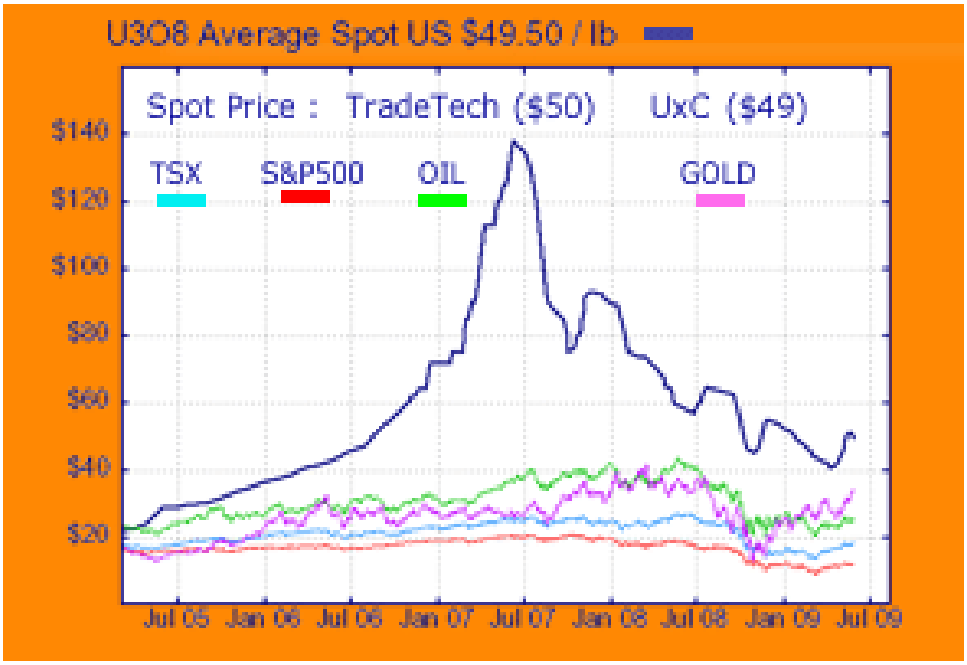
DAVID COFFIN & ERIC COFFIN'S
HRA ADVISORIES
HARD ROCK ANALYST

Uranium Bull?

Eric Coffin
HRA Advisories

June 2009

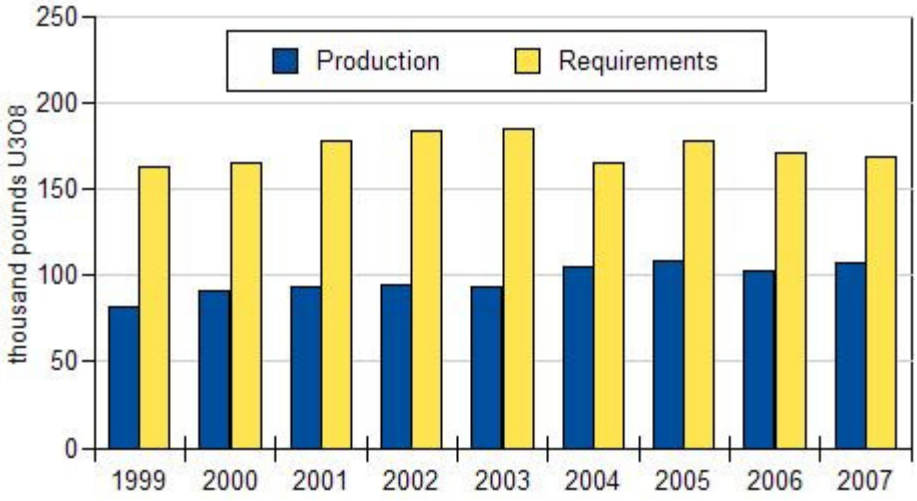
This decade has been a great one for commodities, part of a longer term secular trend that HRA expects to last for another 10-20 years, as previous ones have. Through the first few years of this cycle, few commodities saw the sort of gains that the uranium price did. The chart below (*courtesy u3o8.biz)* shows just how extreme the price move was. Uranium spot prices went from about $7 early this decade to a high of $140 in 2007, a gain of over 1800%, before they started falling back. The spot bottomed earlier this year at $40 and has since moved back to the $50 level.



There are a couple of important points that come out of this. One is that the cyclical low through the past year is almost six times the low reached at the bottom of the last cycle. This speaks to a major change in the market and in market psychology. There is little doubt that some of the price spike earlier this decade was purely speculative. There were a number of funds and hedge funds buying uranium on the spot market and driving the price higher. Many of those funds have either exited the market or simply disappeared in the past year. There are still a few "yellowcake funds", such as Uranium Participation Corp (U-TSX), which has inventories of uranium but these dedicated funds are expected to be long term holders and are on the buy side of the market. Most of the remainder has sold what inventory they had and are no longer considered a factor.

While the spot price is the measure that gets everyone's attention, uranium is really a contract market. 85% of all uranium is sold under long term contracts that usually only vary in price through the life of the contract due to changes in some agreed inflation indicator like CPI. Almost all uranium is bought by utilities for use in power reactors. Utilities demand security of supply and price since their own pricing is usually regulated and it's hard to justify building a multi-billion dollar reactor if you don't know how you're going to fuel it. This is why most uranium producers did not see profit increases matching the big run up in spot prices. For example, Cameco (CCO-TSX), the world's biggest producer, expects its average sales price in 2009 to vary from $35 at $40 spot prices to $39 if spot prices average $60 this year. These contracts are not forever. The longer the uranium price stays elevated the more long term contracts expire and get rewritten near current spot rates. In this manner, at least there is a real advantage to being a new producer since you start out selling at today's higher prices.

The table below shows mine production in blue and demand in yellow on an annual basis. As you can see, uranium has been in significant supply deficit for over a decade. The difference is made up from reworking spent reactor fuel and reprocessing of uranium from dismantled weapons. This has filled the gap for the last decade and should be able to for several more years - but after that things get tough.



In order to make up the shortfall, as reprocessed supply falls, there have to be more mines coming on line. To add to the difficulty, there are 30 new reactors in the planning or construction stage and several countries, notably India and China which have no meaningful domestic uranium production, indicate they will rapidly increase their building programs. For all the hullabaloo about "green" energy, nuclear has proven to be one of the most environmentally benign ways to generate electricity at large commercial scale. We don't think the nuclear energy business is going away any time soon.

Without going into detail, most uranium comes from either very high grade deposits like those found in the Athabasca Basin in Saskatchewan or much lower grade deposits in Australia, Kazakhstan and southern Africa and/or low grade "in situ leach" mined deposits in the western US. The latter two categories of deposit have low grades, rarely exceeding 0.2% U3O8 and new mines require prices in the $50-70/lb range to justify new production. Athabasca style deposits can carry grades above 20% but they are hard to find and there are a number of technical challenges when producing from them. The bottom line is that there will not be enough mine production in the medium and long term unless prices stabilize above current levels. Given the start up and production difficulties a number of operations have had and the long time lines involved in permitting a uranium mine, utilities would have to be brave indeed to wait until the last minute to secure supply. For this reason, there is room for the uranium price to move higher in the next 12-24 months as buyers work to lock in longer term supply.

The best confirmation for our thesis I can think of came recently from Cameco, the world's largest producer of the energy metal. In its most recent quarterly report and conference call, Cameco confirmed that it has been buying spot AND long-term uranium in the market and from other suppliers. Cameco is confident enough about the medium term prospects of the uranium market that it expects to resell these supplies at a profit. We think it's fair to say that Cameco probably knows the uranium market better than anyone else. When the biggest producers of a commodity show that sort of confidence, it's worth paying attention to.

David Coffin and Eric Coffin produce the Hard Rock Analyst publications, newsletters that focus on metals explorers, developers and producers as well as metals and equity markets in general. If you would like to be learn more about HRA publications, please visit us HERE to view our track record, see sample publications and other articles of interest. You can also add yourself to the HRA FREE MAILING LIST to get notifications about articles like this and other free analyses and reports.

Published by Stockwork Consulting Ltd.
Box 85909, Phoenix AZ , 85071
hra@publishers-mgmt.com http://www.hraadvisory.com