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Uranium Cost-Price Squeeze?

Last week's announcement by AREVA and its joint venture partners to postpone the Midwest project in Saskatchewan, Canada (see story on page 2) is a signal that deteriorating financial and market conditions are catching up with the uranium industry. Specifically, AREVA noted that profitability of the project was now in question due to the declining uranium market coupled with rising mining costs. In economic parlance, this is known as a cost-price squeeze. In addition, AREVA mentioned the worldwide financial crisis as a factor in delaying the project.

Uranium costs have been under upward pressure for some time, like the costs of other commodities. As demand placed pressure on the supply of the commodity in question, additional demand was placed on the factors of production for that commodity – including labor, electricity, chemicals (e.g., sulfuric acid in the case of uranium), tires, gasoline, etc. Since this pull was coming from all commodities, companies producing these commodities were competing not just within their own industry, but also between different industries for these goods and services. Skilled labor shortages, which AREVA mentioned as a factor in shelving Midwest, became so bad in uranium that at one time it was reported that companies were offering a new pickup truck as a hiring bonus.

Since most commodities have experienced downward price pressure in addition to increasing costs, uranium is also not unique in terms of commodities that are undergoing a cost-price squeeze. The Wall Street Journal noted this phenomenon of rising production costs and falling prices in a September 2nd article. In particular, this cost-price squeeze was affecting marginal-cost producers which jumped into the market when commodity prices were soaring and higher production costs could be tolerated. One of the implications of this squeeze was that commodity prices would again likely rebound once some high-cost producers were forced out of business, thus reducing supply.

The WSJ commentary appeared just before the financial crisis and its attendant effects on commodity and factor input prices. The impact on these input prices has been somewhat of a mixed bag. Financing costs have certainly increased (if you can obtain financing) in the wake of the crisis. However, oil and gasoline prices have fallen notably, reducing operating costs. As demand and prices for various commodities fell, this has also reduced the demand for labor. This trend has even extended to uranium where producers, which were once offering signing bonuses, now have to let workers go.

Also, the financial crisis has reduced the demand for commodities in general, as the drop in oil and gasoline prices attests. Copper and other commodity prices have also fallen as the demand for these products has declined. As demand for a commodity falls, the need to exploit higher-cost, marginal production and especially to add capital-intensive new projects that would be most susceptible to a cost/price squeeze also declines. Thus, the financial crisis should serve to reduce some of the pressure on supplies associated with the cost/price squeeze.

However, the situation is somewhat different for uranium. The financial crisis doesn't negatively impact uranium demand in the near term very much, if at all. Utilities are not going to cut back on the operations of their existing reactors because of the financial crisis, and thus should continue to consume (and purchase) the same amount of uranium. They will likely opt to build fewer reactors or delay building planned reactors to the extent that acquiring financing becomes more difficult or because economic growth (and the demand for electricity) slows. But, these are more medium to long-term impacts on demand, not the immediate impact as seen with other commodities.

Further, the financial crisis may not impact the costs of some of uranium's key factor inputs, such as sulfuric acid, enough to relieve some of the cost pressure. In fact, the WSJ article cited soaring sulfuric acid costs as one of the key culprits in cost escalation, as it affects other metals such as nickel. Also, even if labor is considered less of a problem in general now with falling commodity production, it may present localized problems in places like Western Canada, as AREVA stated in its press release. Finally and perhaps most importantly, there is a need to expand production capability and thus to bring new projects online in uranium, which means that the impact of higher financing costs will be greater in uranium than in other commodities that may currently find themselves in an overcapacity situation.

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