BARRON'S

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Glowing With Potential

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Uranium, used in power plants and weapons, has long been a quiet corner of the commodities market. But demand may soon take off, due to (what else?) China.

URANIUM, IN THE FAST-MOVING WORLD of commodities, is a wallflower, with prices publicly quoted just once a week. But interest in the radioactive substance, used in weapons and energy production, may soar, courtesy of China.

The Chinese have been on a buying spree thatisn't yet fully reflected in the price. Financial players, who helped uranium hit a record $136 a pound in June 2007, are returning to the spot market. And the launch of an exchange-traded fund for physical uranium, now tradable only through a tiny futures market, a uranium mining-company ETF and Uranium Participation Corp., a closed-end fund (ticker: U.Canada), seems inevitable.

"There are big structural changes going on," says Thomas Neff, a physicist affiliated with the Massachusetts Institute of Technology's Center for International Studies. In the early 1990s, he was a main architect of the "Megatons to Megawatts" program, under which thousands of Russian nuclear warheads have been dismantled, with the uranium sold to the U.S. for use in commercial reactors. In 2009, it satisfied about 24 million of the 174 million pounds of global demand, according to the World Nuclear Association. But it expires in 2013.

Cameco

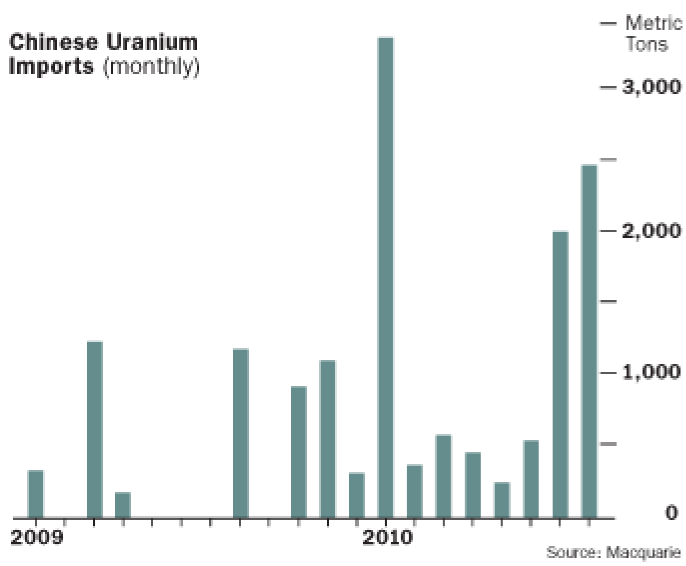
The Line on Mines -- Just eight mines produce more than 50% of global uranium. Above, a Cameco mine at Rabbit Lake, Canada. At right, yellowcake–a concentrate that is formed by extracting uranium from ore.

Neff views $70 a pound as "a reasonable price" over the next 12 to 18 months, if China keeps buying, but some bulls say $90 is more likely. Uranium, which bumped along in the low $40s in 2010's first half, while industrial metals like copper were on fire, recently hit a two-year high of $53.50.

"This is a commodity that, when it starts to move, it can get crazy," says Robert Mitchell, general partner of Portal Capital in Oregon, noting that spot prices never ticked down in the three years through 2007. He's the portfolio manager of Green Energy Metals, a hedge fund with 70% of its portfolio in physical metals—its largest stake is in uranium—and the rest in related equities, and Odysseus, a metals-stock fund. The two are up 16% and 20.5%, respectively, this year.

A mere eight mines account for more than 50% of global output, much of it in places like Kazakhstan, rife with political risk. Mitchell, who called the 2007 top in the market, closing a fund when the metal was around $133, says the current price isn't high enough to encourage new mine construction. It would have to reach the 60s or 70s for that to happen.

Utilities buy uranium largely through long-term contracts, cuurently paying about $10 a pound above the spot price. At about 20% of the overall market, the spot market is particularly volatile. In addition to U.S. dollar weakness, the recent runup has been helped by producers like Rio Tinto (RIO) and Cameco (CCJ), which have been buying in the spot market to meet commitments, and Kazakhstan, which says it won't hit its 2010 production target.



But China is the market's powerhouse. The Chinese now have about nine gigawatts of nuclear-generating capacity and, until last week, were expected to have 70 gigawatts by 2020. But Thursday, according to published reports, China boosted its goal for that year to 112 gigawatts. That would mean that the Chinese would need 64 million pounds by then, nearly 50% of the 132 million pounds that will be produced this year, based on methodology used by consulting firm McKinsey, which thinks that the real capacity goal is higher: 120 gigawatts.

China operates 11 reactors, and has 28 under construction; in the U.S., 104 are in operation. Through September, China had imported 22 million pounds, four to five times as much as it needs this year, says MIT's Neff. He thinks that in addition to stockpiling the metal, China might plan to enrich and sell fuel to others. He says weekly spot prices quoted by TradeTech and Ux Consulting mostly reflect Canadian producers and U.S. utilities, and don't include all the Chinese buying. Last week, a major Chinese utility reportedly inked a pact with France's Areva to buy 20,000 metric tons of uranium over 10 years at $75 a pound.

Several other countries plan to build new reactors, too. Fletcher Newton, an executive vice president of Canadian miner Uranium One (UUU.Canada), expects U.S. utilities to add about 10 gigawatts of capacity in the next few years.

Recently, Global X Uranium, an exchange-traded fund (URA) linked to the uranium mining industry, was launched, joining a couple of ETFs that track the producers as well as utilities and infrastructure.

As for stocks related to the metal, Rio Tinto and BHP Billiton (BHP) hold uranium assets. But Cameco, with a stock-market value around $13 billion, is the only large-cap pure play. Though it is a low-cost producer, it has sold forward a huge amount of production," so its sensitivity to changes in the uranium price is reduced," says Adam Schatzker, an RBC Capital Markets analyst. While Cameco trades at 1.3 times net asset value, Uranium One, which Mitchell has in his portfolio, trades at net asset value, according to RBC. But Mitchell believes that because Uranium One hasn't sold any of its 2012 production, it has leverage to higher prices, and "should probably trade at a premium to Cameco."

Before year end, Russia plans to increase its holding in Uranium One to 51%, at which time it will pay shareholders a $1.06-a-share dividend. Mitchell thinks the shares, now at C$5.04, could fall by more than the special dividend after it is paid, which would be a good entry point. Another pure play: Australia's Paladin (PDN.Australia), although at A$4.48, it's 40% above net asset value, RBC says. Schatzker expects it to perform very well if uranium goes up and views it as a potential takeover target. So, it offers investors two ways of becoming enriched.