Cameco Corp. (TSX:CCO): Could a Little Aggression Lift the Stock Further?

Description

Troubled uranium mining and nuclear fuel supply giant **Cameco Corp.'s** (TSX:CCO)(NYSE:CCJ) stock has been a strong outperformer so far in 2018 amid speculation that the long-depressed uranium market could finally bottom out this year and due to the fact that, after a very long losing streak, the company finally reported some profit in the first quarter of 2018.

Cameco is set to release its second-quarter (Q2 2018) financial results on Wednesday, July 25, after market close, and I'm wondering if it's possible that we may see another positive quarter, especially considering that the profitability drivers during the last quarter were seemingly unsustainable.

Unsustainable profits?

Some of the profitability drivers in the company's first profitable quarter in eight consecutive quarters are not repeatable.

The new accounting method, adopted for Cameco's former joint venture, JV Inkai project, from consolidation to equity accounting after Cameco reduced its stake in the project to 40%, produced some significant one-time gains that boosted quarterly earnings by $49 million. Such a gain may not be recorded ever again.

Further, there was an interesting paragraph in Cameco's Management Discussion and Analysis (MD&A) for the first quarter titled "Portfolio Optimization," which read as follows:

> "As part of our ongoing efforts to optimize our contract portfolio and convert uncertain future value into certain present value, we restructured an agreement with one of our utility customers. The restructuring advanced the majority of contract deliveries into the first quarter of 2018 and displaced a small amount of future uranium and conversion deliveries, resulting in a gain of $6 million being recognized."

That was an aggressive revenue-generation strategy that accelerated contract revenue recognition right into the first quarter and deprived subsequent quarters of some earnings from deliveries on the affected contract — again, another unsustainable profit-making strategy.

Should Cameco turn more aggressive?

The company has managed to survive a severely depressed market as a result of (among other strong competencies) its robust, tight, and high-value supply contracts portfolio, which recently got a little dented by the TEPCO dispute. However, this strong portfolio is not immune to the low spot prices currently bedeviling the uranium market.

Uranium supply contracts usually include a mix of fixed-price and market-related pricing components, which, for Cameco, target a 40:60 ratio. Contracts fixed at higher prices or with higher floor prices have yielded higher-than-market prices for the company, saving the uranium giant from selling into the nonviable spot market.

However, with spot prices still near the US$23-a-pound mark by mid-July 2018, down from US$72 in January 2011 and US$35 in July 2014, the realizable prices from the contracts portfolio are falling consistently over time, and they may fall below the $30 by 2021 if the market remains down, exacerbating Cameco annual losses year over year.

With this possibility in mind, it may therefore make some sense to quicken the realization of some better supply prices by accelerating future deliveries into the present to book some near-term profits, while anticipating a rebound in the spot market from improved demand, as Japan restarts its nuclear power plants, and as China, India, and the UAE build new reactors, making spot market supplies viable again by the time the company sources for new contracts.

That said, aggressive revenue strategies aren't sustainable, as the contracts will be exhausted in good time.

What happens if market prices don't improve by the time such contracts expire?

Aggressive revenue recognition will only carry the company through for short while, but a sustained rebound in the uranium market is the cure for Cameco's problems; I'm hoping that new U.S. protectionist policies will not haunt the company, too.

Investor takeaway

Uranium stocks remain speculative buys at this point, as there is severe uncertainty about pricing dynamics going forward. This is especially so for Cameco, which has some significant near-term litigation and financial risks facing its balance sheet. The company may be tempted to become a little more aggressive in trying to generate higher values from supply contracts, as the market remains subdued, but this will not be a sustainable business activity.

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