Don’t Waste Your Money on This Classic Value Trap

Description

Bargain-hunting investors continue to load up on the world’s largest publicly listed uranium miner, **Cameco Corp.** (TSX:CCO)(NYSE:CCJ). They are convinced that the market for uranium is improving and the radioactive metal is due to recover sometime soon. Given that Cameco is responsible for roughly 17% of the world’s total uranium output, any upward momentum in the underlying commodity would certainly give its stock a healthy lift — even more so when it is considered that its stock is down by 18% for the year to date and trading at almost a quarter of its pre-Fukushima disaster peak.

Nonetheless, there are signs that the prolonged slump in uranium will continue and is not going away anytime soon.

Now what?

Nuclear power, the primary consumer of uranium, has been on the back burner since the Fukushima disaster in March 2011, and it is difficult to see it gaining significantly in popularity. While the push to reduce climate change gains momentum, which is perceived to be favourable for nuclear power given that it has zero emissions, other sources of renewable energy have become significantly cheaper in recent years.

Those renewables, such as solar and wind, do not have the same drawbacks as nuclear power.

According to research from advisory and asset management firm Lazard, utility scale solar has a median cost per megawatt hour produced of less than half of nuclear, while wind can be just over a third cheaper. Both sources of electricity do not carry the risk of an environmental disaster in the event of catastrophic failure, nor is there a need to dispose of radioactive waste that can remain deadly for decades.

As a result, uranium prices have tanked, trading at just over US$20 per pound — close to its price just over 13 years ago. While there are 50 nuclear reactors under construction, according to the World Nuclear Association, these won’t generate sufficient demand to lift it to the critical level required to trigger a sustained recovery in uranium prices.

You see, there are moves afoot in a range of nations to reduce their dependence on nuclear power.

France plans to cut its share of nuclear produced power to 50% by 2025, while back in June South Korea announced plans to phase out nuclear power by halting new reactor construction and not expanding the lifespan of existing plants. Switzerland has banned nuclear power, and Germany intends to eliminate it by 2022.

This does not bode well for uranium's outlook in a world where supply is forecast to grow substantially.

The world's largest producer, Kazakhstan, has expanded production at a rapid clip in recent years, while deeply impoverished African nation of Namibia is determined to become the world's third-largest producer by tripling production. That plan appears feasible given the commencement of operations at the massive Husab mine, which is among the world's largest mines.

Surging supply coupled with diminishing demand does not bode well for the price of uranium.

That has led to a reluctance among power companies operating nuclear plants to sign long-term contracts and instead initiate those contracts at the last moment, when spot prices are lower, or they source their fuel needs through the spot market. This is placing considerable pressure on Cameco; in the past, it locked in revenue through long-term contracts that allowed it to generate a substantial premium over the spot price.

So what?

It is for these reasons that an analyst from Scotia Capital downgraded the outlook for Cameco over concerns that uranium prices will remain weak for the remainder of this decade and into the next. If anything, Cameco is fast shaping up as a classic value trap, as growing uranium supplies and the declining usage of nuclear power weigh heavily on its operational performance for years to come.

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