Cameco Corporation: Is it Time to Buy This Beaten-Up Stock?

Description

Cameco Corporation (TSX:CCO)(NYSE:CCJ) is down about 50% in the past five years, and investors are wondering if the stock will ever break out of its slump.

Let's take a look at the current situation to see if Canada's top uranium producer deserves to be in your portfolio.

Market outlook

The uranium market remains in a state of oversupply as secondary sources keep spot prices under US$40 per pound. That situation is expected to persist in the near term, but demand catalysts are starting to point to a shift in the market.

Japan has restarted two of its nuclear reactors, and that process should bring more confidence into the market. Three more of Japan's reactors have been approved for restart and another 20 are awaiting the green light.

On the global stage, there are 65 new reactors currently under construction, and additional units planned for the next 10 years means uranium demand is going to increase.

Cameco expects annual uranium requirements to increase from the current level of 155 million pounds to 230 million pounds by 2024.

The extended duration of the current slump has forced producers to delay or completely abandon plans for new projects. That could create a supply shortage in the coming years as the pool of secondary supplies dries up and not enough primary supply is available.

Uranium prices can move quickly and energy companies don't want to get caught short in a rising-price environment. Most power producers sign long-term contracts to ensure adequate supply at reasonable costs. The prolonged slump has encouraged energy companies to fill demand gaps in the spot market and put off signing new long-term agreements.

As soon as the market begins to shift to a neutral or shortage position, energy companies will rush to lock in rates, and that should be supportive of prices. If everyone scrambles at the same time, the uranium market could see a significant pop and Cameco’s share would follow it upward.

Earnings

Cameco is a very efficient company, and management has done a good job of keeping costs down during the slump.

The company reported Q3 2015 adjusted earnings of $78 million, or $0.20 per share, down from $93 million, or $0.23 per share in the same period last year.

Production

Cameco is well positioned to profit when the cycle finally turns. The company is a low-cost producer with some of the planet’s highest-grade resources. The Cigar Lake mine is finally operational and exceeding production expectations, and Cameco has the ability to adjust output to meet the market’s needs.

Risks

Cameco is in a battle with the Canada Revenue Agency (CRA) over taxes owing for the 2003-2009 tax years. To date, the CRA has sent Cameco notices of reassessment for about $2.8 billion of additional income that would translate into taxes owing of about $820 million if Cameco loses the case. The company also expects the CRA to send notices for the subsequent tax years.

The potential hit is significant if things go the wrong way for Cameco, and investors should watch the process carefully.

Should you buy?

The CRA issue is well known and probably already priced in. If you have a contrarian style and like the long-term outlook for the industry, Cameco looks like a good bet, but volatility should be expected until the CRA dispute is resolved.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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