Cameco Corp.: 2 Big Near-Term Risks Facing the Uranium Giant Right Now

Description

Cameco Corp. (TSX:CCO)(NYSE:CCJ) is a pure uranium play that has successfully survived a severe nuclear fuel market price downturn for most of this decade. While there's still huge uncertainty over recovery prospects in the uranium market, some company-specific risks could significantly punish the stock in the next two years, the big ones being litigation risk and potential refinancing risk.

The litigation risk related to Cameco's tax dispute with the Canada Revenue Agency (CRA) could cause severe damage to the stock and significantly compound the emerging refinancing risk facing the firm by 2019.

Let's look at these two risks independently.

Litigation risk

Cameco has been embroiled in a long-winding tax dispute with the CRA over transfer pricing issues involving international uranium sales activities since 2008. The CRA is reassessing Cameco's tax returns for several years and levying more taxes and penalties.

Cameco expects to receive notices of reassessment for a total of about $8.4 billion of additional income taxable in Canada for the years 2003 through 2017. This would result in a tax expense of about $2.5 billion, while cash taxes and penalties could get to $2.15 billion before interest charges.

The company will be required to remit or provide security for half the cash taxes and transfer pricing penalties plus related interest and instalment penalties, even before the dispute is settled, amounting to about $1.07 billion.

All other legal proceedings related to the case were concluded last year, and the final court ruling is due any day now. The president and CEO recently reported that he is checking his phone for a notification on the case every morning.

The CRA case could significantly hurt the cash flows of the $4.5-billion-market-cap nuclear giant.

There is some hope, though. Both parties have the right to appeal the ruling within 30 days, and the matter could drag for another two years, offering Cameco some critical breathing space, but a negative ruling against Cameco could severely impact the next risk the company faces before the end of next year.

Refinancing risk

Cameco has $500 million in unsecured debt, which is due for repayment on September 2, 2019, and has total long-term debt amounting to $1.5 billion on its balance sheet.

The company had cash and short-term investments amounting to $592 million by the end last quarter and is not yet certain whether it will refinance the maturing unsecured notes in the debt market or meet the hefty cash outflow in the next 19 months.

Management says it will look into the debt markets and judge how favourable the refinancing terms will be, and it will make a decision on whether to refinance or pay down from accumulated cash resources when the time comes.

While Cameco's debt is still rated investment grade, the company's current unsecured notes are rated just a notch above speculative or non-investment grade by DBRS (BBB-) and S&P (BBB) credit-rating agencies, both giving a negative-trend outlook.

If uranium markets fail to recover during the year, and the CRA case go against Cameco, credit-rating agencies may decide to lower Cameco's rating to junk before the company manages to refinance maturing notes next year. Cameco may resort to an undrawn $1.25 billion unsecured revolving credit facility, but such facilities are usually not available when needed the most.

That said, the company may significantly boost its free cash flow this year through inventory liquidation after suspending operations at its key assets, McArthur River mine and the Key Lake milling plant, for 10 months, reducing capital expenditures and making operating expense savings through 2018.

Investor takeaway

The CRA case may significantly affect Cameco's equity price in the short term, while debt-refinancing challenges could worsen its cash position. Investors in Cameco should hope for a potential long-term recovery in the uranium market, while taking solace in the discounted price-to-book valuation of 0.9 on the stock that provides some margin of safety.

That said, by winning the CRA case, Cameco may also recover the $724 million already paid or secured towards the disputed taxes to date. Moreover, Cameco may also be a winner in a disputed TEPCO contract case due for arbitration next year, where it seeks $682 million in damages.

There might be reason to hold on to the stock.

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