



OUTSTANDING INVESTMENTS

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Uranium Is Down and Out — So Let's Invest in Uranium!

The Industry's Newest Producer, With Super-Low Costs and a Strong Future...

By Editor: Byron King

When an earthquake devastated Japan in March, it also led directly to the meltdown of four nuclear electric power reactors along that nation's Pacific coastline. What happened in Japan was a disaster of epic proportions.

In the past few months, the scale of the Japan meltdown has become apparent. A vast swath of eastern Japan is dealing with radioactive fallout. Hundreds of thousands of people are displaced. The Japanese economy has slowed dramatically, and the ripples have spread to economies on other continents. Radioactive material has spilled into the Pacific Ocean and vented into the atmosphere. Word is that the nuclear cleanup effort in Japan may last well over 100 years.

So do the Japanese meltdowns ring the death knell for the world's commercial nuclear power industry? After all, not long after Japan's disaster, Germany adopted a plan to eliminate its nuclear electric generating sector by 2022, a mere 11 years hence.

Obviously, nuclear power has problems. But as investors, we have to keep our minds open. That is, what if the issues with nuclear power are neither as bad nor insoluble as many people think? Is there a potential investment advantage for you? In this issue of OI, let's discuss the background of nuclear power, think it through and look at a new investment idea.

Electricity and the U.S. Nuclear Legacy

Let's start with some basic facts. Commercial nuclear power has been online for well over 50 years. There are nuclear plants across the globe, with 436 operating reactors in 30 countries. Close to home, there are

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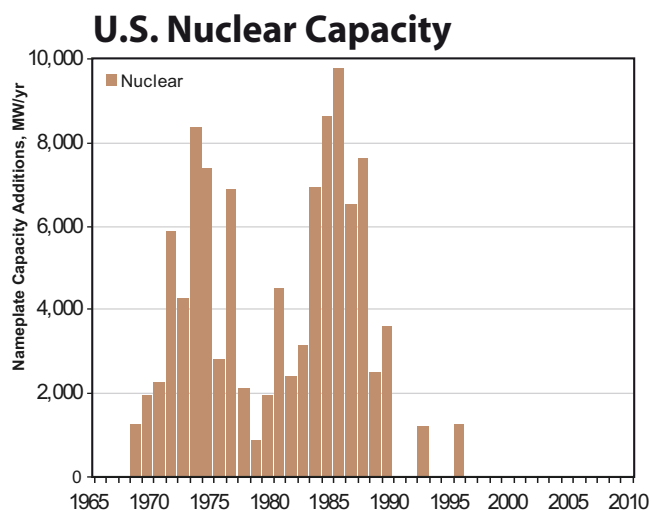
Action to take:

Buy Uranium Energy Corp. (UEC: AMEX) up to \$3.50.



104 working reactors in the U.S.

Let's go a bit deeper into the history of these plants. Most U.S. nuclear reactors are old — designed in the 1960s–1970s and built and commissioned in the 1970s–1980s. Here's a graph that shows the megawatt capacity of U.S. nuclear installations over the past four decades.



Note the building boom of the mid-1970s, with a sudden drop in 1979. That was when there was an accident at Three Mile Island, Pa. Regulatory authorities suspended work on most new projects, pending investigations.

After scrubbing and scrutinizing the plans, the regulators eventually allowed previously committed U.S. projects to move to completion by the mid- and late 1980s. Still, there was no new nuclear construction in the U.S. in the 1990s–2000s. The U.S. nuclear industry was moribund in terms of new construction, although it focused on running the existing reactors with a strong emphasis on safe operations and improving technical competencies.

Overseas Nuclear Issues

In the rest of the world, where nuclear power is used, there are many similarities to what we see in the U.S. The rest of the nuclear world also runs a large array of 1970s–1980s era legacy systems. In fact, the Japanese reactors that recently melted down were 40-year-old, vintage technology.

Three Mile Island shocked the whole world in 1979. In 1986, the far-worse nuclear accident at Chernobyl, Ukraine, drove home a different point. That is, in a then Cold War world, everyone saw that nuclear safety knows no ideology. Both “capitalist” nuclear plants and “socialist” nuclear plants need to operate at uncompromising standards of technical effectiveness.

The bottom line of the Three Mile Island and Chernobyl accidents was that, across the world (excepting France), almost no large plants were built in the late 1980s, 1990s or 2000s time frames.

Global Power

So where are we today? Well, the world's nuclear power business is made up of mostly aging plants. That is, there are the legacy nuclear power systems, and then there's about a 20–25 year gap, in terms of “missing” capital investment in new plants.

Still, you need to understand that nuclear power today generates almost 15% of the world's electricity. (If you're wondering, about 20% of total U.S. electricity comes from nuclear power.) On the following page is a graph that shows the general worldwide breakdown.

One way to interpret the chart is that despite several decades of organized opposition to nuclear power, the current 14.7% slice of the electric pie represents a lot of the world's energy supply.



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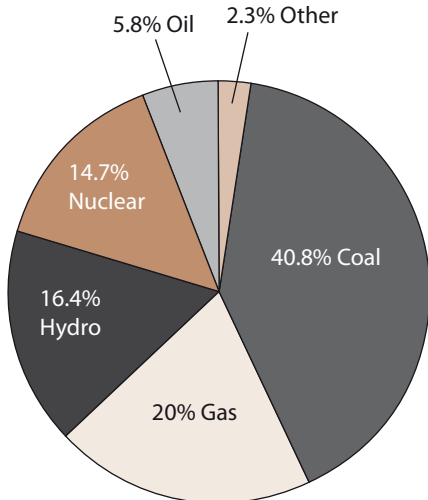
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World Electricity Generation



Source: OECD/IEA

The China Syndrome

Now for the next question in pretty much any investment scenario these days — what about China?

According to *The New York Times*, “China is preparing to build three times as many nuclear power plants in the coming decade as the rest of the world combined.” The Times reported that China’s “civilian nuclear power industry” (and there’s a Chinese military nuclear power side as well) has 11 operating reactors, with as many as 10 new reactors per year planned for the next 15 years. That’s 150 new reactors just in China.

Indeed, the Chinese are quite sanguine about their future need for nuclear power. After the Japanese nuclear disaster in March, Chinese officials made the following points:

- Japan’s reactors are old, 1960s–1970s-era technology
- Japan’s safety systems are outdated and inadequate
- Japan’s reactors are sited in dangerous seismic zones
- Japan’s emergency response measures are inappropriate
- China will continue with its nuclear program, but definitely not make the same kinds of mistakes as Japan.

Call it self-serving, call it bluster or call it anything else. But Japan meltdown or no, China is still going forward with its nuclear program.

A Renaissance, or Not?

How can we summarize this? Up until March and the meltdown in Japan, it was fair to say that there was a global nuclear renaissance coming down the track. After March, it’s fair to say that the jury is out on nuclear power in some jurisdictions — Germany is backing away from nuclear power, but apparently, China is not.

So what do we do? It’s not prudent investing to write off the entire nuclear industry. In any event, the world will have a tough time if it tries just to flip the nuclear off switch and walk away.

The world is dotted by those above-described legacy systems, plus, there are new-builds out there on the horizon. By one authoritative estimate, over 50 nuclear reactors are currently under construction worldwide. There are about 137 more reactors formally planned and another 295 reported proposals in the wings, under preliminary review.

Where’s the Future Fuel Supply?

It’s clear there are a lot of reactors out there (436 worldwide), with perhaps 200 more on the way over the next 25 years or so. Where will the world nuclear industry obtain the uranium fuel for all these new reactors? That’s a darn good question, because the reality is that the world’s uranium pipeline is pretty thin. What do I mean?

Just in the U.S., annual uranium demand for the nuclear power industry is about 55 million pounds. The U.S. produces less than 4 million pounds of this fuel — about 7% — and imports the rest. Only 7%? If you thought the U.S. had a problem with imported oil, now you know there’s also an issue with imported uranium.

This fact alone — that the U.S. imports 93% of the uranium it uses — is astonishing. It was one thing for the U.S. to import uranium from the Belgian Congo during World War II. Indeed, the U.S. actually used captured German uranium for a while after World War II. But that was long ago, at the beginning of the nuclear age, when there were no other options.

The short history is that from the late 1940s to the early 1980s, there was a robust U.S. program to explore for uranium and produce nuclear fuel. Those were the days of the old Atomic Energy Commission (AEC). Under the AEC, the U.S. put significant national resources into its uranium

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industry. As a result, once upon a time, the U.S. had a strong uranium mining and processing industry. No more.

Today, in fact, much of the nuclear fuel the U.S. imports comes from decommissioned nuclear warheads from Russia. The Russian warheads trace their origins back to the days of the Soviet Union. The highly enriched, weapons-grade Russian uranium gets mixed down to a lower potency suitable for nuclear power plants. Thing is, the Russian warhead pipeline is running down. The stockpile of decommissioned nukes is nearing the bottom, and the Russian-U.S. nuclear agreement expires in 2013.

Connecting the Dots

Let's connect the dots and use the picture to examine the investment case for uranium. In just the U.S., we have a legacy nuclear industry, 65 years old, that has suffered from two recent generations of chronic underinvestment, as well as public uncertainty.

Also in the U.S., we have a large number of old nuclear plants that still need fuel, but the U.S. uranium mining industry ain't what it used to be. So the U.S. imports most (almost all) of its fuel, including from decommissioned Russian nuclear warheads — a deal that will expire in 2013.

Now we're watching a fitful global resurrection of nuclear power, despite what happened in Japan. Worldwide, there are possibly 200 or more new plants coming online.

Finally, it's important to keep in mind that carbon-based energy systems are out of favor, certainly in the elite salons of the Western world. Coal-fired power won't cut it in the West. There are almost no new coal-fired generating plants on the drawing boards anywhere in the U.S. So energy planners need to keep an eye on nuclear as a default source of energy, now and long into the future.

To its credit, the modern nuclear power industry has been working on new designs over the past couple of decades. Today, there's fourth-generation technology that's MUCH safer than it was in the past. This includes nuclear reactors with standardized designs and less dangerous fuel systems. These new designs are faster to construct and much less costly than in the olden days.

The Uranium Energy Story

So let me introduce you to the world's newest, low-cost uranium producer. It's called **Uranium Energy Corp. (UEC: AMEX)**, with headquarters in Vancouver and most of its major work effort going on in the energy-friendly state of Texas.

I've had UEC in the *Energy & Scarcity Investor* portfolio for about 18 months. UEC delivered a nice gain along the way, but the share price has pulled back in recent months. Still, for reasons that I'll describe below, I believe UEC is appropriate for OI as well.

UEC shares trade for around \$3 each right now, way down from their high of well over \$7 early in the year before the Japan disaster. UEC shares have also traded down sharply during the recent stock market sell-off. The share price is simply not reflective of the value here, and in my view, this company is selling in the bargain-base-ment range.

Right now, the UEC market capitalization is just over \$200 million, which is at the low end of any company that I'd usually consider including in the OI portfolio. Then again, the share price is down while the stock has strong trading volume and a solid set of market makers. Based on the company's fundamentals, I believe that UEC is poised for a strong rebound when the markets settle down. There are handsome gains to be made here.