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Uranium- Stick with the Best 6/22/05

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Uranium has been one of the strongest of all the resources recently, with the price almost tripling in the past two years. Volumes have also been strong, with almost as much traded on the spot market in the first five months of this year as all of last. The spot market accounts for about 20% of uranium traded. (The spot price is currently $29, a tad less than the term price.)

Uranium is also a very thin market, dominated by a handful of suppliers and not many more buyers. Last month, for example, there was a grand total of eight transactions on the spot market.

Strong demand for power generation

We continue to believe that uranium has some of the best long-term fundamentals of all resources. The price moves in long cycles, and has only recently come off a period of destocking after the Cold War which saw extraordinary secondary supplies hit the market. During that period, there were no new nuclear facilities to boost demand, so the price declined, and little exploration or development was undertaken.

All that has changed, with demand from new nuclear facilities boosting demand, even as supplies, both from mine production and secondary sources, declines. Nuclear power plants are most likely the wave of the future, with 30 reactors under construction in 11 countries. Looking ahead, China has plans for up to 40 plants; Japan, India, South Korea and France have all announced plans for new plants. In the U.S., some 15 reactors have been granted license renewals extending their lives out to 60 years.

Interestingly, opposition to new facilities may be more subdued going forward. Many environmentalists have publicly recognized that nuclear power is the cleanest of available sources.

Supply-demand inbalance

The result is a huge gap over the next 10-15 years between expected requirements and production from existing sources (plus anticipated secondary sources). The World Nuclear Association, in fact, estimates that by 2020, supply (from existing facilities and secondary sources) will be only half the expected demand (40,000 tonnes versus 70,000 -- 80,000 tonnes of demand).

This enormous gap arises from an over-reliance on inventories and secondary sources in the last decade, and the long lead times to permit new mines and bring them into production. Other than Cigar Lake, there are no major projects moving to the development phase, while Russia is likely to export less as it holds back material for its own growing generating needs.

To meet this new demand, there will have to be higher prices and new supplies; many of the properties being explored now will have to come into production.

The most recent jump in the spot price can be attributed to buying from the new Uranium Participation Corporation. But, the fact that the price responds to this kind of buying illustrates clearly just how tight supplies are.

What to buy, what to avoid

So this is a great time to be building long-term positions in uranium investments, but also time to be selective and wary. Given the price strength over the past year and the market hype, there has been a huge increase in exploration companies with “uranium” in their name. According to Doug Casey, in 2003, there were less than 20 public uranium companies, and now almost 100. Most of these should be avoided.

As a value investor who invests in a broad range of sectors, I tend to seek the very best investments in each sectors. I want stocks that will definitely respond to any move in the sector, but at the same time have relatively low downside. This often means emphasizing balance sheets and management. I am quite prepared to miss out on some of the best rewards that might come from the more speculative investments. But in volatile resource markets, even conservative plays will reward investors handsomely if the sector is strong.

Top uranium investments

So I am focusing on four main areas in uranium, with one or two top buys in each.

- ***major producers*** that will benefit from higher prices; **Cameco** (CCJ, NY, 42.69) is the world leader; management would have to try very hard indeed not to benefit from higher uranium prices.
- ***world service leaders*** that will benefit from increased demand and market activity. **Areva** (CEI, France, Euro 353) is a major recycler and leader in nuclear plant construction and management; it has lots of projects in the pipeline (including some in China). To be privatized by the French government, it currently trades on a “when-issued” basis.
- ***top exploration companies*** that have the goods and are likely to bring properties into production. **Strathmore Minerals** (STM, Toronto, 1.64), with technically strong management, lots of properties, and a strong balance sheet, is arguably the best.
- ***Companies one likes for other reasons*** with exposure to uranium. We like two exploration companies, active in a range of metals, who operate essentially on the prospect generator model; both have some uranium projects: **Virginia Gold** (VIA, Toronto, 6.27), one of our top picks for an exciting new gold discovery, with great management and a solid balance sheet; **Altius Minerals** (ALS, Toronto, 3.50), with numerous joint ventures in Newfoundland, as well as a royalty on Inco’s Voisey’s Bay nickel mine. In addition, though much more speculative, we like **Bitterroot** (BTT, Toronto, 0.30) which has a joint-venture in Michigan with Cameco, set to drill in the fall. Given the small market cap (around $10 million), any success would lead to a dramatic move in the stock price.

Needless to say, we own all of these for clients of our money management firm. Of these, Strathmore and Altius are probably the best buys at today’s prices, as well as Bitterroot.

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