Cameco Corp.’s Cautious Hopes for 2017

Description

Cameco Corp. (TSX:CCO)(NYSE:CCJ) is a low-cost uranium-producing giant whose cost advantages has made it survive a potentially catastrophic decline in uranium prices for six straight years. Faced with the prospect of a bullish recovery for the nuclear power fuel this year, the company’s directorship says they have cautious hopes.

Indeed, there are hopes for the company and the industry as a whole from 2017 going forward, but there is a big reason for bullish investors to tread with caution.

With the bottoming in uranium spot and contract prices in November 2016, there is a ray of hope that the market could be headed for a sustained recovery through 2017 and beyond. The mineral’s price recovery is hinged on several factors though, some of which are tangible, but some are just but mere hopes for a better future.

For instance, Cameco hopes that the announced 10% production cuts from Kazakhstan, the other production heavyweight, will help arrest the growing excess supplies on the market and potentially drive prices up in a sustainable way.

However, there are fears that significant secondary market feeds will continue dampening any price growth prospects for some years. The Kazakhstan cutback does not make fresh uranium sufficiently rare to justify a sustained rise in spot prices. These cuts are, however, a realization that current market prices are neither rational nor sustainable.

The rise in spot and contract prices, if sustained, could also induce further speculative demand from uranium consumers rushing to lock in lower prices in fear of further price increases. This could be a good sign, but the move could lead to a lock in of low prices in long-term contracts, further dampening future profitability prospects for producers.

There are high hopes that Japan could be making serious progress in bringing back online several reactors in the near term. A lot of regulatory politics are still involved though.

China and India, faced with high and increasing energy demands from their growing industry, are expected to bring online some massive numbers of reactors. A number of 58 comes up for China. However, the timelines could be unreliable and long delays could occur.

Revenue sensitivity to sales price is very low for Cameco. A big price move will be needed to make a significant recovery in cash flows. Such a high-magnitude rise is still a distant hope.

Foolish bottom line

Cameco has to be cautious in its hope of a uranium recovery. Significant demand will come when anticipated reactors come online. It will likely take some years for the secondary uranium waste market supplies to dwindle and for sustainable demand for fresh produce to increase.

One big risk to seriously consider is the pending litigation with the CRA. The company is downplaying this event risk. If the settlement comes in the $3 billion range, that would be a whopping 50% of the current Cameco market valuation.

There will be increased stock price volatility as the case moves forward. Until there's a settlement with the CRA, investors should trade with caution. If overly bullish on uranium, I suggest a direct investment in the fuel through the **Uranium Participation Corporation** (TSX:U), a closed-ended fund investing in physical uranium inventory.

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Author
brianparadza