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(The) Future's Now

Those of you that have read these pages for a while are quite familiar with our discussions about market failure and our admonitions about the shortcomings and inefficiencies in the uranium market, even though we publish one of the primary price indices. Addressing the annual WNA Symposium last September in London, UxC's President Jeff Combs gave the market a grade of only a "D+," and in our initial cover story of the year we concluded that in many ways the market should get a failing grade. Allow us to address this issue once more, but hopefully for the last time, as there is now hope that the market will operate much more efficiently with an emerging futures market.

In June of 2003, we were alarmed (we said "fascinated" at the time) by the fact that uncovered requirements on the part of U.S. utilities were so large in 2006, just three years away at the time. There seemed to be an impasse or perhaps a disinterest in contracting, which translated into this large uncovered position. Because of the large amount of contracting yet to take place in an environment where production was not expanding, it appeared to us that there was no way the market could clear at anywhere near the then spot price of \$10.90 when 2006 came around. Because of this, we wondered if the market had failed. (see "A Case of Market Failure?" The Ux Weekly, June 9, 2003, p. 1-2).

Because of this concern, we tried an experiment in our mid-year price survey that we conducted in July and August of that year. We asked buyers and sellers what they would bid and offer for 250,000 pounds U_3O_8 for July 2006 delivery. Although these bids and offers were nonbinding, some survey participants indicated that they were willing to act on them, so we believe that this was a fairly realistic representation of the forward market at that time.

The results of this survey were published in a cover story (see The Ux Weekly, September 1, 2003, p. 1-2). The survey showed that most of the respondents believed that the spot uranium price would be in the \$11.00-11.50 range by the end of 2003, and between \$13 and \$16 (or about \$100 below the current price) by 2008. The vast majority of buyers' bids for a 2006 purchase were in the \$11.50-12.00 range, or not much higher than what they believed the end-year 2003 price would be. No sellers' offers were below \$12, so the market would have cleared above this point.

An interesting observation, and one that foreshadowed the coming increase of price, was while the bids and offers overlapped in the \$12 to \$13.50 range, once these were cleared out, the next range of offers was \$13-\$15. Since bids outnumbered offers by a 2:1 margin, there was more demand being sought than supply being offered, and price would likely have to be bid up. Of course, price increased tremendously over the next three years as there was not nearly enough "low-priced" uranium to meet demand.

In hindsight, a futures market existing in 2003 would have served the market well, as it would have given more advanced notice of the tight future supply situation that existed. Prices would have been bid up sooner, prompting a quicker response in production and exploration. Utilities certainly would not have liked seeing higher prices, but if they had known what the alternative was (which is what actually happened), they would have been more accepting.

Clearly, a well-functioning futures market would not have prevented the floods at McArthur River and Cigar Lake or the rains and water problems at Ranger. But, it would have provided a more immediate price signal to which buyers and sellers alike could have reacted, resulting in a more efficient market operation. Importantly, it would have allowed market participants to hedge against such events.

We were not in a position to establish a futures market then, nor was there likely sufficient interest on the part of nuclear fuel market participants or the investor community at that time. However, subsequently interest in the uranium market and its future (as well as the future of nuclear power) has increased dramatically, as has the interest in futures markets in general (see the lead editorial in The Wall Street Journal of April 11, 2007) and the ability to trade derivatives electronically. Thus, developments in our market as well as financial market and futures markets infrastructure in general have made a futures market in uranium more desirable and more feasible.

It is into this environment that NYMEX, with our support, is introducing uranium futures products on electronic trading platforms, using UxC prices to settle these trades (see story below). We are pleased to participate in this endeavor because we believe that this is a crucial step to ensure the future success of the market during a time which is critical for the future of nuclear power.

We should also note that some, thinking that a futures market in uranium is two or three years away, may be surprised by this announcement; however, some futures trades have already taken place in uranium and Tullett Prebon has set up a nuclear fuel derivatives desk (see the Ux Weekly, April 2, 2007, p. 3). Thus, the market has already started to evolve in the direction of a uranium futures market, and NYMEX has elected to support this development in a major way.

Certainly, developing nuclear fuel futures markets today can do nothing to change how the markets have developed up to this point. But, it will aid in price transparency and the establishment of a forward price curve. Our cover last week discussed how market participants are facing an uncertain situation when it comes to future uranium prices, since most forward contracts today are being written on a market price basis, or where the price to be paid (or received) is to be based on the market price existing at or near the time of delivery, and thus is not known today. This makes budgeting and planning difficult, if not impossible.

Importantly, futures markets create the opportunity for hedging to reduce price uncertainty, a feature that is exceedingly valuable in today's market. Establishing futures contracts and a forward price curve should also make it easier for new mines to get financing, thus helping to speed up the needed recovery in production. Thus, futures contracts can be of immediate benefit to market participants, and in the process set the stage where supply is more robust in the future.

To many, it may seem like the uranium market has changed more in the past two weeks than it has in the previous 40 years with price soaring to new heights and the introduction of a futures market, while they are still getting used to the presence of hedge and investment funds. And, although a number of participants have bemoaned the entry of hedge and investment funds into the market, their entry signaled that the uranium market was mature enough to attract those with solely financial interests, i.e., those that will also participate in a futures market. While hedge funds can and will participate in a uranium futures market, futures trading is regulated by the government and large positions reported, again adding to the transparency of these markets.

In the coming weeks prior to the launch date of May 7, NYMEX in conjunction with UxC will be holding meetings to discuss the various products and services that will be provided. All in the industry are invited to these meetings, and we will be happy to answer any questions you might have about the functioning of futures markets, from market, technical, and regulatory standpoints.

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