Is Cameco Corporation Worth a Shot?

Description

Cameco Corporation (TSX:CCO)(NYSE:CCJ) continues to trade near its lowest levels in more than a decade, and investors are wondering if the stock will ever shake off the slump.

Let's take a look at Cameco to see if better days are on the horizon.

Uranium market

The world is experiencing a widespread commodity slump, but the uranium market has been particularly weak for nearly five years.

Spot prices remain stuck below US$40 per pound, a level that puts a significant number of global projects in the red. The tough times are projected to continue for the near term, but demand growth in the coming years should breathe new life into the market.

Japan shut down its entire fleet of nuclear reactors after the tsunami hit in 2011. The country is just beginning to restart its plants, and that process should bode well for the uranium market in the next few years.

Two of the Japanese facilities are now up and running again and three more have been approved for restart. About 20 others are waiting for approval.

Global demand for electricity is driving countries to expand their nuclear facilities. There are 65 new reactors currently under construction, and at least 80 net new reactors are expected to come online in the next decade.

This should increase annual uranium demand from the current level of 155 million pounds to 230 million pounds by 2024.

As demand is set to ramp up, supply might not keep pace.

Spot prices have remained low in the past four years because secondary supplies have thrown the market out of balance. That resource pool is drying up and the long slump in prices has forced producers to delay or cancel plans for new mines.

The result could be a supply squeeze in the coming years.

Most energy companies sign long-term agreements with producers to ensure stable prices and a steady supply of uranium. They simply can't afford to get caught out by a shortage. Depressed prices have deterred power producers from entering new contracts because they have been able to fill supply gaps with cheap uranium in the spot market.

Once the market shifts from being oversupplied to a neutral state, power suppliers will want to sign new long-term deals, and that should be good for Cameco and its shareholders.

Earnings

Cameco is one of the industry's most efficient companies. Adjusted earnings for Q3 2015 came in at $78 million, or $0.20 per share, down from $0.23 per share in the same period last year. The company has remained profitable throughout the downturn, and investors should see a strong earnings boost once the market finally turns.

Production

Cameco runs the world's largest uranium mine and owns some of highest-grade resources on the planet. Its Cigar Lake project is finally up and running and exceeding production expectations, so the company is well positioned for a rebound in the market.

CRA issues

Cameco is in a dispute with the Canada Revenue Agency (CRA). The disagreement is connected to taxes owing for 2003-2009, and the CRA could extend the claim into subsequent years. If Cameco loses the case it would be on the hook for more than $800 million in additional taxes.

Should you buy?

Uranium prices will eventually recover and most of the CRA risk is probably priced into the stock. A turnaround in the market is not imminent, but contrarian investors might want to start a small position to get ahead of the curve. If the CRA dispute gets settled in a way that avoids the worst-case scenario, the stock could bolt higher.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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