Should You Own Cameco Corp. (TSX:CCO) Stock As a Contrarian Play?

Description

Cameco Corp. (TSX:CCO)(NYSE:CCJ) just came out with some rather bleak news.

The company is cutting hundreds of mining and head office jobs after a decision to extend the shutdown of its McArthur River and Key Lake operations "indefinitely." Given the ongoing difficulties in the uranium market and the uncertainties surrounding U.S. tariffs, this shouldn't come as much of a surprise to investors.

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Let's take a look at the situation to see if this is the right time to add Cameco to your contrarian portfolio.

Uranium woes

Any time a company says it is cheaper to buy product in the market to supply customers than it is to produce, things can't be good. That's exactly the situation Cameco is in according to CEO Tim Gitzel.

Secondary supplies in the uranium sector continue to keep prices at unsustainable levels over the long haul, but that has been the case for several years, with little evidence to show the situation will change in the near term. Cameco and its peers have cut production and shelved development projects in an effort to balance primary supplies with demand, but the efforts haven't worked, and uranium spot prices continue to trend near multi-year lows.

Japan is slowly getting its fleet of reactors restarted after the country shut down all nuclear power sites in the wake of the 2011 Fukushima disaster, but the process is taking much longer than anticipated.

In addition, power companies that have traditionally purchased uranium on long-term contracts are happy to buy on the spot market or make short-term deals while uranium trades a such a discount. The current spot price is close to US$23 per pound. It was US$70 in early 2011.

This is a problem for Cameco, as it requires long-term agreements at higher prices to guarantee the cash flow required to plan for capital investment and growth. Existing contracts that were signed at higher prices are expiring, and customers don't want to commit to new agreements. As that process continues, Cameco's revenue outlook worsens.

Adding to the pain, the United States is potentially considering tariffs on uranium imports. Canada supplies about 25% of the uranium U.S. power companies use, so the impact could be significant.

Finally, Cameco is still waiting on a decision in a court case regarding its fight with the Canada Revenue Agency over taxed owed on earnings generated by a foreign subsidiary; news should come in the next 12 months. If Cameco loses the case, it could be hit with taxes and penalties of more than $2 billion.

Upside potential

More than 50 new reactors are under construction worldwide and more are planned. In addition, secondary supplies will eventually be used up, so the market should rebalance. In fact, there is a strong possibility that the industry could see a supply squeeze. Getting a new uranium mine up and running takes years, and if the moment power companies think they might get caught short, they will scramble to lock-in supply.

Should you buy?

The long-term outlook is attractive, but there's no way of knowing when prices will recover. Throw in the uncertainty around tariffs and the CRA case and you get a situation that makes Cameco a risky bet right now.

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I would look for other opportunities today.

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