Paladin 22/03/2011 **FAT-AUS-516**

PDN AUD $3.40 Spec. **HIGH** B

Be greedy when others are fearful

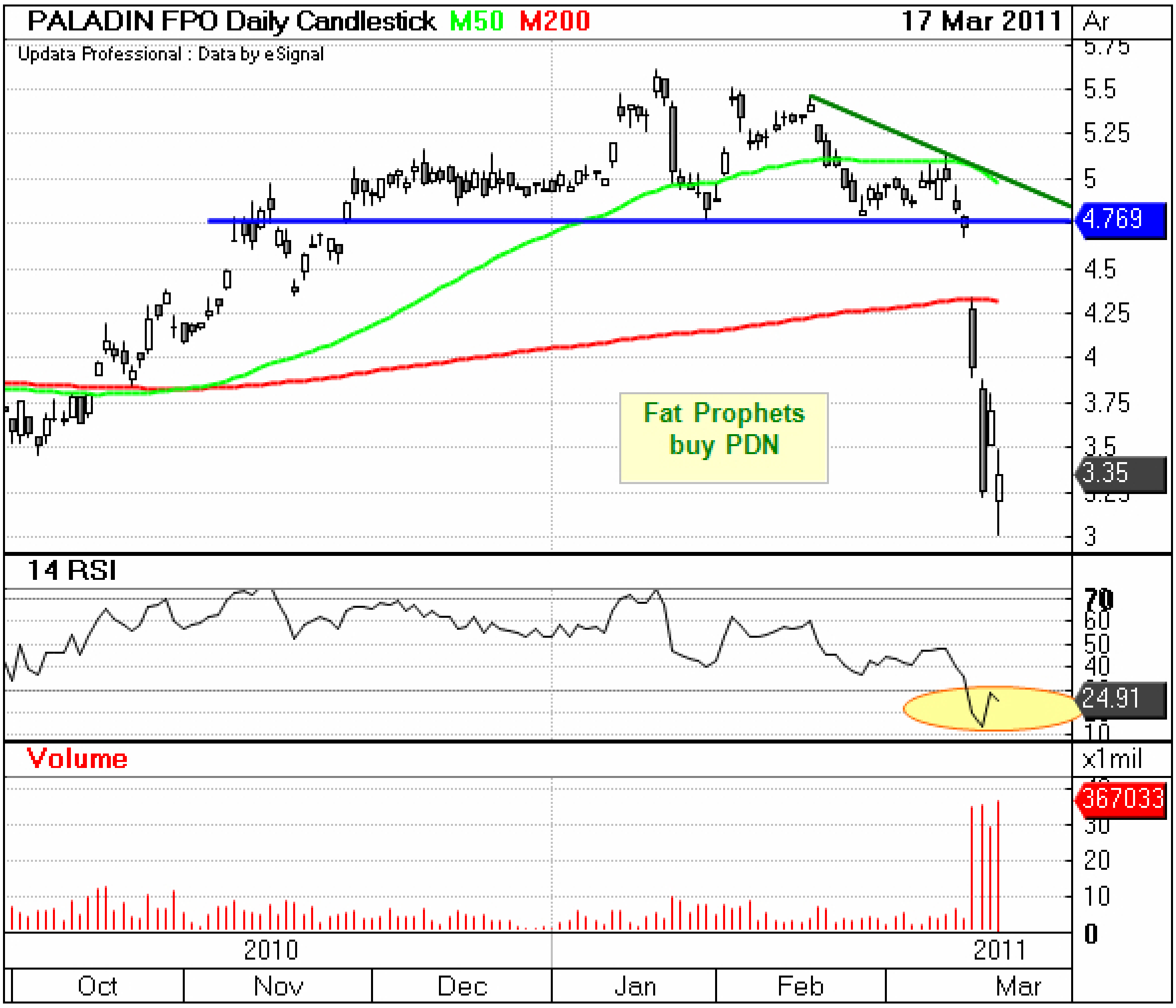
As tends to happen from time-to-time, broad market panic has seen good quality companies thrown out with the bad. This has created a few opportunities and one of them is right at ground zero as far as the current volatility is concerned. Paladin Energy suffered a vicious bout of selling as soon as the market became aware of Japan's nuclear crisis.

We do not expect the disaster at Fukushima to significantly impact the world's march towards greater reliance on nuclear energy. Alternative energy sources may become more prevalent in the future. But the present reality is that the modern world needs a clean, reliable source of base-load power and that is what nuclear provides.

That's not to say there won't be any impact at all. It's just that it will be limited to a temporary suspension of development of the 60 reactors that are currently under construction around the world. Tighter safety and design standards will probably be introduced, before development resumes.

Indeed, Russia has initiated safety checks at its facilities. In what could be construed as a snipe at Japan, Russia's President Medvedev stated that nuclear power was safe, as long as plants were in appropriate locations and managed properly.

China has temporarily suspended approvals for new nuclear facilities while it completes a safety audit of its existing plants. China is highly significant to future uranium demand, with 50 nuclear reactors in the pipeline. Some of which will contribute to the nation's plans to ramp up its nuclear energy capacity from around 11 gigawatts currently to 80 gigawatts by 2020.



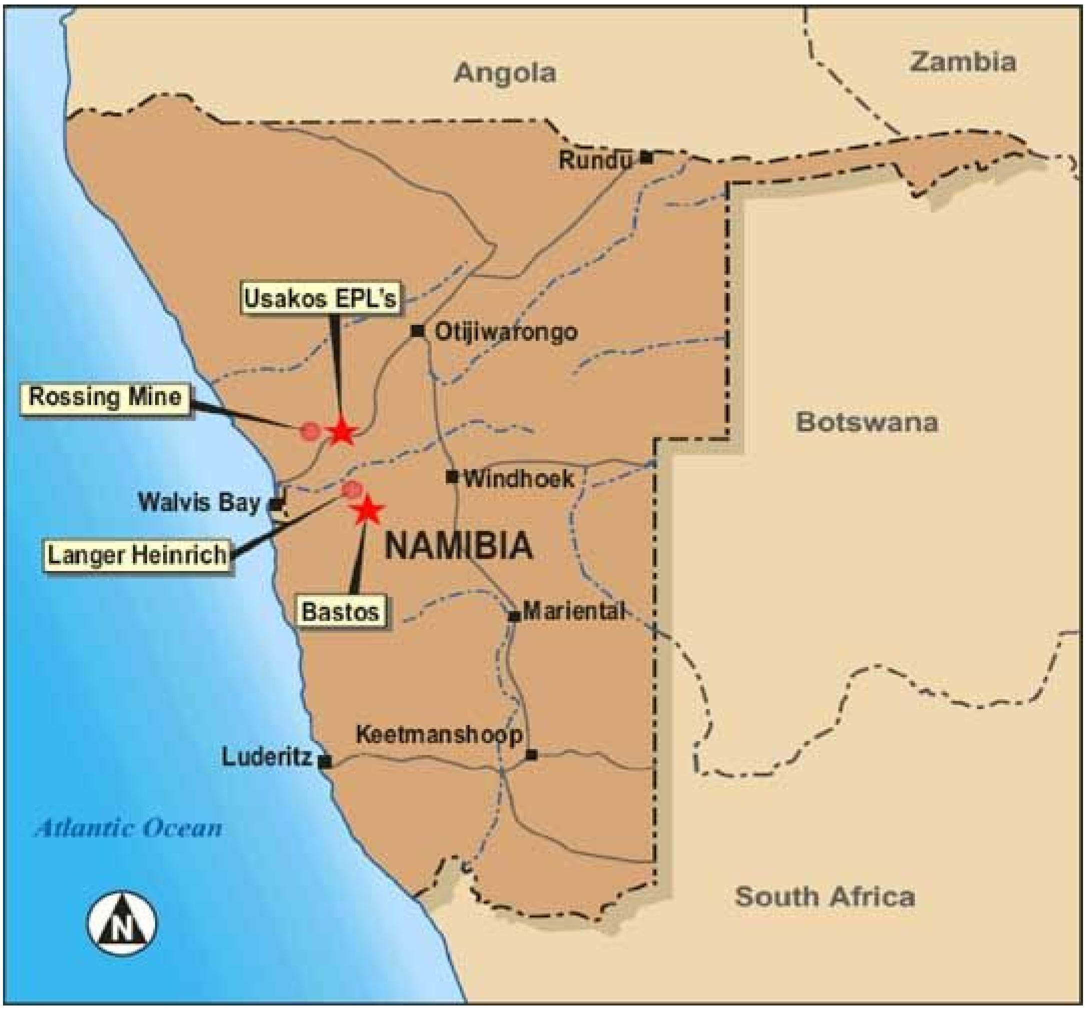
If China does indeed build these reactors, as we expect, it will need a further 60 million pounds of uranium per annum. This compares to current global demand for 180 million pounds, of which only around 77% is met by current mine production. Uranium stockpiles and de-commissioned weapons-grade material make up the shortfall.

Given our view that China will continue to pursue its push towards nuclear energy, it follows that the country would be very interested in securing supply if an opportunity presented itself. The world's largest uranium mine is South Australia's Olympic Dam, but that is obviously not a realistic target. One because it's owned by BHP and two because it's a strategic asset for Australia, as is the case for the other significant deposits.

Namibia on the other hand is unlikely to have any concern for the nationality of the company behind Langer Heinrich, just as long as it is developed. This must leave Paladin as a potential target in China's eyes, particularly if the stock was to suffer a further major sell-off. This in our opinion provides downside protection for Paladin. Meanwhile, the underlying and in our view undamaged longer term fundamentals for uranium supply and demand provide the potential for significant upside.

Langer Heinrich

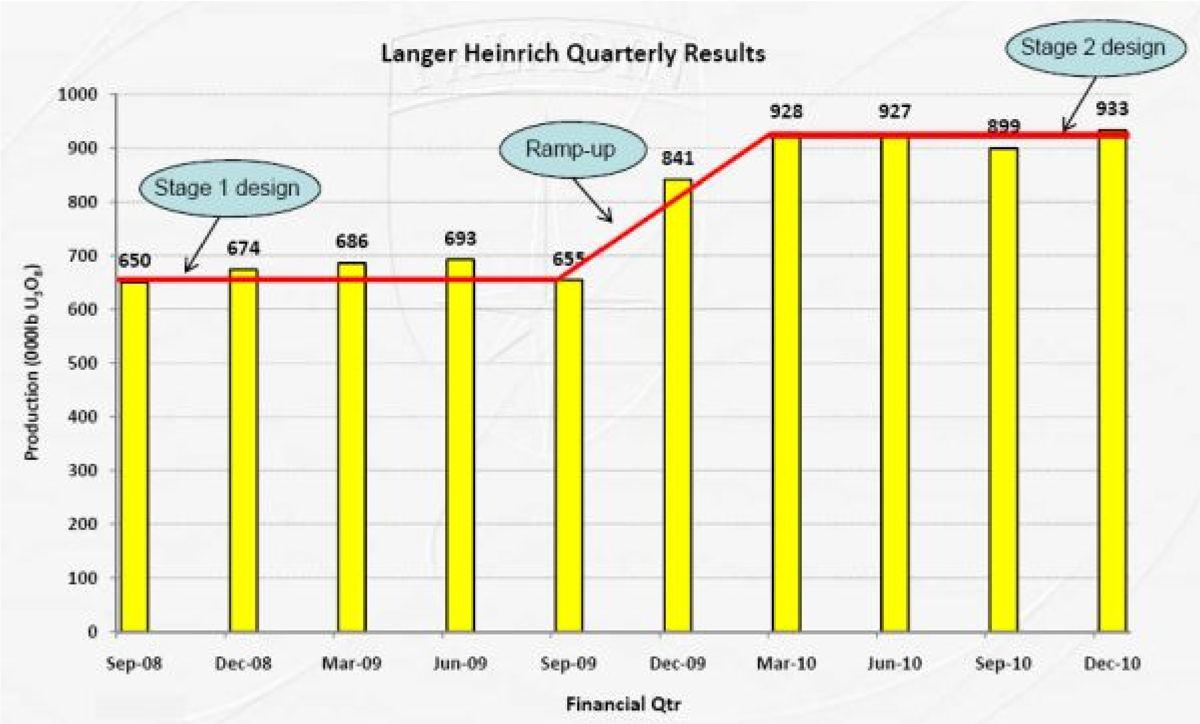
Paladin's primary production asset is its 100% owned Langer Heinrich project located in a renowned uranium region of Namibia. There are a number of other uranium projects in the region. The most notable of which is Rio's Rossing mine, which is located 40km to the north west of Langer Heinrich.



The fact that Rossing has been in operation since the 1970s speaks volumes for Namibia's geopolitical stability. Namibia understands the need to allow access to its uranium resources to external companies, in order to maximise their value for the country. We don't expect their position on this front to change anytime soon.

Paladin acquired Langer Heinrich from Aztec Resources in 2002 and construction at the site finally got underway in 2005. The plant was officially opened in March 2007.

Sourcing adequate reserves is the primary challenge for many mining companies. Others have a more attractive problem, in working out how to process the substantial quantity of ore which they are sitting on. Langer Heinrich falls into this latter category. The project has a current resource base of 173 million pounds of uranium, of which 134 million pounds are classified as reserves.



Production at Langer Heinrich reached stage 2 name-plate capacity at the end of 2009. Production has since run at or around this level through 2010, but a further production boost is just around the corner.

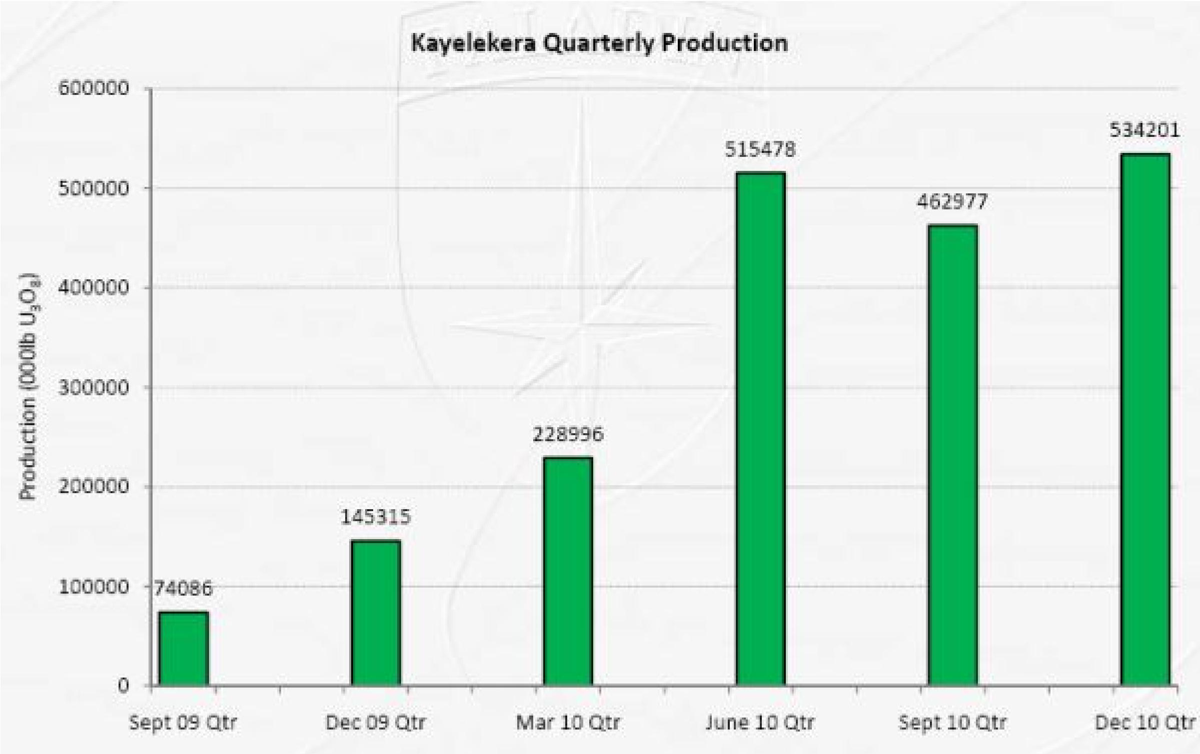
Management expects to complete construction of the stage 3 expansion project during the current quarter, with commissioning scheduled to follow in April. The project has been delayed by a couple of months, due to the late receipt of various components. The expansion will probably also be slightly over-budget, although management expects to be with 25% of the original US$120-125 million forecast.

The expansion will allow Langer Heinrich to ramp-up to annual production of 5.2 million pounds. This compares to the 3.69 million pounds of uranium the project produced last year. It's not going to stop there though. Work has already begun on a possible fourth expansion, which could potentially push Langer Heinrich's production through 10 million pounds per annum.

The project's cash costs of production have been reasonably consistent through its life so far, between US$25 and US$27 per pound.

Kayelekera

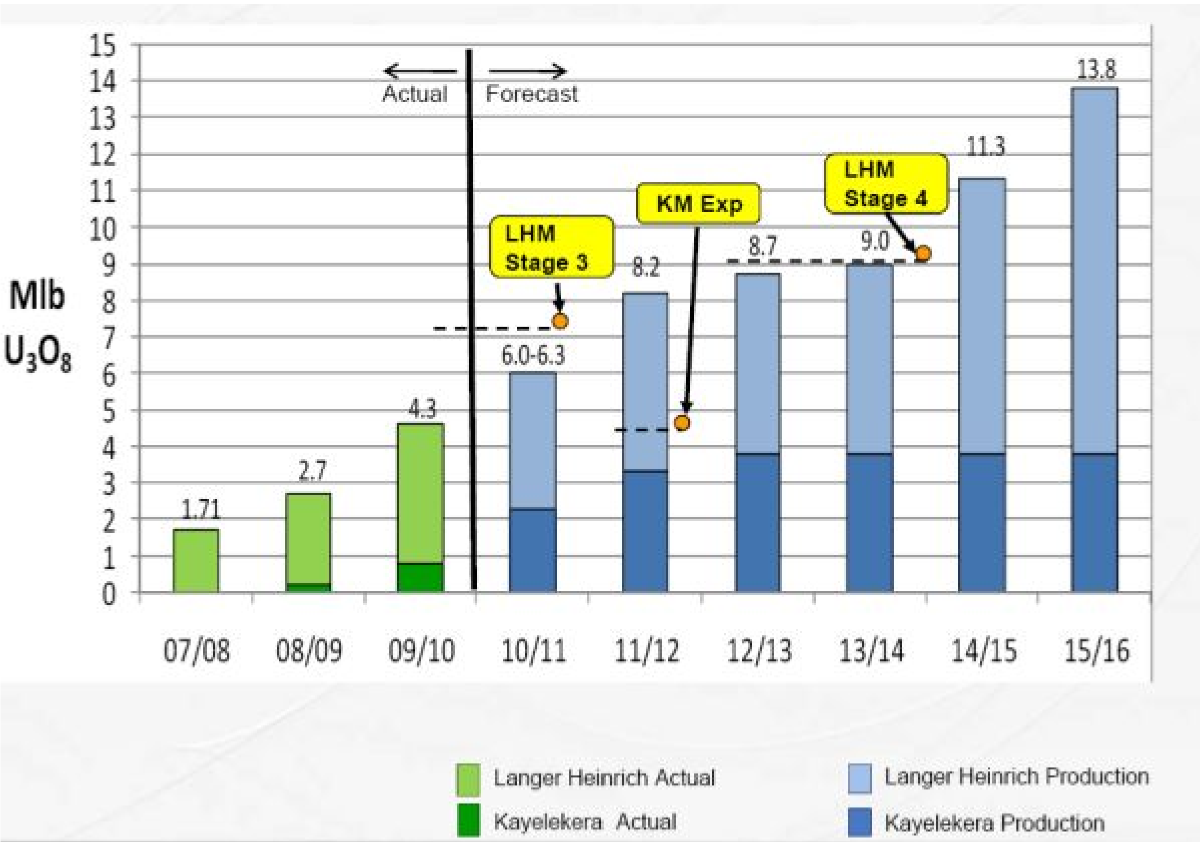
Paladin's second production asset is the 100% owned Kayelekera uranium project. Kayelekera is located in Northern Malawi and has a resource base of 46 million pounds. The project was commissioned in 2009 and delivered its first full year of production last year. Nameplate capacity is currently 3.3 million pounds of uranium and the project is still undergoing its ramp-up towards this level.



The project suffered a set-back in February, shutting down for four days due to fuel shortages in Malawi. The supply issues were however quickly resolved and management does not expect a repeat of the situation. The shut-down did not impact the project's ability to meet its production guidance, because planned maintenance was simply brought forward.

Group full year production guidance remains unchanged at 6-6.3 million pounds of uranium.

Kayelekera provides a welcome element of project diversification to Paladin's production portfolio. As the chart below shows though, Langer Heinrich is the primary engine of growth. Kayelekera really just provides a safety net in the event that Langer Heinrich's production suffers a setback.



Paladin also has an extensive portfolio of exploration assets. These include the recently acquired Michelin project in Canada, as well as various other exploration assets in Australia and one in Niger.

Financials

Paladin held cash of US$251.8 million as at the end of December 2010, which provides a healthy buffer in the event spot uranium prices underwent a steeper fall than has already occurred. One of the factors that held back Paladin's valuation in the past is the length of time it's taken for its operations to become cash-flow positive.

This changed in the December quarter, driven in part by the resurgent price of uranium. Uranium prices have of course come off since Japan's crisis began to unfold, falling from around US$73 in early February to around US$60 per pound at present. Further weakness would put pressure on Paladin's ability to remain cash flow positive, but we would not expect this to occur for a protracted period of time.

This leaves Paladin likely to remain profitable through the full year to June 2011. While its level of profitability will be slim relative to its valuation, this is not the case when one looks further ahead to 2012 and beyond. We believe those investors that are comfortable with possibly high levels of near term volatility will be rewarded over the longer term.

Since breaking to the downside from a descending triangle on March 11, Paladin sold off sharply. The short term decline saw the psychological significant $3.00 whole number offer solid support, resulting in a close of $3.35 (35 cents off the intraday lows). With reference to the weekly chart, the large spike in volume is suggestive of an exhaustion of selling pressure. Should current levels hold, we would anticipate strong gains to be made over the broader term.

In short, Paladin does not currently sell any of its production to Japanese utilities and owns an A-grade production asset in Langer Heinrich. The company's forward production profile positions it to capitalise on the longer term tightening of the uranium market, while the strategic value of its primary asset provides downside protection.

We recommend Paladin as a BUY to all Members around $3.40.

Snapshot PDN

Paladin

Paladin has a focus on uranium exploration and production in Australia and Africa. The company's first mine, Langer Heinrich in Namibia, was commissioned in 2007 and was the first conventional new uranium mine in the world for a decade. The mine is now ramping up to full capacity, with a planned Stage II expansion during early 2009. The company has recently announced a 55% increase in the resource base and a 75% increase in the reserve base at Langer Heinrich, boosting mine-life out to at least 11 years. The company's second mine, Kayelekera in Malawi, is also on track for production during 2009. Paladin is based in Australia, but has listings on the Australian, Toronto and Namibian Stock Exchanges. It also trades on the Munich, Berlin, Stuttgart and Frankfurt exchanges.

Market Capitalisation:$2.3bn