Cameco Corporation: Look Out Below?

Description

Cameco Corporation (TSX:CCO)(NYSE:CCJ) continues to hit lows not seen in more than a decade, and investors are wondering if more pain is on the way.

Let's take a look at Canada's largest uranium miner to see if the stock deserves to be a contrarian pick right now.

Weak uranium market

Uranium has been under heavy pressure for more than five years, and there is little hope for a near-term recovery.

What's the scoop?

In early 2011 the market was actually in recovery mode. Uranium had bounced back from its financial-crisis plunge and traded at a healthy US$70 per pound. Cameco's stock had also rallied, racking up a gain of nearly 100% to $40 per share.

Then the Fukushima disaster happened in Japan and the market crashed.

Japan shut down its entire fleet of nuclear reactors, and governments around the world put new developments on hold while they revisited their electricity-generation growth programs.

Things are getting back on track, but progress is slow.

How bad is it?

Uranium now trades close to US$25 per pound, and Cameco can be bought for $11 per share.

Demand situation

Japan only has three of its 43 operable reactors back in service. The restart program continues to face public opposition and operational issues, and analysts don't see the situation improving quickly.

Around the world, countries are starting to ramp up their nuclear programs again with more than 60 new reactors under construction and additional sites planned for future development. As a result, annual demand for uranium is expected to increase by 50% through 2030.

Supply outlook

Producers have cut production to the point where primary supply currently falls short of annual demand, but secondary supplies are significant enough to fill in the gap. Eventually, the stockpiles will be used up and the market should rebalance, but that isn't expected to happen soon.

The situation actually looks positive for the industry over the long term, but there is a company-specific issue to consider at Cameco.

Legal woes

Cameco is caught up in a nasty battle with the Canada Revenue Agency (CRA) regarding taxes owed on income earned by a foreign subsidiary.

The case is currently before the court and a decision isn't expected until late 2017 at the earliest. If Cameco loses, it could be on the hook for more than $2 billion in additional taxes and penalties. Pundits have different opinions on how the battle will end, but the fact that a deal wasn't reached before going to court suggests both sides are digging in their heels, and that is making the market nervous.

Should you buy?

At some point the uranium market will rebalance and could even shift to a shortage position in the coming years if new production doesn't keep up with dwindling secondary supplies. Cameco is a low-cost producer with some of the best resources on the planet, so it is positioned well to benefit when better days arrive.

For the moment, however, the market situation doesn't look good, and concerns about the CRA case could put additional pressure on the stock.

As such, I would avoid Cameco today.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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