Could Cameco Corporation Double This Year?

Description

Cameco Corporation (TSX:CCO)(NYSE:CCJ) is up more than 20% since the middle of January and investors are wondering if the rally will continue through the end of the year.

The recent strength in the stock is a welcome sign for long-term investors who have watched the shares lose more than half their value in the past four years, but the market is still unsure if the stock is about to take off or simply bounce along the $20 mark forever.

Let's take a look at the current situation to see if Cameco deserves to be in your portfolio.

New deal

The stock received a nice vote of support in April when the Indian prime minister announced a new multi-year agreement between Cameco and India's Department of Atomic Energy. The deal means that Cameco will supply 7.1 million pounds of uranium concentrate in the next five years to fuel India's large fleet of nuclear reactors.

Canada banned the supply uranium to India back in the 1970s after India used Canadian technology to build a nuclear bomb. Diplomatic tension over the issue lasted more than 40 years.

In 2013 the two countries decided to bury the hatchet and signed the Canada-India Nuclear Cooperation Agreement. This gave companies like Cameco the green light to begin negotiating new contracts with the Indian government.

India is the world's second-fastest growing nuclear energy market, with 21 reactors currently in operation and another six under construction. The new reactors are expected to go into service by the end of 2017. Together, the 27 units will have a total capacity of 10,300 megawatts.

The new agreement is good news for Cameco in the near term, but investors should be looking at the long-term potential. By 2032 India expects to have 45,000 megawatts of nuclear capacity.

Demand growth in China

The Chinese government just started approving new reactor projects after a four-year moratorium following the disaster in Japan. China now has 26 reactors in operation and 23 under construction.

Globally, Cameco says 63 new reactors are under construction, and 81 net new facilities are expected to go online in the next 10 years.

Uranium prices remain in a trading range between US$35-40 per pound as current supply continues to meet demand. In the past four years producers have reduced production and delayed or cancelled mine expansions, and Cameco says ongoing production issues at several of the industry's larger mines could tighten supply even more in the coming year. This should put a floor under global prices.

Risks

Cameco continues to fight tax battles with both the IRS and the Canada Revenue Agency (CRA). The CRA dispute is the most significant, with potential penalties as high as $820 million if Cameco is unsuccessful in its appeal. A decision on the case isn't expected before 2017.

Should you buy Cameco?

The global uranium market has probably hit the bottom of its cycle and history shows that uranium prices and the shares of producers can move significantly higher in a short time span.

I suspect the tax concerns are built into Cameco's stock price at this point, so there should be limited downside risk. A settlement that is better than the worst-case scenario would put a tailwind behind the stock.

Japan is expected to restart two reactors this summer. As soon as that happens the market should get a boost.

For Cameco to double, uranium prices would have to spike significantly, and that probably won't happen in 2015, but the next couple of years could produce some big gains. Long-term investors should be comfortable picking up the stock at current prices, although volatility should be expected until the tax fights get settled.

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