The Starboard Side Report

The week ending February 28, 2014

Next month will mark the three-year anniversary of the Fukushima nuclear disaster in Japan. As such, we are going to focus our report this week on why the nuclear industry (and specifically uranium needed to generate nuclear power) may finally be ready for investment dollars after a brutal decline resulting from the fallout of the 2011 accident.

The best investments are usually those that combine an attractive economic fundamental story with an attractive risk-reward from a technical analysis perspective. Technical analysis is the study of price and sentiment rather than the economics of an investment. Wall Street and industry estimates/projections have to be taken with a grain of salt due to the inherent optimistic bias that is usually built into their assumptions. That is why it pays to cross check them with technical analysis in order to see the "picture" behind the story.

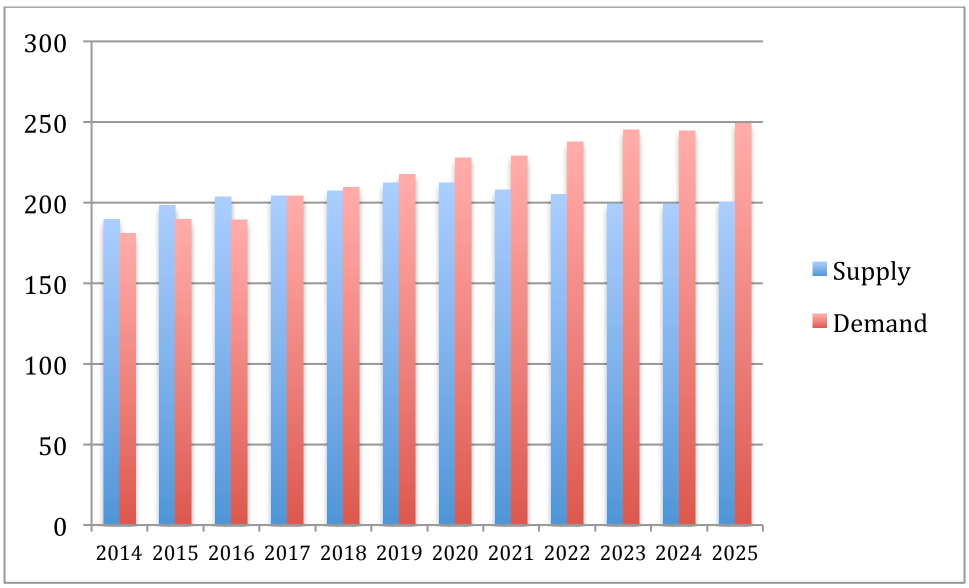
Uranium Fundamental Analysis

One part of the fundamental story is that Japan announced this week that they are going to reverse course and slowly begin to reopen dozens of nuclear reactors that were shutdown following the Fukushima incident. Japan's 49 Gigawatt (GW) of nuclear capacity gave it one of the largest nuclear power footprints in the world prior to March of 2011 (approx. 15% - 20% of world capacity). Post-Fukushima, a plunging currency has led to soaring energy import prices and a need to do an about-face on the closure of the nuclear industry. Turning their reactors back on is a major psychological boost for the supply-demand dynamics of uranium mining due to Japan's role as a top uranium buyer. According to Raymond James research, Japan will never be back to pre-Fukushima capacity of 49 GW, but should gradually ramp back up to 32 GW over the next five years.

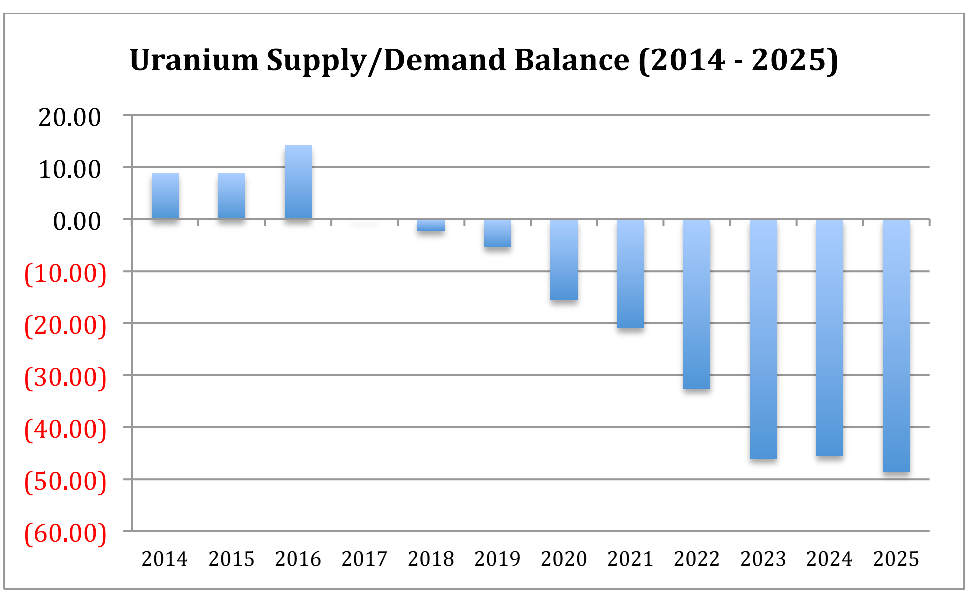
The most positive fundamental argument in favor of uranium comes down to the basic law of economics, supply vs. demand. We mentioned Japan coming back online and its affect on demand. However, the real story is that China and India are about to enter the nuclear power business in a big way in order to power the growing power needs of their rising middle classes. By 2025, Raymond James estimates that 131 GW of Capacity will be online in just these two countries, up from just 24 GW at present! This will take China and India from 7% of world nuclear capacity to 20% and result in a 55% increase in total global nuclear utility capacity. This increase in nuclear power generation capacity will have a dramatic effect on uranium demand and lead to a very significant supply-demand imbalance by 2025.

The supply side of the equation will not be able to keep up with demand for a variety of reasons. Interestingly enough, the price collapse in uranium after Fukushima is one of the main reasons for the long-term supply problems that the industry is facing. There have been enormous production cutbacks that have taken much-needed future supply offline. The uranium mining industry needs high prices in order to secure financing for projects that have enormous lead times (typically 10 years or more). That financing has all but vanished in the wake of Fukushima. The other supply side issue is the expiration of the Russian Megatons to Megawatts program that converted nuclear weapons into usable fuel for US utilities. This will take 20 Mlb/year of secondary uranium supply out of the market that will have to be filled by new uranium mining projects. Below we see the very bullish supply demand picture between now and 2025.

Uranium Supply vs. Uranium Demand (2014 – 2025)



Source: Raymond James



The bottom chart shows the trend from an 8.8 Mlb/year surplus in 2014 to a nearly 50 Mlb/year deficit by 2025. It seems to us that uranium prices may have troughed after a three-year bear market and should start to head higher over the foreseeable future given the positive fundamental backdrop.

Uranium Technical Analysis

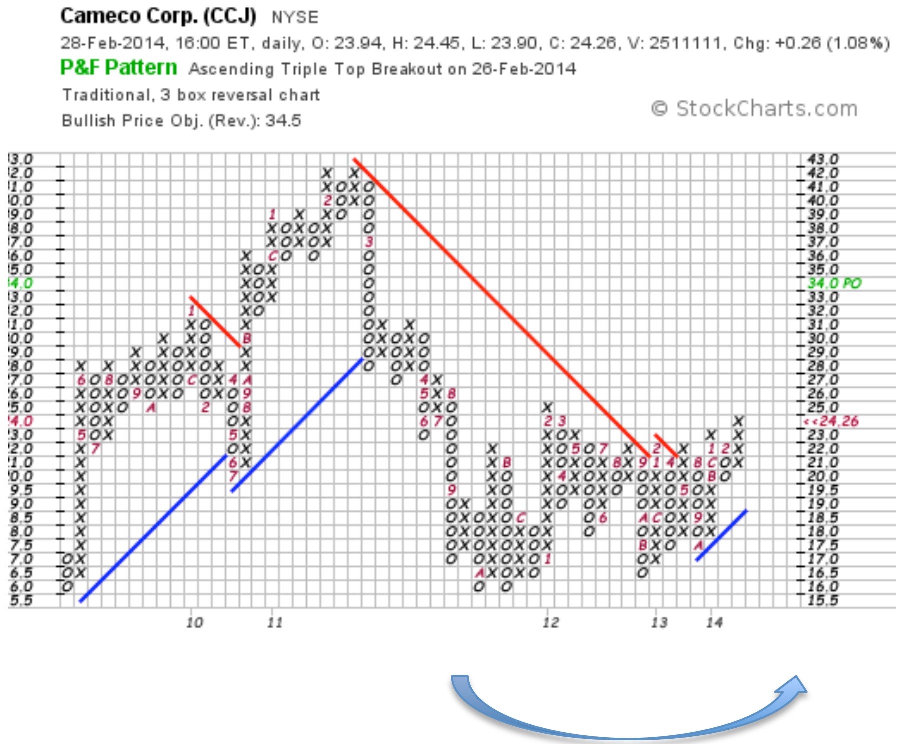
As mentioned above, the price of uranium has been pummeled since March of 2011. However, the price history shows that there have been a few concrete signs of a bottom over the past few months. The chart below is of the Canadian stock Uranium Participation Corp. According to their website, Uranium Participation is "a company that invests substantially all of its assets in uranium oxide in concentrates ("U3O8") and uranium hexafluoride ("UF6") (collectively "uranium"), with the primary investment objective of achieving appreciation in the value of its uranium holdings through increases in the uranium price." That makes it a great benchmark of uranium prices and the market's appetite for uranium as an investment.

Uranium Participation Corp (Last 9 Years)

A couple items of note: First, notice how Fukushima stopped a burgeoning rally in its tracks and sent the price spiraling lower. Second, this chart has spent the past year making a nice rounded bottom and has just broken above a seven-year downtrend line. This is powerful price action that we often see before a bear cycle turns to bull.

The other chart that we will highlight this week is that of Cameco Corp, the largest publicly traded pure uranium miner in the world. It has been a challenging couple of years to say the least, but we are seeing signs of demand starting to win out versus supply in this blue-chip miner.

Cameco Corp, Point & Figure Chart



Cameco actually been forming a large rounded bottom over the past two years year and is finally starting to accelerate the breakout above its long-term downtrend line (red line on point & figure chart above). This is a very bullish pattern that projects higher prices ahead.

While Cameco is the blue-chip miner, there are other smaller and more speculative names in the sector. The majority is encompassed in this next chart of the Global-X Uranium Miners ETF. This too is showing signs of ending a long and painful bear market that wiped off 75% between March 2011 and last October.

Global X Uranium ETF (2011 – Present)

As risk adverse investors, we are at the point of the investment cycle where we want to be looking for assets that are in their own cycles and not dependent on the S&P 500's direction (which we believe will be down over the next year or two once it tops out). We have discussed gold and US treasury bonds over the past few months as assets that should be able to have their own bull cycles independent of the US stock market. Commodities like uranium have historically been able to trade uncorrelated to US stock bear markets, so that is why we are also looking for ideas in the broad array of investable commodities. As investors discovered with a vengeance in 2011, the risks to investing in the nuclear sector are definitely high from a safety perception standpoint. However, three years of price declines, washed out expectations, improving chart patterns and very solid long-term fundamentals make this an interesting time to consider adding some exposure to uranium. The icing on the cake is that uranium can trade in an uncorrelated manner to the overvalued US stock market and the fragile global economy.