Why Cameco Corp. Desperately Needs TEPCO Reinstated Right Now

Description

Cameco Corp. (TSX:CCO)(NYSE:CCJ) is still in financial turmoil, but the announcement that **Tokyo Electric Power Company Holdings, Inc**. ("TEPCO") would not accept a uranium delivery scheduled for February 1, 2017, and would not withdraw the contract-termination notice it provided to Cameco could prove more disastrous than it actually seems right now.

Cameco desperately needs that contract reinstated. A deeper look into the earnings call transcript and the company's Management Discussion and Analysis (MD&A) reveals the reasons why.

A high-price contract in a depressed market

Firstly, the TEPCO contract is a high-price contract. Cameco desperately needs high sales prices right now. The MD&A revealed that TEPCO was paying about $140 per pound when the current term rate is about $30 in the market.

The termination would affect approximately 9.3 million pounds of uranium deliveries through 2028 worth approximately $1.3 billion in revenue to Cameco, including about $126 million in each of 2017, 2018, and 2019. These are significant sums to a struggling corporation.

Cameco announced that it delivered 31.5 million pounds of uranium at an average realized price of $54.46 per pound — about 60% higher than the average uranium spot price for 2016. This high realized average price is a result of the high-price term contracts in Cameco's portfolio, including the TEPCO contract.

Risk of contagion

While Cameco's marketing and legal teams are confident that their term contracts a water tight, there is probably something that TEPCO is confidently looking at. If a loophole is found and capitalized on, there is a very material risk that other contract clients may follow the TEPCO route so as to get away from paying the high term prices.

Most noteworthy, Cameco's average realized price is substantially above the market, and this creates pressure from some customers who want to be more in the spot market. Should there be "contagion," Cameco may be forced to renegotiate contracts. The move will have serious consequences for the bottom line and the company's viability.

To avoid contagion risk, Cameco desperately needs that contract reinstated through arbitration.

The dividend is threatened too

There was even talk of the sustainability of the $0.1 quarterly dividend in the same paragraph as the TEPCO contract discussion. It was concluded that "…the board will continue to use the dividend and will take the action they deem necessary based on the circumstances including the TEPCO contract cancellation and to ensure long-term value creation," said Tim Gitzel (president and CEO).

I see a dividend cut should the contract go.

Investor takeaway

The contract cancellation may have some serious impact on Cameco.

Company operations may be severely affected as management will invoke a revaluation of the optimal mix of its sources of uranium supply to feed into its contract portfolio. This could cause Cameco to make changes to its inventory position, production profile, or its purchasing activity.

Even worse, the company is currently under the threat of a credit-rating downgrade. Possible TEPCO contagion and resultant price re-negotiations may worsen the company's cash flow and credit ratios, making a credit-rating downgrade a sure thing.

This further weakens the company's ability to manage the serious current tax-litigation risk involving the Canada Revenue Agency and refinancing risks.

The impact is just too heavy. Cameco Corp. needs the TEPCO contract issue resolved quickly.

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