The Case for Investing in a Uranium Miner

Description

Cameco (TSX:CCO)(NYSE:CCJ) is one of a handful of investments on the market that is often misunderstood by investors. The company operates in a unique segment with little competition, which is usually a good thing. However, a string of unfortunate events over the past decade has caused Cameco to post less-than-stellar results during earnings season and its stock to drop by a whopping 33% over the past five-year period.

Cameco's current predicament

Cameco is one of the largest uranium miners on the planet. Uranium extracted from Cameco's mined is used as fuel for nuclear reactors around the world. On the surface, that resembles an ironclad investment opportunity — a niche product, limited supply, and a recurring revenue stream being fed by demand for nuclear power.

Unfortunately, demand for uranium dropped sharply following the Fukushima disaster in 2011. As a result, uranium prices also fell from US$70 per pound to the mid-US$20s per pound, where they have remained for several years. Cameco kept production levels steady, which resulted in a supply glut of uranium on the market.

In other words, Cameco is stuck mining something that is dropping in price and that fewer people want. Ouch.

In terms of results, in the most recent quarter reported an adjusted net loss of $33 million, which, while not entirely unexpected from the company's guidance, paled in comparison from the $23 million in earnings announced for the same period last year.

Where exactly is that opportunity?

Believe it or not, there are viable reasons to warrant taking a fresh look at Cameco.

First, there are the efforts that Cameco has made in cutting costs and production. To address the supply glut and lack of demand, Cameco shuttered several facilities and turned to the supply glut and the open market to fill contracts. This not only helped the oversupply issue but also served as a catalyst for the market while slashing costs. The spot price as at the end of May for Uranium was $24.01 per pound, while the contracted price was US$31 per pound.

While the spot price for May remains low, year over year the price has improved from the US$19.60 per pound noted in 2017 and the US$22.73 per pound from 2018.

The second point to note relates to those contracted prices. Similar to traditional utilities that have PPAs, Cameco has long-term contracts in place with its customers that stipulate a higher (than the open market) contracted price. This continues to provide Cameco with some price protections against the prolonged weakness in demand.

There's also the demand for uranium itself. While demand suffered following the Fukushima disaster, there are growing signs of a resurgence in nuclear power. In total, there are nearly 50 reactors under construction around the world, with an additional 100 planned to begin construction, while a further 300 are being proposed.

China and India in particular are investing heavily into nuclear power due to their growing infrastructure needs; they represent nearly half of the new reactors under construction.

What does this mean for investors?

The uranium market appears to be showing signs of improvement. Cameco's supply issues also appear to be steadily improving. Both of these should, over the long term, lead to Cameco becoming an attractive, long-term investment.

As it stands now, Cameco still carries a significant amount of risk, and investors with shorter timelines would be better served by investing elsewhere, while current investors of Cameco are best left to hold their positions until the market recovers.

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