

Cover story originally published in the November 3, 2003 issue of *The Ux Weekly*.

The Party's Over

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The sharp rise in the uranium price over the past six months or so coupled with more frequent warnings of a growing supply shortfall has sparked debate whether this increase is just a transitory phenomenon or whether it is the beginning of a more permanent shift to much higher prices. To address this question, during the next two weeks we will present cover stories that argue the opposing sides of this issue. The first, appearing below,

will take the position that we are at the beginning of a giant wave that will produce higher and higher prices. After both of these cases are made, we would like you to vote on which one you believe is most convincing, and provide any comments you deem appropriate.

The party has been going on for some time now. For a while, it seemed like just about every piece of news about the uranium market was good from the standpoint of buyers. Starting in the late 1980s, massive new supplies started coming, first from the Soviet Union and then its newly freed republics. The Olympic Dam mega-project came on line in the late 1980s and expanded in the 1990s. McArthur River, by far the richest deposit in the world, also came on line during the 1990s. The mid-1990s also saw the release of uranium formerly locked away inside nuclear weapons. Shortly thereafter, the U.S. government decided to liquidate most of its inventories through the privatization of USEC.

Over the last couple of years, however, bad news has been raining on the party. There's been a fire at Olympic Dam and a flood at McArthur River. A ship carrying uranium has run aground. Some of the inventory transferred to USEC was found to be contaminated.

The longer-term prospects for production, which on a world basis is less than 100 million pounds, is not good. There are few projects in the pipeline, little exploration occurring, and limited ability to squeeze additional output out of existing projects. And, even though uranium prices have increased over 25% this year, this increase has largely been offset by the growing strength of the Australian and Canadian dollars against the U.S. dollar. Consequently, there has been little incentive to spur exploration or production in those countries.

Then there's Russia. Once the source of what seemed like unlimited uranium, things are much different today. Russia has sold most of its inventory, and its needs are expanding, both internally and for its captive export market. There are greater indications that Russia wants to retain as much of the HEU feed supply that it can, both now and in the future. In this regard, it seems increasingly unlikely that there will a follow-on HEU deal, as Russia seems to need the material itself or will hold it for strategic purposes, much like the U.S.

Granted, inventories resulting from mismatch between procurements and actual requirements will always represent some component of uranium supply, and we would assume HEU and tails will continue to meet a portion of uranium requirements, at least until 2013. But these supplies will not nearly be enough to fill the shortfall. Much of the price-mitigating aspect of a movement to lower tails has already been accounted for, as tails stripping already makes up a large component of supply. Utilities can select lower tails, but this just reduces the ability of enrichers to underfeed their plants and put the extra supply back in the market.

Irrational Expectations - The reaction

The gold price has increased, and uranium production is down. A delivery gets missed. And so on.

Sure, it might be pointed out that these are all short-term problems, and have been or will be rectified with little to no impact on the basic supply situation. But this isn't the really bad news. The really bad news relates to how dramatically the underlying fundamentals of the market are changing. Demand has been steadily increasing, as capacity factors improve, uprates take place, and reactor lives are extended. This is not

happening just in the United States, but all around the world. As a result, world uranium requirements are heading toward 200 million pounds by 2010.

to talk of any impending supply shortfall is that we've heard this warning a number of times before and nothing has happened. So, of course, this means that it can't happen.

Correct? The reality is that the party has been kept going by the appearance of HEU supplies and the liquidation of government inventories, truly extraordinary events. To say that price won't move to higher levels is the same as saying that it is expected these extraordinary events will continue to happen.

This perennial optimism actually makes the future imbalance between supply and demand worse. Buyers don't believe there's a problem, so they delay contracting, failing to send the needed signals to producers. For their part, producers have been burnt so many times in the past that they are not about to invest more on the mere promise of an improving market. Consequently, nothing gets done.

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