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US mulls uranium limits

Peninsula Energy chief executive Wayne Heili is touting “the expected positive outcomes” from a US government review of uranium imports as “an imminent share price re-rating event” for his company.

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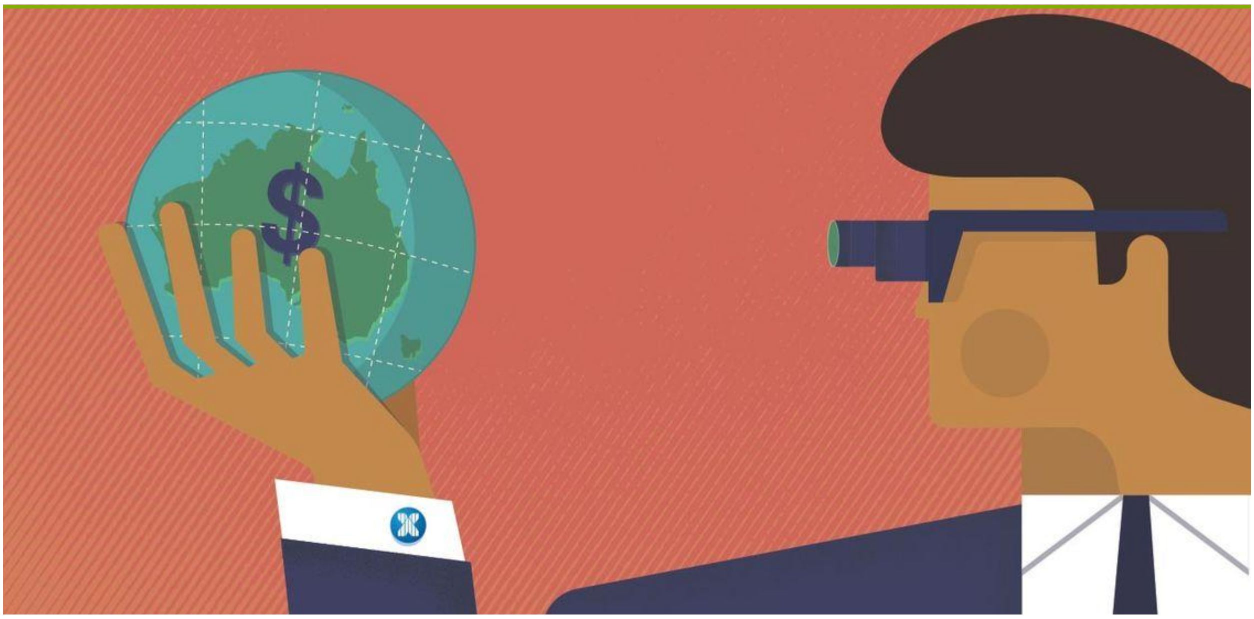

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Uranium related investments should be less risky than those involving other commodities. Long planning and construction lead times for nuclear power facilities add certainty to uranium usage forecasts. Having to guess the direction and pace of macroeconomic forces is correspondingly less important.

Waning hostility toward uranium mining, particularly among those on the political left who are now prioritising action against anthropogenic climate change, has boosted its investment prospects.

Uranium is one of the few mined commodities in which relatively stable contract prices, with beneficial effects on earnings predictability, have retained a role.

With movements in prices of mined commodities showing strong tendencies toward mean reversion, investment odds favour laggards. Uranium qualifies.

However compelling, today's bull points in favour of uranium investment could have been stated just as emphatically two or three years ago. Investors have faced a frustratingly long wait as stockpiles are run down, development plans mothballed and production cut to expedite a cyclical recovery.

The most important ingredient for investors - buyer anxiety among power utilities - remains elusive. Buyers appear satisfied that incremental production is poised to respond in a timely fashion to their needs. So, as complacency rules, spot transactions outweigh contracted quantities by a historically large margin.

Peninsula Energy, which commenced in-situ leaching of a 53.9 million pound resource in 2015, is one of the best positioned companies to meet any uptick in uranium demand. ASX-listed Peninsula (PEN) has annual U3O8 production capacity of 1.15Mlb in the Powder River Basin of Wyoming, with approvals to go to 3Mlb. Only 90,000-110,000lb of production is expected in 2019.

The company has contracts extending to 2030 to deliver 4.5Mlb of U3O8 at prices above US$50/lb. Market conditions have created an incentive for it to make sub-US$30/lb spot market purchases to profitably fulfil delivery obligations.

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Near term margins would be immediately compressed by higher spot prices but improved demand would allow the company to expand production and lower costs. A 2018 feasibility study suggests production costs could be cut from US$40.58/lb to US$30.36/lb with a doubling in capacity.

Meanwhile, Peninsula has shaved its administration expenses. To permanently lower cash costs, it is converting its production technology from the alkaline based process favoured by US in-situ producers to an acidic process used extensively among producers outside the USA.

Heili put his case to investors in a trip to Australia recently. The company, he said in a Melbourne presentation, is poised to benefit from a combination of controllable initiatives, more favourable future market conditions and a likely US government decision to shore up domestic uranium production.

A 40% share price rise since the day of an investor webcast in early February has been a welcome respite for a stock which had lost as much as 97% since early 2011.

In presenting his investment case, Heili has characterised a US Department of Commerce investigation into whether national security justifies reducing uranium imports as an imminent win for such long suffering Peninsula shareholders as well as any newcomers.

US uranium production has fallen short of five million pounds a year for 20 consecutive years despite annual US use exceeding 40Mlb. A 25% domestic production quota has been floated as a possible outcome from the examination of market conditions under Section 232 of the Trade Expansion Act Of 1962.

The willingness of the current US administration to embrace trade restrictions as a policy tool has stoked expectations of action favouring uranium producers. If they have done it for steel and aluminium, why not for uranium, was the question asked by at least one investor in Melbourne.

One reason uranium may miss out on similar treatment is its relative economic impact, one of the criteria for Section 232 investigators to consider. Uranium mining employment is less than 400 people nationwide, according to the US Energy Information Administration.

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Whether uranium is singled out for special treatment in April, when the Commerce Department report is due, will most likely hinge on whether Pentagon chiefs push for more domestic production to ensure their military needs. Without their backing, the argument looks especially weak.

No mainstream economist anywhere, including within the Trump administration, regards trade restrictions as sensible policy. Trump's trade restrictions have been tolerated only as a possibly useful tactical bargaining tool.

Restricting uranium imports through a quota would not precipitate negotiations leading to sustainable improvements for US business, consumers or, more practically, voters.

A quota used to shore up US uranium production may simply prolong the global market agony, if US output is expanded needlessly. US miners could end up being asked to supply higher volumes at lower prices.

The Trump administration has invoked national security to justify trade restrictions not out of a strong belief that commodity imports threaten security but because that was the only legally acceptable way in which it could grab the attention of China, Trump's principal economic adversary.

An apparently imminent rapprochement with president Xi might signal Trump has made his point. Future decisions about trade policy may revert to those with more mainstream market views.

Uranium is not the only commodity for which the US depends on overseas mines. For a range of technologically oriented metals, US policymakers must decide whether to underwrite a basic US production capacity, irrespective of commercial merit, or whether they are better off locking in economically sustainable supplies from allied countries. This warrants a careful strategic assessment, not a kneejerk response.

Heightened expectations of a US uranium quota have fed into a recently higher share price for Peninsula Energy. A failure to impose a quota, otherwise known as sensible policy, could turn quickly into another investment setback.

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