Contrarian Investors: Is a Bottom in Sight for Cameco Corporation?

Description

Cameco Corporation (TSX:CCO)(NYSE:CCJ) is trading at levels not seen in more than a decade.

Let's take a look at the current situation to see if there is any light at the end of the tunnel for Canada's top uranium company.

Dark days

Cameco's stock has been in a downward trend since 2007, but most investors have focused on the performance over the past five years.

Why?

In early 2011 it looked like the industry was finally in recovery mode. The price of uranium had rallied to US$70 per pound, and Cameco's stock traded for $40 per share–more than double its low during the financial crisis.

Then the tsunami hit Japan and everything changed.

The Fukushima disaster forced Japan to shut down its entire fleet of nuclear reactors, and countries around the world decided to revisit their need for nuclear energy.

As a result, uranium went into a tailspin and currently trades for about US$25 per pound. Long-term holders of Cameco are in shock at the extent of the slide, and new investors can pick up the shares today for about $10.50 each.

Positive developments?

Contrarian investors look for opportunities to buy just before the tide turns. In the case of uranium, it is quite clear that better days are on the horizon. The trick is to determine how far out the recovery lies.

The current uranium price is not profitable for most producers, and cuts have been made to the point where primary supply doesn't meet current annual demand. However, secondary stockpiles are filing the gap, and that has kept prices under pressure.

Most uranium is delivered under long-term agreements, and the majority of those contracts are at higher prices. That’s why producers continue to stay alive despite the brutal market conditions.

Miners and their customers are playing a waiting game. Utilities don’t want to sign up for new agreements because they can fill supply gaps with cheap product on the spot market. Miners won’t commit to new investment until they know what price they are going to get over the long term.

As secondary supplies get used up, the market will eventually begin to rebalance, and utilities will start signing new agreements to avoid getting caught out in a potential supply squeeze.

When that process picks up momentum, uranium should move significantly higher.

Demand outlook

Japan only has three of its 43 operable reactors back online, but the country has little choice but to move forward on the restarts. Eventually, most of the reactors will be back in service.

Around the globe, more than 60 new reactors are under construction and additional sites are on the drawing board.

As a result, annual uranium demand should jump 50% by 2030.

So, supply is likely to fall and demand is headed higher. That’s good news for Cameco in the long run.

Is the bottom in sight?

Market conditions remain difficult, and there is little evidence to suggest things will improve in the near term, despite the positive long-term outlook.

Cameco is also being hit by a nasty battle with the Canada Revenue Agency (CRA) over taxes owed on revenue generated by a foreign subsidiary. The case is currently before the court and isn’t expected to receive a decision before the end of next year.

If Cameco loses, it could be on the hook for additional taxes and penalties of more than $2 billion.

Should you buy?

At some point, Cameco will see better days, but it might be too soon to back up the truck for this stock. As such, I would look for another contrarian opportunity today.

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1. Investing
2. Metals and Mining Stocks

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Date
2025/07/27
Date Created
2016/10/18
Author
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