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Will History Repeat Itself?

The first thing that may pop into your mind upon seeing the title of this cover story is the similarity of the price increase over the past several years with that of the mid 1970s, which, of course, was followed by an equally dramatic decline. However, we are talking about a more recent history relating to the beginning of the current up cycle in price.

In June 2003, the Energy Information Administration (EIA) released its report on U.S. uranium marketing activity. That report showed an extremely high level of unfilled requirements on the part of U.S. utilities for 2006. As shown in the chart below, these unfilled requirements took a precipitous jump after the third year, exceeding 40 million pounds four years out (the EIA data were as of the end of 2002), indicating that there had not been much contracting done for delivery then. This was opposed to the situation at the end of 1992, when unfilled requirements exhibited a more linear trend.

To us, this suggested there could be a problem in 2006, as it was pretty clear that price levels in June of 2003 (price was about \$11 a pound when we wrote the cover) were not nearly sufficient to stimulate enough production to meet 2006 needs. We made the simple (but true) observation that "(i)inventories will decline still further between now and 2006, and there are not many uranium projects waiting in the wings." We also pointed out, in rather straightforward terms, that given such high unfilled requirements, there was a "better chance for supply and demand getting out of whack."

Now that we are in 2006, it is apparent that supply and demand have become out of whack given that uranium prices (spot and long-term) reside in the mid-\$40s and have an excellent chance to crack \$50, something that was unthinkable back in 2003 (and for some market participants, still probably unthinkable).

EIA has released its most recent results, which are also incorporated in the chart. These data show that, as of year-end 2005, U.S. utility unfilled requirements were quite low in 2006, 2007, and 2008, but showed another precipitous jump in the fourth year (2009), although total unfilled requirements were over 10 million less than they were for 2006 as of year-end 2002. Meanwhile, looking five years out reveals that the level of unfilled requirements are nearly identical for both year-end 2002 and year-end 2005, suggesting little change in forward contracting this far out.

This level of unfilled requirements may seem surprising given the extent of long-term contracting that has taken place over the last year and a half. With over 250 million pounds transacted last year and a similar pace this year, the market could see a half a billion pounds placed under contract in a two-year time period. Given the contracting so far this year, U.S. utility unfilled requirements are less today than what the EIA indicated at the end of last year. However, it also needs to be pointed out that this additional contracting has come at a price, since the long-term contract price has increased by over \$10 since the beginning of the year, and is still under upward pressure. At the same time, uncommitted production has decreased.

Thus, utilities (both U.S. and non-U.S.) are not complacent about arranging for future supplies in 2006 as they were in 2003 when long-term volume amounted to less than 75 million pounds (see chart on page 2). Also, the statement that there are not many uranium projects in the queue no longer holds true given the flurry of activity in response to higher prices. How many of these projects will actually come on line by 2009 is another question, but the production side is clearly different now than in 2003.

Even the situation about the future availability of inventory supplies three years out is different now than in 2003, when we first made this observation. In 2009, DOE is able to begin selling the HEU feed and other inventory it agreed to hold off of the market. Thus, while overall inventories will continue to decrease between now and 2009 as requirements outstrip production, the amount of inventory available to the market will increase in 2009.

The question before us now is whether the market is setting up for another big move up in 2009 or whether there might be a move in the opposite direction by then. On the one hand, supplies are very tight, and even with the lower unfilled requirements in 2007 and 2008, there is a struggle to find supplies for these years, and hence the upward pressure on price. There are even higher unfilled requirements in 2009, suggesting that such pressure might intensify by then. Even if there is not a repeat of the \$30+ price increase that we have seen since June of 2003, price could be pushed considerably higher.

On the other hand, more production will come on line between now and 2009 and the HEU inventory sales moratorium comes off in 2009. This creates the potential for an oversupply situation, if most requirements are filled by 2009 and additional production and inventory supplies are available and looking for a home. The EIA data (as well as our own) indicate that a segment of utilities

are leaving requirements open, likely in anticipation of a reversal in the market.

Certainly, the massive amount of contracting taking place today suggests concern exists regarding future supply availability, almost the exact opposite of the situation in 2003, which was marked by a sense of complacency. In retrospect, inaction in 2003 was the “wrong” decision. Will contracting at today’s prices turn out to be the wrong decision by the time 2009 rolls around?

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