therefore, nuclear power is the most powerful and the cleanest base-load energy source available to us today. We see the lack of a sustained economic growth environment and cash-strapped

Six barrels of yellowcake uranium produces the same amount of energy as 220,000 barrels of oil

Western governments as unlikely to continue to support expensive research and development stage alternative energy projects and, as outlined earlier in this report, continue to invest in nuclear energy generation.

Our View: The perceived threat of shale gas

Recent reports have suggested that the boom in natural gas in the United States has the potential to make the country energy self-sufficient within the next 20 years to the detriment of nuclear power and, in turn, the uranium market. The reality is that it is still not clear that this is the case and, more importantly, the technical complications of drilling for shale gas are considerable. Much of this new production is a result of horizontal drilling and hydraulic fracturing which in itself is generating opposition from environmental groups who are concerned about the geological effects and the potential for water contamination as a result of the extensive use of chemicals in the 'fracking' process. Whether the aforementioned is an issue or not, it is clear to us that it is not a threat to the nuclear industry for a couple of reasons. Firstly, governments need to have a diversified energy mix and putting all their eggs in the fossil fuel basket is never going to be a realistic scenario. This is particularly true in the US where President Obama is openly pushing for increased use of alternative energy. Secondly, the world population is forecast to grow by c.30% to 10 billion people by 2050 and the International Energy Agency predicts that energy demand will grow by c.35% by 2035. The emerging markets are estimated to be a substantial part of this growth (China, India, Africa and the Middle East), as the growing middle classes demand the same standards as the Western world which, in turn, will create huge incremental demand for electricity.

The end of 2013 will see the supply of global uranium reduce by 13%

The end of the 'Megatons to Megawatts' programme

We see the ending of the Highly Enriched Uranium Agreement – the so-called 'Megatons to Megawatts' programme – as a catalyst for the acceleration of uranium prices and recommend investors have exposure to uranium stocks in expectation of this. The HEU Agreement was implemented in 1993 between the United States and Russia to down-blend highly enriched uranium from dismantled Soviet-era nuclear warheads to low enriched uranium to be used as nuclear fuel. The programme was to run for 20 years and will come to an end at the end of 2013 with no view for extension. The cost of down-blending uranium from these nuclear warheads now actually exceeds the cost of new mine production, hence we fully expect the agreement to terminate on schedule.

The end of the deal will see an immediate reduction in the total supply of uranium to the global market of c.13%, meaning end users will have to look to other sources for their supply – namely traditional uranium miners and producers. To put this in perspective, the deal has guaranteed US utilities access to supplies of down-blended HEU for the past 20 years and supplies 45% of the US's annual uranium requirements. Once this supply dries up, the 104 nuclear reactors in the US will need to seek alternative supplies of the 55 million lbs. of the fuel they consume each year; the US produces a mere 4 million lbs. per year. In addition, there are approximately 30 million lbs. of uncovered uranium requirements for 2015 on a global scale which we expect to see utilities wish to cover sooner rather than later – utilities tend to contract for 2-3 years

ahead of their requirements. Struck with such stark figures, the cease of supply from the Megatons to Megawatts programme should put upward pressure on uranium prices in the medium-term and, in turn, increase the revenues of uranium producers leveraged towards the changing prices of the material.

The outlook for the uranium market

With the increasing investment in nuclear energy in Asia and the Middle East and certain Western governments' see-sawing attitudes towards nuclear power, we see a key role for nuclear in the future electricity supply chain. With these factors putting upward pressure on uranium demand and the end of the Megatons to Megawatts programme putting downward pressure on supply, we are bullish on the current depressed price of uranium and see an initial push back towards the levels seen at the beginning of 2012. Before the Fukushima disaster, spot uranium was trading just above \$70 per lb. compared to the current spot price of c.\$42 per lb. Despite industry buyers placing purchase orders primarily through long-term price contracts (which are substantially above current levels), financial market participants continue to be fixated by the spot price, which, for certain larger producers, is actually irrelevant.

While the Fukushima disaster has had a negative short-term effect on the uranium market, at Prosdocimi we believe that the knock-on effects will eventually exacerbate the demand/supply deficit in the medium-term. The initial knee-jerk reaction of several governments was to either announce a 'phase out' of nuclear reactors, or a temporary halt to nuclear energy production to allow time for regulators and industry players to ascertain the true safety of their nuclear reactors. Spot uranium prices tumbled on the back of these announcements and uranium demand softened as a result of an immediate cessation of buying from Japanese and Chinese utilities; we fully expect this scenario to change in the coming quarters. Confidence in the marketplace was also eroded, subsequently causing many uranium mining projects to be shelved, sold or, in some cases, fail. Perhaps the most notable of these announcements was BHP Billiton delaying their uranium/copper expansion at Olympic Dam, which many expected to help contribute to the uranium demand/supply imbalance over the medium to long-term. However, even though the proposed expansion would have produced an extra 10 million lbs. of uranium per year, it would have been insufficient to replace the anticipated 2013 shortfall of 20 million lbs. In the summer of 2012, Cameco and Areva also delayed their respective projects in Australia and Namibia.

Out of favour but still in play...

Post-Fukushima, much of the planned nuclear expansion has been re-confirmed by the countries that represented the majority of the growth. Notably, Russia, China and India represent c.70% of global nuclear plant builds and they have all re-affirmed their nuclear strategy. Additionally, the UK has five new reactors planned while the United States recently approved four reactors for the first time in 34 years.

Uranium Energy Corp. (UEC.US)

Our most preferred stock for playing our uranium macro view

The company

Uranium Energy Corp is a US-based uranium production, development and exploration company with 100%-owned assets in the US – Texas and Arizona – and Paraguay. The company controls one of the largest databases of historic uranium exploration and development in the United States and, as a result, focuses its property acquisition programme primarily in the south and western states of Texas, Wyoming, New Mexico, Arizona, Colorado and Utah.

Asset highlights

UEC controls a portfolio of uranium projects in the Texas uranium belt which extends approximately 300 miles from east-central Texas to south Texas and is known to hold significant resources of uranium which are amenable to the low cost in-situ recovery (ISR) method of mining which UEC employs at all of its projects. The company has a 43-101 resource estimate of 58.8 million lbs. in the ground across its US assets and the Yuty project in Paraguay with a further estimate of between 23 and 56 million lbs. at its Oviedo projects. UEC also controls 23.2 million lbs. in the US in the historical resource category.

Palangana

The Palangana ISR project is UEC's first producing mine which, since production inception to 31st July 2012, has produced a total of 323,000 lbs. of uranium (U3O8). Its Production Area (PA-2) commenced production in March 2012 and continues to ramp up while PA-3 is due to commence operation by December 2012. Surface facilities, including roads, electrical utilities, pipeline infrastructure and well-control systems, are in place and initial core leach studies indicate encouraging recovery yields. The latest 43-101 for Palangana was filed on 23rd February 2010 and provides for a 'Measured and Indicated Resource Estimate' of 1,057,000 lbs. located in PA-1 and PA-2. An additional 1,154,000 lbs. of U3O8 is classified as an 'Inferred Resource Estimate' and is located in six new exploration zones:

Resource Estimates - Palangana Mine				
Resource Category	Cutoff GT	Tons	Grade % eU3O8	Pounds eU3O8*
M&I Resource	0.5	393,000	0.135	1,057,000
Inferred Resource	0.5	328,000	0.176	1,154,000
* Disequilibrium Factors Applied				
GT - is grade-thickness determined by multiplying the grade of mineralization expressed in percentage terms by mineralized thickness measured in feet.				

Goliad

Goliad represents what could possibly be UEC's second producing mine as it has received all of the required permits from the State of Texas and is currently awaiting the final piece of the jigsaw which is the federal government's Environmental Protection Agency's (EPA) stamp of approval on an aquifer exemption granted by the State of Texas; management still fully expects to get EPA approval by the end of 2012. Goliad has 6.9 million lbs. of 43-101-compliant resource in the ground and, with EPA approval, the asset is likely to be producing within 6-8 months which, when compared to other uranium projects, is a very short time to production.

The latest 43-101 for Goliad was filed on 7th March 2008 and provides for a 'Measured and Indicated Resource Estimate' of 5,475,200 lbs. of U3O8. An additional 11,501,400 lbs. is classified as an 'Inferred Resource Estimate'.

Resource Estimates - Goliad Project				
Resource Category	Cutoff GT	Tons	Grade eU3O8 %	Pounds eU3O8*
M&I Resource	0.3	3,790,600	0.05	5,475,200
Inferred Resource	0.3	1,547,500	0.05	1,501,400
* Disequilibrium Factors Applied				
GT - is grade-thickness determined by multiplying the grade of mineralization expressed in percentage terms by mineralized thickness measured in feet				

The Hobson Processing Plant

UEC's Hobson plant is a processing facility designed to process uranium-loaded resins into the final U3O8 product. Hobson has the capacity to process 3 million lbs. of uranium per year and is one of only five operating ISR processing plants in the United States. This means that UEC could effectively generate revenue for itself by charging competing uranium miners to utilise Hobson in its production process. Perhaps more importantly, the plant is central to all of UEC's projects in South Texas and is used as a central facility whereby loads from satellite projects are transported to Hobson for processing. Rather than having to build a new processing plant at each project, the company is able to keep its cost of production low by feeding this single processing plant from multiple locations. In a world where cost of production often holds the key to a mining company's success, this is strategically paramount.

Investment case

We see UEC as being ideally placed to take advantage of increasing uranium prices and we expect it to turn cash flow positive as it ramps up production at Palangana and begins to bring its portfolio of projects into production. The company has strategically positioned itself to take advantage of the demand/supply imbalance that exists globally and which looks set to intensify. There are currently 62 reactors under construction today with 80 new reactors due to be operating by 2021 and, as explored in the first half of this report, the increasing demand for cheap, efficient and low carbon-emitting energy generation is likely to see nuclear energy remain a staple source of electricity.

UEC's initial focus is on growing production and cash flow from its Texas operations and, in doing so, help bridge the US's domestic uranium supply gap. However, a key part of the company's long-term growth strategy revolves around developing their large land packages in Paraguay as UEC positions itself to take advantage of the global opportunity in uranium supply. The company operates a very low CAPEX method of production – Palangana needed a mere \$10 million of CAPEX to construct – which means that the company, with its strong cash position and no debt, would be able to extend production without having to raise any new capital.

A low-cost producer

To date, UEC has produced uranium at \$18 per lb. cash-cost, which makes it one of the lowest cost producing assets globally. UEC production is un-hedged which, at present, is a short-term negative as the company is forced to sell its uranium in a depressed spot market. Competitors are typically selling their production based on long-term contracts, fetching prices above \$60 per lb. As and when Goliad is approved by the EPA, we believe that UEC will be able to enter similar long-term pricing contracts which will give it an immediate pricing lift of approximately 50%. In the meantime, we view UEC as the most highly-leveraged producer to potential spikes in the spot market as the market starts to understand the demand/supply dynamics of the sector.

We see Uranium Energy Corp. as significantly undervalued and a particularly attractive investment opportunity for exposure to our bullish stance on the uranium market.



Uranium Energy Corp.

Rating	BUY
Current Price	\$2.38
Target Price	\$7.00

Earnings potential

In our view, UEC's stock is currently trading at a significant discount to its intrinsic value. At c.\$2.35 per share, the market is giving UEC zero credit for any increase in production that the company can achieve and is merely using a low price per lb. of resource in the ground calculation to value the company. We see UEC's earnings potential and derive our price targets from very achievable forecasts.

Current valuation

UEC has a total of 82 million lbs. of 43-101-compliant resource in the ground across all of its assets. The market values uranium resource in the ground of non-producing uranium explorers at between \$2.50 and \$3.00 per lb., giving UEC a \$2.40 to \$2.90 per share value before deducting cash. We see the mistake of this valuation as a lack of credit for the fact that UEC is *not* merely an explorer, it is a **producer**. At a production level, companies are valued by the market at between \$4.50 and \$5.00 per lb. for resource in the ground. Even on this basis and not taking into account any kind of earnings multiple, UEC's value could be as high \$4.80.

Base case

If we look more closely at UEC's earnings potential, the company, even on a conservative basis, presents a strong 18-24 month investment case. We expect UEC's 2013 annual production to be c.300,000 lbs. of uranium and c.700,000 lbs in 2014. By the end of 2014, we see the company producing an annualised 1 million lbs. of uranium. Using this 1 million lbs. annualised production figure and what we see as a base case average uranium forward contract price of \$60 per lb., UEC's 2015 EBITDA should be c.\$55 million.

Historically, the market assigns a sector earnings multiple of around 8x earnings. Therefore, in our base case scenario, we would expect to see Uranium Energy Corp. trading at c.\$5.16 by the end of 2013.

Bull case

Being slightly more bullish – but in no way unreasonable – we anticipate UEC to achieve production of at least 1 million lbs. by 2015 annualised. Using a slightly increased average uranium forward contract price of \$80 per lb. would put the company on EBITDA of \$75 million and, with the same 8x multiple as in our base case, would see UEC at a fair value of c.\$7.00 per share. We anticipate this price target being achieved during 2014.

Conclusion

Uranium Energy Corp. is ideally placed to benefit from a rally in uranium prices which we see beginning during 2013. We firmly believe in the company's strong management and technical team and we are extremely positive on their production and, in turn, earnings potential. With its attractive portfolio of assets and its low CAPEX in-situ recovery mining process, we see UEC as being fully able to achieve our bull case price target of \$7.00 in 2014.