

# CAMECO CORPORATION

## Earnings warning due to forex losses; 2017 cost cutting measures announced

### EVENT

Cameco has announced preliminary FY/16 expectations along with operational changes for 2017.

### BOTTOM LINE

**Negative** – Cameco warned that there is a “significant discrepancy” between consensus adjusted earnings estimates and company expectations, which are lower. Full financial details will be disclosed on February 9, 2017. While negative for Cameco specifically, this news should not impact the recent change in fundamentals that have been driving uranium equity values higher. However as the global bellwether, it may cast a shadow over the space that may reverse the upward momentum. We are maintaining our Buy recommendation and target price of \$17.10/share.

### FOCUS POINTS

- **Consensus too high** – Cameco expects adjusted net earnings to be significantly below those of analyst expectations. FY/16 consensus revenue estimates were \$2.4B, with adjusted earnings of \$273M, or \$0.69/share. Our estimates for the year were for \$2.5B in revenues and \$260M for adjusted earnings, or \$0.51/share.
- **Forex Hedge Contracts** – The variance between the street’s estimates and Cameco’s expected numbers can be traced to foreign exchange contracts. These contracts were not fully factored into estimates and Cameco has committed to providing additional disclosure to close this knowledge gap.
- **Further operational changes in 2017** – The workforce at McArthur River, Key Lake and Cigar Lake is expected to be reduced by approximately 10%. These changes are not expected to impact production in FY/17.

### Recommendation:

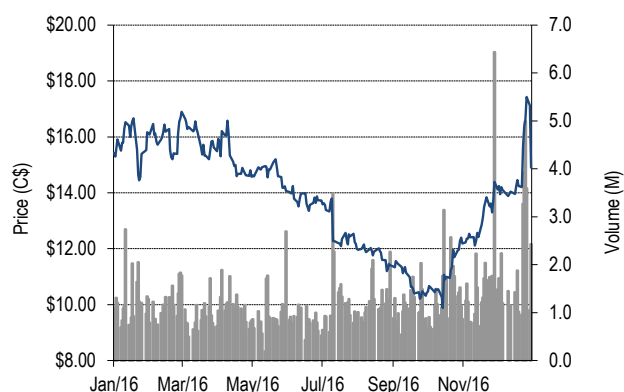
### BUY

Symbol/Exchange:	CCO/TSX; CCJ/NYSE
Sector:	Metals and Mining
<i>All dollar values in C\$ unless otherwise noted.</i>	
Current price	\$14.39; US\$10.84
One year target:	C\$17.10
Return to target	19%
Market Capitalization	\$5.7B
Cash on hand	\$199M
Yield	2.8%

### Company Summary

Shares O/S (M)	395.8	52-week range	\$9.88-	17.43
Market cap (\$M)	\$5,695.5	Avg. weekly vol. (000)	6.138	
Market float (\$M)	\$5,689.8	Fiscal year-end	31-Dec	
	<b>2015A</b>	<b>2016E</b>	<b>2017E</b>	<b>2018E</b>
Uranium Production (M lbs)	28.4	26.1	25.8	27.5
Revenue (\$M)	2,754.4	2,468.4	2,373.8	2,876.6
Operating Cost (\$M)	2,057.3	1,991.6	1,926.4	2,087.0
Avg Cost (US\$/lb)	\$33.85	\$23.53	\$18.99	\$21.17
EBITDA (\$M)	775.9	599.3	553.4	913.1
EPS	\$0.86	\$0.09	\$0.22	\$0.91
CFPS	\$1.29	\$0.55	\$1.41	\$2.30

Source: Company Reports and Cantor Fitzgerald Estimates



**Company profile:** Cameco Corporation is a world leader in uranium mining and processing, with additional exposure to fuel trading. Cameco’s uranium mines and projects are situated predominantly in Canada, U.S., Kazakhstan, and Australia.

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See disclosure and a description of our recommendation structure at the end of this report.

## CAMECO WARNS THAT ANALYST EXPECTATIONS ARE TOO HIGH

Cameco specifically stated that there is a “significant discrepancy” between consensus adjusted earnings estimates and company expectations, which are lower. However the company further noted that guidance included in the 2016 Outlook table, which is updated quarterly, was not expected to change materially.

### Exhibit 1. 2016 Financial Outlook as from the Q3/16 financials

	CONSOLIDATED	URANIUM	FUEL SERVICES	NUKEM
Production	-	25.8 million lbs	8 to 9 million kgU	-
Delivery volume <sup>1</sup>	-	30 to 32 million lbs <sup>2</sup>	Decrease up to 5%	7 to 8 million lbs U <sub>3</sub> O <sub>8</sub>
Revenue compared to 2015 <sup>3</sup>	Decrease 10% to 15%	Decrease 5% to 10% <sup>4</sup>	Increase up to 5%	Decrease 20% to 25%
Average unit cost of sales (including D&A)	-	Increase up to 5% <sup>5</sup>	Increase 5% to 10%	-
Direct administration costs compared to 2015 <sup>6</sup>	Increase 10% to 15%	-	-	-
Gross profit	-	-	-	Gross profit 1% to 2% <sup>7</sup>
Exploration costs compared to 2015	-	Increase 15% to 20%	-	-
Tax rate <sup>8</sup>	Recovery of > 200%	-	-	-
Capital expenditures	\$245 million	-	-	-

<sup>1</sup> Our 2016 outlook for delivery volume does not include sales between our uranium, fuel services and NUKEM segments.

<sup>2</sup> Our uranium delivery volume is based on the volumes we currently have commitments to deliver under contract in 2016.

<sup>3</sup> For comparison of our 2016 outlook and 2015 results for revenue, we do not include sales between our uranium, fuel services and NUKEM segments.

<sup>4</sup> Based on a uranium spot price of \$18.75 (US) per pound (the Ux spot price as of October 31, 2016), a long-term price indicator of \$36.00 (US) per pound (the Ux long-term indicator on October 31, 2016) and an exchange rate of \$1.00 (US) for \$1.30 (Cdn).

<sup>5</sup> This increase is based on the unit cost of sale for produced material and committed long-term purchases. If we make discretionary purchases in the remainder of 2016, then we expect the overall unit cost of sales could be different.

<sup>6</sup> Direct administration costs do not include stock-based compensation expenses. See page 9 for more information.

<sup>7</sup> NUKEM gross profit is net of inventory write-downs.

<sup>8</sup> Our outlook for the tax rate is based on adjusted net earnings.

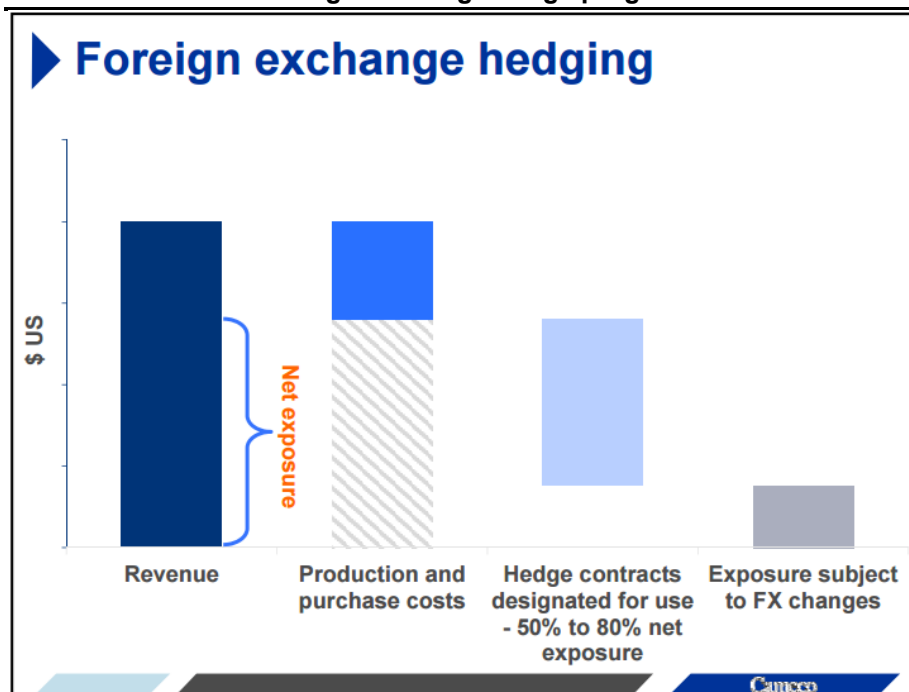
Source: Cameco

Through conversations with management, it is believed the variance between consensus estimates and Cameco’s expected performance lies in the foreign exchange hedge program.

## FOREX IMPACT ON EARNINGS

Cameco routinely hedges foreign exchange risk in its contract sales portfolio by hedging 50%-80% of the net US dollar exposure it has. This was illustrated in the company’s investor day last November (see exhibit 2). The program involves the layering of contracts over a three year period with effective rates that Cameco has committed to disclosing beginning with its Q4/16 financials. As a result, the street was not fully factoring in the impact of the hedge book in its estimates, however Cameco has noted that it will provide detailed disclosure for the hedge portfolio on a go forward basis.

**Exhibit 2. Cameco’s foreign exchange hedge program**



Source: Cameco

After several discussions with management, we have adjusted our estimates as follows:

**Exhibit 3. CCO - Revenue and adjusted earnings forecast**

C	Q4/16		FY/16	
	New	Previous	New	Previous
Revenues (\$M)	924.1	994.1	2,468.4	2,538.0
Adjusted Earnings (\$M)	-17.5	206.4	36.3	275.5
EPS	-\$0.04	\$0.51	\$0.09	\$0.64

Source: Cantor Fitzgerald Canada Research

The dramatic change in adjusted earnings is attributed to adding a \$73.6M loss on derivatives to our forecast for Q4/16. To arrive at this figure, we took our revenue estimate and subtracted US operations costs and USD denominated uranium purchases to arrive at a net USD exposure amount. We then assumed that Cameco hedged 50% of this amount (the stated range is 50%-80%) and applied the difference between an effective hedge rate and the year-end USD/CAD exchange rate of 1.3441.

The effective hedge rate was determined using information garnered from Cameco’s investor day in November. That event revealed that the effective rate would be a blend of the USD/CAD rates in the preceding three years with the weight of each year increasing the closer it was to the year it is applied (2016).

**Exhibit 4. Estimated effective USD/CAD hedge rate**

Year	Avg. USD/CAD rate	Weight	Weighted Avg.
2013	1.030	20%	0.206
2014	1.100	30%	0.330
2015	1.280	50%	0.640
Effective Rate			1.176

*Source: Cantor Fitzgerald Canada Research*

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With a net exposure of \$875.1M and a 50% hedge rate, the -0.1681 difference between the effective hedge rate and the year-end USD/CAD rate equates to a derivative loss of \$73.6M.

## **SALES AND REALIZED PRICE WITHIN GUIDANCE**

As expected, during FY/16 a total of 31.5M lbs. of uranium were delivered at an average realized price of C\$54.46/lb. This translates into Q4/16 sales of 11.7M lbs at an average price of \$50.55/lb. (or US\$37.87/lb). The resulting revenue of \$1.7B in revenue is 8% lower than 2015 and within the 5%-10% guidance range provided by Cameco. We were previously expecting sales of 12.2M lbs at an average price of US\$40/lb.

## **IMPAIRMENTS LEAVE THEIR MARK**

Total impairments to adjusted earnings to arrive at IFRS earnings are expected to be approximately \$180M-\$220M after-tax (\$0.45-\$0.56 per share).

The costs of suspending Rabbit Lake, the curtailment of U.S. operations, a collaboration agreement with aboriginal communities, various restructuring costs, and increased legal costs pertaining to the on-going dispute with the Canadian Revenue Agency are expected to account for \$120M. This cost will be partially offset by the \$59M of additional income generated by the termination of two supply contracts in Q3/16.

## **2017 OPERATIONAL CHANGES**

In terms of operational changes, for 2017 the workforce at McArthur River, Key Lake and Cigar Lake is expected to be reduced by approximately 10% (a total of 120 employees). These changes are not expected to impact production in 2017.

The air commuter service used to transport workers to the various sites in Saskatchewan will be changed to reduce costs. Work schedules will also be made to further garner savings. We have reduced our cost expectations for McArthur River and Cigar Lake by 4% to account for these savings.

Production at Inkai (Cameco's share being 3.3M lbs. in FY/16) is expected to drop by almost 10% to 3.1M lbs U<sub>3</sub>O<sub>8</sub> in 2017. This change in production was expected and is in line with the 10% decline in production announced by Kazatomprom recently (Inkai is a 50/50 joint venture between Cameco and Kazatomprom).

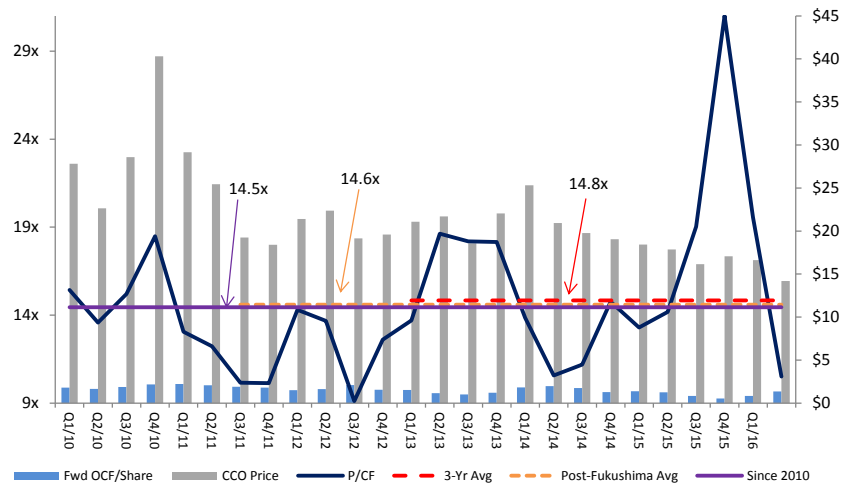
## **RECOMMENDATION AND VALUATION**

We are maintaining our Buy recommendation and are holding our target price at \$17.10/share. While we typically revise our target prices as our forward price to cash flow methodology rolls into a new period, we are holding back on this until we get the increased disclosure regarding derivative contracts so that they may be applied into upcoming years.

Ultimately, yesterday’s news should not impact the fundamentals that have recently been driving the uranium equity market higher but since it comes from Cameco, it may cast a shadow over the space. Full financial details will be disclosed on February 9, 2017.

Note that historically, Cameco has traded at an average multiple of 14.5x-14.8x with 14.6x being the average post-Fukushima. As of the end of Q4/16, CCO traded at a 10.0x multiple to our revised forward cash flow estimate.

**Exhibit 5. Historical Price to Forward Cash Flow**



Source: Cantor Fitzgerald Canada Research

**Exhibit 6. Cameco NAV**

Projects	Cameco Corporation		Comment
	NAV (\$C Millions) Per Share		
Uranium, Fuel Services, and Nukem Divisions	5,266.5	\$13.31	2017 DCF @ 8% Discount Rate
Wheeler River/Millennium/Kintyre	1,439.5	\$3.64	In-Situ Valuations
UEX Corp.	10.6	\$0.03	22.58% Ownership at a 20% discount
Working Capital	1,506.6	\$3.81	Q3/16 Financials
<b>Total</b>	<b>8,223.2</b>	<b>\$20.78</b>	

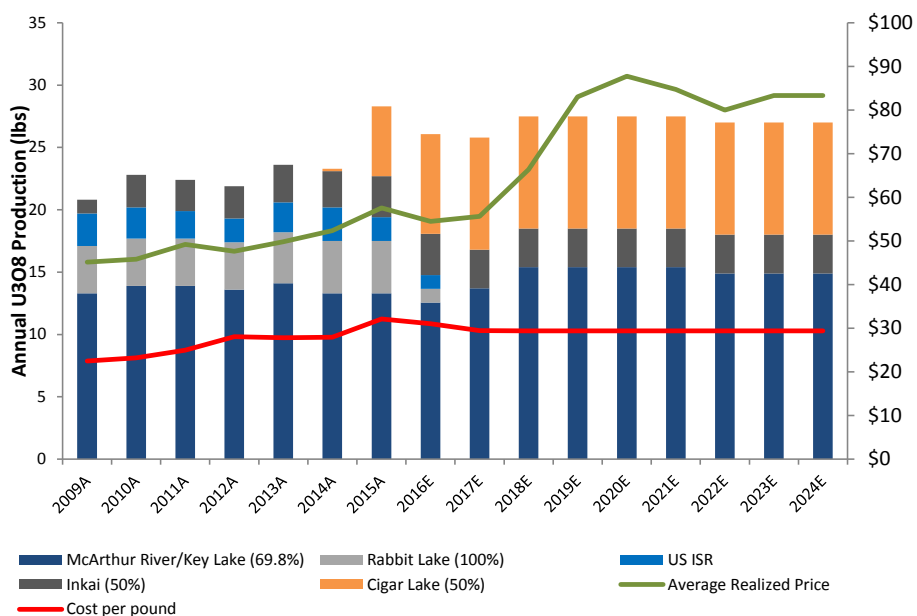
Source: Cantor Fitzgerald Canada Research

**Exhibit 7. Uranium Price History and Forecast**

	2013A	2014A	2015A	2016A	2017E	2018E	2019E	2020E
U3O8 Price	\$38.17	\$33.21	\$36.55	\$26.41	\$28.63	\$45.00	\$66.25	\$80.00

Source: Cantor Fitzgerald Canada Research and TradeTech

**Exhibit 8. Uranium Production, Realized Price and Cost Profile**



Source: Cantor Fitzgerald Canada Research

## APPENDIX A: FINANCIAL STATEMENT ANALYSIS

### Exhibit 9. Cash Flow Analysis

*In C\$ 000s	2014A	2015A	2016E	2017E	2018E	2019E
<b>Cash Flows from Operations</b>						
Net Income	183,413	63,362	67,695	87,644	360,693	783,316
Adjustments	296,769	386,648	133,143	482,599	569,291	658,417
	<b>480,182</b>	<b>450,010</b>	<b>200,838</b>	<b>570,243</b>	<b>929,984</b>	<b>1,441,733</b>
<b>Cash Flows from Investments</b>						
Additions to property, plant & equipment	-480,108	-358,562	-245,000	-300,000	-250,000	-227,250
Other	459,366	17,775	-234	0	0	0
	<b>-20,742</b>	<b>-340,787</b>	<b>-245,234</b>	<b>-300,000</b>	<b>-250,000</b>	<b>-227,250</b>
<b>Cash Flows from Financings</b>						
Change in Debt	145,430	-10	25,988	0	0	-496,152
Issuance of Shares/Stock Option Plan	6,228	0	0	0	0	0
Other	-235,550	-227,820	-208,114	-158,317	-158,317	-158,317
	<b>-83,892</b>	<b>-227,830</b>	<b>-182,126</b>	<b>-158,317</b>	<b>-158,317</b>	<b>-654,469</b>
<b>Net Change in Cash</b>	<b>375,548</b>	<b>-118,607</b>	<b>-226,522</b>	<b>111,926</b>	<b>521,667</b>	<b>560,014</b>

Source: Cameco Corporation, Cantor Fitzgerald Canada Estimates

### Exhibit 10. Balance Sheet Analysis

*In C\$ 000s	2014A	2015A	2016E	2017E	2018E	2019E
<b>Current Assets</b>						
Cash & Equivalents	566,583	458,604	225,829	337,755	859,422	1,419,436
Other	1,501,123	1,725,361	1,724,408	1,724,408	1,724,408	1,724,408
	<b>2,067,706</b>	<b>2,183,965</b>	<b>1,950,237</b>	<b>2,062,163</b>	<b>2,583,830</b>	<b>3,143,844</b>
<b>Fixed Assets</b>						
Property, Plant and Equipment	5,291,021	5,228,160	5,049,728	4,972,928	4,826,578	4,657,478
Other	1,113,940	1,382,512	1,494,964	1,494,964	1,494,964	1,494,964
	<b>6,404,961</b>	<b>6,610,672</b>	<b>6,544,692</b>	<b>6,467,892</b>	<b>6,321,542</b>	<b>6,152,442</b>
<b>Total Assets</b>	<b>8,472,667</b>	<b>8,794,637</b>	<b>8,494,929</b>	<b>8,530,055</b>	<b>8,905,372</b>	<b>9,296,286</b>
<b>Current Liabilities</b>						
Accounts Payable	316,258	317,856	221,119	221,119	221,119	221,119
Other	199,556	353,781	196,042	196,042	196,042	196,042
	<b>515,814</b>	<b>671,637</b>	<b>417,161</b>	<b>417,161</b>	<b>417,161</b>	<b>417,161</b>
<b>Non-Current Liabilities</b>						
Long Term Debt	1,491,198	1,492,237	1,493,045	1,493,045	1,493,045	996,893
Other	1,021,851	1,085,484	1,150,180	1,150,180	1,150,180	1,150,180
	<b>2,513,049</b>	<b>2,577,721</b>	<b>2,643,225</b>	<b>2,643,225</b>	<b>2,643,225</b>	<b>2,147,073</b>
<b>Shareholders' Equity</b>						
Share Capital	1,862,646	1,862,646	1,862,646	1,862,646	1,862,646	1,862,646
Other	3,581,158	3,682,633	3,571,897	3,607,023	3,982,340	4,869,406
	<b>5,443,804</b>	<b>5,545,279</b>	<b>5,434,543</b>	<b>5,469,669</b>	<b>5,844,986</b>	<b>6,732,052</b>
<b>Total Liabilities and Equity</b>	<b>8,472,667</b>	<b>8,794,637</b>	<b>8,494,929</b>	<b>8,530,055</b>	<b>8,905,372</b>	<b>9,296,286</b>

Source: Cameco Corporation, Cantor Fitzgerald Canada Estimates

### Exhibit 11. Profit and Loss Analysis

*In C\$ 000s	2014A	2015A	2016E	2017E	2018E	2019E
Revenue	2,397,532	2,754,378	2,468,440	2,373,843	2,876,606	3,510,041
Operating Expenses	1,420,768	1,744,815	1,600,281	1,549,581	1,690,611	1,810,286
Depreciation	338,983	312,518	391,296	376,800	396,350	396,350
<b>Gross Profit</b>	<b>637,781</b>	<b>697,045</b>	<b>476,863</b>	<b>447,462</b>	<b>789,645</b>	<b>1,303,405</b>
Exploration	46,565	40,259	48,311	48,311	48,311	48,311
Other	552,884	411,211	347,672	222,561	224,553	226,564
<b>Earnings from Operations</b>	<b>38,332</b>	<b>245,575</b>	<b>80,880</b>	<b>176,590</b>	<b>516,781</b>	<b>1,028,530</b>
Finance Cost	-77,122	-103,615	-102,729	-69,293	-69,293	-57,979
Other	-80,308	-221,228	44,414	2,258	3,378	8,594
<b>EBT</b>	<b>-119,098</b>	<b>-79,268</b>	<b>22,565</b>	<b>109,555</b>	<b>450,866</b>	<b>979,145</b>
Tax	-175,268	-142,630	-45,130	21,911	90,173	195,829
<b>Net Income</b>	<b>56,170</b>	<b>63,362</b>	<b>67,695</b>	<b>87,644</b>	<b>360,693</b>	<b>783,316</b>
<b>EPS</b>	<b>1.04</b>	<b>0.86</b>	<b>0.09</b>	<b>0.22</b>	<b>0.91</b>	<b>1.98</b>

Source: Cameco Corporation, Cantor Fitzgerald Canada Estimates

**APPENDIX B: RESOURCE INVENTORY**

**Exhibit 12. Cameco Global Resource & Reserve Inventory**

Property	Mining Method	Proven & Probable			Measured & Indicated				Inferred			Totals
		Tonnes (x1000)	% U3O8	lbs (M) U3O8 Attributable	Tonnes (x1000)	% U3O8	lbs (M) U3O8 Attributable	Tonnes (x1000)	% U3O8	lbs (M) U3O8 Attributable	Global lbs (M) Attributable	
McArthur River	underground	1,395.1	10.94	234.9	66.8	3.77	3.9	344.2	7.72	40.9	279.7	
Cigar Lake	underground	601.8	16.70	110.9	20.2	7.39	1.6	284.7	16.43	51.6	164.1	
Rabbit Lake	underground	913.5	0.59	11.9	1,402.7	0.86	26.7	2,645.6	0.57	33.7	72.3	
Key Lake	open pit	61.1	0.52	0.6							0.6	
Millennium	underground				1,442.6	2.39	53.0	412.4	3.19	20.2	73.2	
Wheeler River	underground				166.4	19.13	21.1	842.5	2.38	13.2	34.3	
Fox Lake	underground							386.7	7.99	53.3	53.3	
Tamarack	underground				183.8	4.42	10.3	45.6	1.02	0.6	10.9	
<b>Athabasca Basin</b>		<b>2,971.5</b>		<b>358.3</b>	<b>3,282.5</b>		<b>116.6</b>	<b>4,961.7</b>		<b>213.5</b>	<b>688.4</b>	
Inkai	ISR	51,615.9	0.07	43.1	31,366.1	0.08	30.3	250,958.6	0.05	144.3	217.7	
Gas Hills-Peach	ISR				4,313.3	0.14	13.3	3,307.5	0.08	6.0	19.3	
North Butte-Brown Ranch	ISR	1,018.0	0.08	1.8	5,762.9	0.07	8.8	294.5	0.07	0.4	11.0	
Smith Ranch-Highland	ISR	2,998.8	0.09	6.2	15,580.0	0.05	19.8	6,861.0	0.05	7.7	33.7	
Crow Butte	ISR	412.5	0.08	0.7	2,773.1	0.25	15.2	1,135.2	0.12	2.9	18.8	
Ruby Ranch	ISR				2,215.3	0.08	4.1	56.2	0.14	0.2	4.3	
Shirley Basin	ISR				1,727.4	0.12	4.4	508.0	0.10	1.1	5.5	
<b>US ISR</b>		<b>4,429.3</b>		<b>8.7</b>	<b>32,372.0</b>		<b>65.6</b>	<b>12,162.4</b>		<b>18.3</b>	<b>92.6</b>	
Yeelirrie	open pit				36,640.0	0.02	127.3	0.0	0.00	0.0	127.3	
Kintyre	open pit				3,897.7	0.62	37.5	517.1	0.53	4.2	41.7	
<b>Australia</b>					<b>40,537.7</b>		<b>164.8</b>	<b>517.1</b>		<b>4.2</b>	<b>169.0</b>	
<b>Total</b>		<b>59,016.7</b>		<b>410.1</b>	<b>107,558.3</b>		<b>377.3</b>	<b>268,599.8</b>		<b>380.3</b>	<b>1,167.7</b>	

Source: Cameco Corporation



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### *Disclosures as of January 19, 2017*

CFCC *has not* provided investment banking services or received investment banking related compensation from Cameco within the past 12 months.

The analysts responsible for this research report *have*, either directly or indirectly, a long or short position in the shares or options of Cameco.

The analyst responsible for this report *has* visited the material operations of Cameco. Assets visited include: McArthur River, Cigar Lake, and the Key Lake Mill. No payment or reimbursement was received for the related travel costs.

### *Analyst certification*

The research analyst whose name appears on this report hereby certifies that the opinions and recommendations expressed herein accurately reflect his personal views about the securities, issuers or industries discussed herein.

### *Definitions of recommendations*

**BUY:** The stock is attractively priced relative to the company's fundamentals and we expect it to appreciate significantly from the current price over the next 6 to 12 months.

**BUY (Speculative):** The stock is attractively priced relative to the company's fundamentals, however investment in the security carries a higher degree of risk.

**HOLD:** The stock is fairly valued, lacks a near term catalyst, or its execution risk is such that we expect it to trade within a narrow range of the current price in the next 6 to 12 months. The longer term fundamental value of the company may be materially higher, but certain milestones/catalysts have yet to be fully realized.

**SELL:** The stock is overpriced relative to the company's fundamentals, and we expect it to decline from the current price over the next 6 to 12 months.

**TENDER:** We believe the offer price by the acquirer is fair and thus recommend investors tender their shares to the offer.

**UNDER REVIEW:** We are temporarily placing our recommendation under review until further information is disclosed.

### **Member-Canadian Investor Protection Fund.**

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