Desjardins Capital Markets

MorningPulse

Cameco Corporation (CCO C$23.17, TSX/CCJ US$23.13, NYSE)

4Q11 sales come through; maintaining Buy recommendation and C$38.40/share target

John Hughes	(416) 607-3021	john.hughes@vmd.desjardins.com
Aleem Ladak, Associate	(416) 607-3080	aleem.ladak@vmd.desjardins.com
Paul Medici, Associate	(416) 607-3027	paul.medici@vmd.desjardins.com

Highlights

4Q11 results—sales volumes pick up in the quarter. Cameco sold 13.8m lbs U3O8 in 4Q11, up 52% yoy and 92% qoq; the large increase was due to the ability of customers to decide when to take delivery—and thus make payment—for material produced during the year. We would note that quarterly sales volumes for Cameco fluctuate throughout the year. During 4Q11, uranium production totalled 6.6m lbs U3O8 compared with the sales volume of 13.8m lbs U3O8. The majority of the 7.2m-lb decline was due to sales of high-margin product vs purchased uranium inventory. This inventory 'flush' provided a higher average realized uranium price of US$52.09/lb during 4Q11 compared with US$47.33/lb in 3Q11, and was the driver behind higher-than-expected earnings.

Cigar Lake 2013 production revised down. As a result of lower grades and a more cautious approach to mine development, Cameco has reduced its 2013 production estimate for the Cigar Lake operation down to 0.3m lbs U3O8 from its previous estimate of 1.0m lbs U3O8. The achievement of commercial production has shifted closer to our expected timeframe of 2014.

Highly enriched uranium (HEU) agreement—two full years left. Cameco reiterated its belief that ~24m lbs U3O8 (~15% of annual world production) would 'disappear' from the market after 2013 as the HEU agreement between the US and Russia expires. We note that most utilities have their uranium requirements covered until 2017. Nevertheless, we agree with Cameco's management that volatility in uranium prices would increase with time as the end of 2012 approaches.

Valuation

Our C$38.40/share target price is obtained by applying a 1.25x NAV multiple to our unchanged NAV estimate of C$30.70/share, utilizing a long-term uranium price of US$60/lb. Our valuation assumes Cigar Lakes production begins in 2014, which now appears more certain given the expectation that only 0.3m lbs U3O8 will be produced from the operation in 2013.

Recommendation

We rate the shares of Cameco Buy–Average Risk with a C$38.40/share target price.

Cameco Corporation

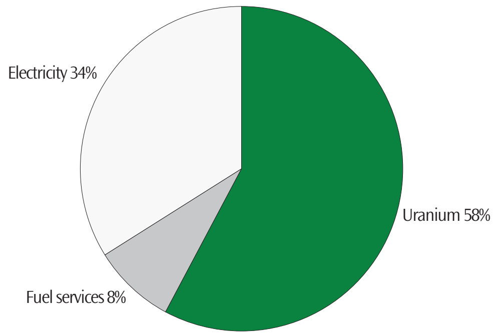
Rating		Buy–Average Risk
Target		C$38.40
Symbol		CCO, CCJ
Exchange		TSX, NYSE
Closing price		C$23.17, US$23.13
Potential return		67%
52-week range		C$17.25–44.28
Shares O/S		403.4m
Market cap		C$9,347m
Year-end		Dec-31
Revenue	**2012E**	C$2,395m
	2013F	C$2,550m
EPS	**2012E**	C$1.45
	2013F	C$1.55
P/E	**2012E**	16.0x
	2013F	14.9x
Book value/sh		C$12.66
Debt/debt+equity		34.6%
Dividend		C$0.40
Dividend yield		1.7%
Quarterly data		
EPS 1Q12E	**Desjardins**	C$0.30
	Consensus	C$0.31
EPS 1Q11A		C$0.48

Source: Desjardins Capital Markets

4Q11 operational review

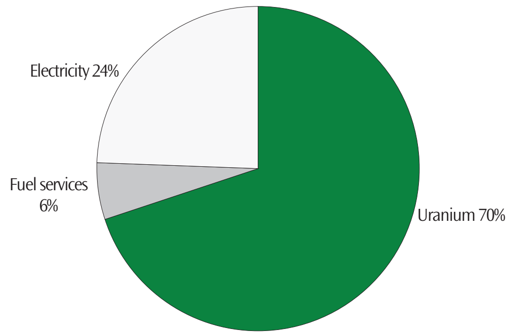
Cameco's uranium operations provided 70% of its gross profit and 58% of its revenue in 4Q11 (see Exhibits 1a and 1b).

Exhibit 1a: 4Q11 segmented revenue contribution



Source: Desjardins Capital Markets, company reports

Exhibit 1b: 4Q11 segmented gross profit contribution



Source: Desjardins Capital Markets, company reports

Uranium business segment—70% of 4Q11 gross profit. Production of U3O8 during 4Q11 reached 6.6m lbs U3O8, up 25% qoq and 3% yoy due to higher production levels at Rabbit Lake and Inkai (se Exhibit 2). Sales reached an impressive 13.8m lbs U3O8, up 92% qoq and 52% yoy. However, Cameco has reduced its 2012 production estimate to 21.7m lbs U3O8 (from 22.0m lbs U3O8).

Exhibit 2: Uranium production by mine

Year-end Dec-31 (m lbs U3O8)	4Q11	3Q11	4Q10	2012 objective
McArthur River/Key Lake	3.9	3.8	4.0	13.1
Rabbit Lake	1.6	0.5	1.3	3.7
Smith Ranch/Highland	0.2	0.3	0.4	2.4
Crow Butte	0.2	0.2	0.2	
Inkai	0.7	0.5	0.5	2.5
Total	**6.6**	**5.3**	**6.4**	**21.7**

Source: Desjardins Capital Markets, company reports

At the McArthur River mine, the extension project is underway and exploration drifts have been advanced to zones A and B, with resources in zone B upgraded to indicated resources. Feasibility work on the extension has been advanced thus far through 2012. The environmental impact study for the Key Lake extension is being drafted as part of the environmental assessment process; during 2012, the company intends to flatten the slope of the pitwalls at the Deilmann tailings management facility as part of the Key Lake extension project and to advance the environmental assessment for submission in 2Q12.

At the Inkai mine, the expansion of existing capacity at the satellite plant is being planned such that it can support a production rate of 5.2m lbs/yr U3O8 from lower grade well solutions. Regulatory approval will be required. Inkai has already received government approval to increase annual production at Blocks 1 and 2 to a capacity of 3.9m lbs/yr U3O8. An MOA has been signed with Kazatomprom to increase production from Blocks 1 and 2 to 5.2m lbs/yr U3O8. Government approval, an amendment to the resource-use contract and a binding agreement finalizing the terms of the MOA will now be needed to implement the increase.

As can be see below in Exhibit 3, Cameco's progress toward doubling its uranium production is on track.

Exhibit 3: Uranium production outlook

Year-end Dec-31 (m lbs U3O8)	2011	2012E	2013E	2014E	2015E	2016E
McArthur River/Key Lake	13.9	13.1	13.1	13.1	13.1	13.1
Rabbit Lake	3.8	3.7	3.7	3.7	3.7	3.4
US ISR	2.3	2.4	3.0	3.1	3.7	3.8
Inkai	2.5	2.6	3.0	3.0	3.0	3.0
Cigar Lake	-	-	0.3	1.9	5.5	7.9
Total	**22.8**	**21.8**	**23.1**	**24.8**	**29.0**	**31.2**

Source: Desjardins Capital Markets, company reports

Earnings sensitivity to changing uranium prices in 2012. During 2012, a change of US$5.00/lb in the uranium spot price would change revenue by C$68m and net earnings by C$55m (C$0.14/share). Cameco's expected realized uranium price as a function of the spot price is shown below in Exhibit 4.

Exhibit 4: Sensitivity of Cameco's expected realized uranium price (constant volumes) under various spot price assumptions

	Spot uranium price													
	US$20/lb		US$40/lb		US$60/lb		US$80/lb		US$100/lb		US$120/lb		US$140/lb	
	US$	%	US$	%	US$	%	US$	%	US$	%	US$	%	US$	%
2012E	38	190	42	105	50	83	57	71	66	66	74	62	81	58
2013E	43	215	46	115	54	90	62	78	71	71	80	67	88	63
2014E	45	225	48	120	56	93	65	81	74	74	83	69	91	65
2015E	43	215	47	118	56	93	66	83	77	77	87	73	97	69
2016E	45	225	50	125	58	97	68	85	78	78	88	73	97	69

Source: Desjardins Capital Markets, company reports

Cigar Lake update. Cameco is yet to spend C$484m (of its 50% share in the operation) to complete the Cigar Lake project. Approximately C$429m should be allocated as capital costs and C$55m as operating costs. During 2012, Cameco expects to finish sinking shaft 2 to the 500-metre level, begin installing infrastructure for shaft 2 (ventilation, electrical cable, water services, etc) and complete the surface ore load-out facility. Additional work scheduled includes resumption of underground development, completion of the Seru Bay pipelines, finalization of the engineering designs and construction of the clarifier. The company expects to file a new technical report at the end of February 2012, which will update the March 2010 technical report and incorporate the impact of the new milling agreement with the McLean Lake mill. Highlights of the technical report follow:

- A decrease in the unit average cash operating cost to US$18.60/lb produced from the previous estimate of US23.10/lb, primarily due to the new milling agreement
- An increase of C$190m in Cameco's share of estimated capital costs at completion, driven by a new surface freeze strategy, general cost escalation, costs to upgrade and expand the McClean Lake mill, and improvements to the mine plan
- A change in the production plan that will result in lower grades in the initial production panels, which has reduced the 2013 production estimate to 0.3m lbs U3O8 (from 1.0m lbs U3O8)
- Full production being reached in 2016
- A 4% increase in Cameco's share of the mineral reserves to 108.4m lbs U3O8 (from 104.7m lbs U3O8)

Fuel services—8% of 4Q11 gross profit. Production reached 3.1m kgU during the quarter, up 11% qoq and down 21 yoy. As a result of the unfavourable market conditions for UF6, Cameco has discontinued discussions to extend its toll conversion contract with Springfields Fuels Ltd. beyond 2016. In 2012, Cameco estimates it will produce 13–14m kgU, with sales volumes and revenue decreasing 10–15%.

Electricity—34% of 4Q11 gross profit. The Bruce Power Limited Partnership produced 24.9TWh (Cameco's share ~7.9TWh), up 17% qoq and down 5% yoy. The capacity factor at the plant reached 87%, down from 93% in 3Q11 and 91% in 4Q10. In 2012, the partnership expects to achieve a capacity factor of 95%, as well as a 5–10% increase in revenue and a 5–10% decrease in the unit costs of sales.

Exhibit 5: Cameco's 4Q11 financial and operational performance

Year-end Dec-31	4Q11	3Q11	4Q10
Physicals			
Uranium production (m lbs U3O8)	6.6	5.3	6.4
Uranium sales (m lbs U3O8)	13.8	7.2	9.1
Uranium fuel production (m kgU UF6)	3.1	2.8	3.9
Uranium fuel sales (m kgU UF_6)	7.2	4.6	6.3
Electricity output (TWh)	7.9	6.7	8.3
Capacity factor (%)	87	93	91
Financials			
Average UxC uranium spot price (US$/lb)	53	52	57
Uranium revenue (C$m)	731	332	457
Uranium gross profit (C$m)	314	133	189
Uranium fuel revenue (C$m)	106	81	91
Uranium fuel gross profit (C$m)	25	10	13
Electricity revenue (31.6% of BPLP) (C$m)	428	114	477
Electricity gross profit (31.6% of BPLP) (C$m)	110	41	189
Total revenue (C$m)	977	527	673
EBITDA (C$m)	414	93	279
EBITDA margin (%)	42.4	17.7	41.5

Source: Desjardins Capital Markets, company reports