Could Cameco Corporation Hit $40?

Description

It’s an ugly scene in the commodity markets these days. Investors are watching a broad-based blowout and uranium miners are no exception. Shareholders of **Cameco Corporation** (TSX: CCO)(NYSE: CCJ) have been in pain for a while. In fact, they have watched the stock drop from $40 in early 2011, to the current price of about $18.

Global equity markets look like they are about to roll off the cliff, so why would anyone consider putting new money to work in this environment? In the case of Cameco Corporation, the story is a compelling one right now for contrarian investors.

Here’s why.

Uranium prices have bottomed

The spot price of uranium reached multi-year lows below $30 per pound in the summer but the market has experienced a significant bounce off the lows over the past two months. In fact, the price is holding steady above $35 per pound. The value is still too low for most producers to be profitable, but it’s a start. For the moment, the equity markets have mostly ignored the gains and that might continue in the near term.

Russian sanctions are partly responsible for the recent strength in the price. The standoff between Putin and the West is probably still in its early stages, so the uranium market should see continued price support on that front.

Demand will increase

Cameco expects more than 90 net new nuclear reactors to go into operation in the next 10 years, as China and India race to keep up with electricity demand. Analysts also expect at least 30 of Japan’s reactors to be restarted by 2019. According to Cameco’s forecasts, the current global demand for uranium of 170 million pounds will hit 240 million pounds by 2023. Miners are producing about 160 million pounds right now, with the rest of the demand being filled by secondary supplies.

Uranium supplies will be tight

The current oversupply in the uranium market should disappear in the next 18-24 months. Producers have cut back on production, and secondary supplies that have filled demand on the spot market are slowly being worked through. Low prices have forced miners to postpone new projects and demand projections now suggest the market could see a significant supply shortage by the end of the decade.

Why Cameco's shares should outperform

Cameco is still profitable, even in the current low-priced environment. In its Q2 2014 earnings statement the company reported profits of $127 million. Cameco enjoys a huge competitive advantage in the uranium space because it holds some of the highest-grade deposits on the planet. The company's McArthur River asset is the world's largest and highest-grade mine. This is a critical point for long-term investors.

With the uranium space being so beaten up, any good news in the market will send producers higher. Investors saw this happen when Cameco's shares rallied nearly 50% from October 2013 to March 2014 on the expectation that Japan was going to restart two reactors.

Risks?

Cameco has an ongoing tax dispute with the Canada Revenue Agency. In the Q2 2014 report, the company said it now sees its risk at $625-650 million. If Cameco loses the case, which could be decided in 2015, the shares could get hit hard.

The next surge in uranium prices will likely be Japan-related, but the long-term fundamentals suggest a sustained move is inevitable. For investors willing to ride out some short-term volatility, the potential gains at this point are significant.

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1. Investing
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Date
2025/07/30
Date Created
2014/10/16
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