Is Cameco Corporation a Good Contrarian Pick?

Description

Contrarian investors are scouring the market for a chance to pick up unloved stocks at very reasonable prices.

Cameco Corporation (TSX:CCO)(NYSE:CCJ) has been in the penalty box longer than most, but that's exactly why it might be the right time to put the stock on your radar.

Uranium woes

Uranium prices have been in the dumps for more than four years, and investors are wondering if the market will ever recover from the catastrophic effects of the disaster in Japan.

They have reason to be concerned.

Back in early 2011, uranium spot prices traded at US$70 per pound. Today, the price is roughly half that amount. The long-awaited return of Japan to the uranium market is just beginning, but demand from the country is going to come in trickles rather than waves. At the same time, prices have been kept low by a large supply of secondary reserves.

Here's the good news.

Those supplies are dwindling and the point is going to come when the market shifts from oversupply to shortage.

Supply squeeze

Producers in most commodity industries can weather downturns for short periods of time, but when the weakness stretches out for years, it has a big impact on new developments.

The current price is unprofitable for many of the world's uranium miners. This has led to the delay or outright cancellation of new projects, and that is going to have important ramifications in coming years.

As supply in the secondary market dries up, spot prices are going to drift higher and that is going to scare utilities.

Why?

Most nuclear energy companies negotiate long-term contracts with miners to lock in reliable supply at predictable prices. The extended weakness in the market has meant that power companies have been avoiding new long-term deals and filling the gaps with cheap purchases in the spot market.

But prices can jump very quickly. Once the industry sees the tide turning, there could be a stampede into the market to secure supply.

Cameco says 82 net new reactors will go online in the next 10 years, but the existing production capacity is unlikely to be enough to meet the extra demand.

The industry knows this. It’s just a matter of who will blink first.

Cost control

Cameco is one of the most efficient companies in the industry. Expense management is part of the reason but the company also owns some of the richest uranium reserves on the planet.

Despite the tough market conditions, Cameco is still profitable. Second-quarter 2015 earnings came in at a respectable $0.22 per share. Total 2015 revenue is projected to be 5-10% higher than last year.

CRA battle

The stock has been held back by a battle with the Canada Revenue Agency (CRA) over taxes on revenue earned by Cameco’s international subsidiary.

Cameco says it could be on the hook for more than $800 million if it loses the case. The issue is unlikely to be resolved before 2017.

Should you buy?

The CRA troubles are well known and mostly priced into the stock. If the company negotiates a deal that is better than the worst-case scenario, the stock could move significantly higher. As a long-term play, the fundamentals for Cameco and the industry look good.

At this point, patient investors might want to consider adding a small position to get ahead of the curve.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:CCJ (Cameco Corporation)
2. TSX:CCO (Cameco Corporation)

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