Cameco Corp.: What Could the Latest Dividend and Production Cuts Mean for the Stock?

Description

Cameco Corp. (TSX:CCO)(NYSE:CCJ) equity shares could be very choppy and volatile starting November 9, 2017, after the company's announcement yesterday of a massive 80% dividend cut and suspension of operations on some key production facilities due to the continued uranium price weakness on the global market.

The stock traded almost 4% down during aftermarket trading hours in the United States on November 8, but the share price could plunge further as investors evaluate the impact of this new piece of news and adjust their equity valuation in Cameco.

Dividend cut

Cameco has cut its annual dividend payout from $0.40 per annum, which was previously paid in $0.10 quarterly installments, to $0.08 per annum, which shall be paid in a single annual payment.

The old dividend payout was good for a 3.48% yield at the $11.49 share price on November 8, while the new promised annual dividend will only yield a mere 0.7%.

This is sad news for most investor groups.

Income investors in the stock, if there were still any, will have their "dependable" paycheque taken away next year, and they have to look elsewhere for a 3.5% yield. However, there could have been a very small proportion of income-oriented investors on Cameco stock owing to an already apparently high risk of a dividend cut on the stock.

Contrarian investors who are betting on a uranium market recovery were loving the great dividend yield, which was a good reward for waiting and keeping the faith in Cameco.

Most noteworthy, the $0.40 dividend may have shielded Cameco from short-seller attacks, as the shorts had to pay the dividend on borrowed shares. The dividend cut could therefore introduce more volatility to the stock going forward and result in an increase in short interest in Cameco shares.

Production cut

Cameco will suspend production from its McArthur River mine and stop operations at the Key Lake mill, which processes all of the ore from McArthur River to uranium concentrate by end of January 2018. The two projects contributed about 11.1 million pounds of uranium in the first nine months of this year, of which Cameco’s share was 7.8 million pounds.

This move could turn out to be a brilliant one, since the company will arrest the unsustainable growth in high value inventory on its balance sheet with no clear visibility on the uranium price recovery front.

Management explains that the company intends to avoid selling into a depressed spot market and will sell inventory into its contracted market where uranium fetches higher prices. This move would significantly limit Cameco losses.

A production cut will allow Cameco to reduce its inventory stockpiles, while reducing the insurmountable pressure to sell into an oversupplied, depressed uranium spot market, where losses could accelerate from their 2017 year-to-date levels.

As things stand, there is not much to lose for Cameco by suspending the named operations for a planned 10 months next year, as much of the output was likely to go into stockpiles.

This is the point where Cameco could really need the reinstatement of its lucratively priced TEPCO contract, but the hearings will only start in early 2019.

Most noteworthy, it would seem like Cameco plans to buy more uranium from the spot market and feed into its contract deliveries in the short term rather than produce its own mineral output, saving its resource base for a better future.

Investor takeaway

Cameco is doing all it can to survive the depressed uranium market, yet the recovery outlook still remains cloudy.

A dividend cut is a natural short-term remedy to preserve cash flow, but the immediate investor reaction may be negative for the stock.

The announced production cut seems a well-crafted idea that may be good for the stock in the short term, but Cameco will need a rebound in uranium prices to survive another decade in the industry.

Most importantly, investors need to watch the serious tax-dispute proceedings with the Canada Revenue Agency after the trial was concluded in September, and judgement could be handed six to 18 months from the date.

Volatility will increase in Cameco's share price, but downside pressure is much more likely to overpower the bulls in the near term.

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