Cameco Corporation: Should You Buy This Stock?

Description

Cameco Corporation (TSX:CCO)(NYSE:CCJ) is trading near its 12-month low, and investors are wondering how long the tough times are expected to last.

Let's take a look the current situation to see if this is the right time to step into the stock.

Market woes

Commodity prices across the board are going through a rough time right now, but uranium has been under pressure for almost five years.

Uranium spot prices actually bottomed out last year below US$30 per pound, but the market has struggled to gain much traction since then. At the moment, the price is about US$36.

The initial fallout began with the 2011 disaster in Japan, which forced the country to shut down its entire fleet of nuclear reactors and pushed a number of other countries to put new projects on hold.

The resulting drop in demand has hit the market, but a surplus of secondary supplies is also keeping prices under pressure and power producers are simply filling supply gaps with purchases in the spot market, rather than signing new long-term contracts with miners.

Better days ahead

The oversupplied conditions are expected to continue into 2016, but the market could be nearing a bottom.

Japan has already restarted two of its nuclear facilities and two more are expected to go back into service in the first quarter of 2016. Another 20 are waiting for approval.

Globally, there are 65 reactors currently under construction, and Cameco expects at least 80 net new reactors to begin generating electricity over the next nine years.

As a result, annual uranium demand should increase from the current level of 155 million pounds to

230 million pounds by 2024.

Supply concerns

The extended rout has forced uranium producers to shelve expansion projects, and that could result in a supply squeeze in the coming years as secondary supplies dry up and primary production falls short of market needs.

As soon as the market starts to move from being oversupplied to a balanced state, energy companies might scramble to lock-in long-term supply on new contracts, and that should give the uranium market a lift.

Cost controls

Cameco has done a good job of lowering expenses through the downturn and has managed to turn an operating profit despite the weak market. Adjusted Q3 2015 earnings came in at $78 million, or $0.20 per share, down from $0.23 per share in Q3 2014.

Production outlook

Cameco operates the industry’s largest mine and controls some of the highest-grade uranium deposits on the planet. The company recently put its long-troubled Cigar Lake project into operation and production is exceeding projections.

With the significant capital expenses behind it, Cameco is positioned well to benefit from a turnaround in the market.

Risks

Cameco is in a battle with the Canada Revenue Agency (CRA) over taxes owing for 2003-2009. The CRA could also extend the claim to subsequent years. If Cameco loses the case it could be on the hook for more than $800 million in extra payments.

Should you buy?

The CRA issue is well known and likely already priced into the stock. The uranium market will eventually recover, and Cameco is a low-cost producer in the industry. If you have a contrarian investing style and are willing to wait for the cycle to turn, this might be a good time to add the stock to your portfolio.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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Author
aswalker