



Like Mining But Hate Mining Companies? Here's a Way To Play

Description

You know when you go through periods in life when nothing seems to go your way? If so, you can relate to the current state of the mining world. Financing has dried up, costs are spiralling, and write-downs larger than the GDP of a small country have been an ongoing theme. This sector scares a lot of investors. We Fools see opportunity.

Allow me to introduce....

Meet **Major Drilling (TSX:MDI)**, one of the world's largest metals and minerals contract drilling companies. Headquartered in New Brunswick, Major Drilling operates in 22 countries and has a fleet of 760 drills ready, willing, and able to help mining companies with their exploration needs. If you're sick of the risks involved with investing directly in mining company stocks, but still believe in the resource theme over the long-term, Major Drilling should be in your portfolio.

The here and now

Major Drilling is not firing on all cylinders. A late January release from the company indicated that the current quarter will be weaker than originally expected. The stock has declined by 47% over the past year and the senior mining companies that account for 78% of Major's revenues are in a state of flux with the issues alluded to in the opening.

Major is well positioned to skate through this stormy environment relatively unscathed. With net cash (cash – debt) of \$30 million, the company faces absolutely no financial risk. In addition, the company's cost base is highly variable. No drilling, no (well, at least limited) costs.

What's to like?

Longer term, there is reason for optimism. Underlying the mining industry is the issue of depleting resources. To survive, mining companies must continually replenish their resource base. There are two ways to do this: 1) acquire new assets or 2) develop the assets in their current portfolio through exploration. We have just come through a period where option 1) was the go to strategy for reserve replenishment. Especially for gold producers, the biggest chunk of MDI's business at 44% of revenues

(copper next at 17%). [This strategy has not turned out very well.](#)

Given the acquisition related blow ups that have occurred, it's reasonable to assume that in the coming years the focus will shift to exploration and development of current assets. This fits perfectly into Major Drilling's model. In addition, the company focuses on specialized drilling. Resources are growing increasingly difficult to access and Major's fleet is well suited to uncovering these hard to get at deposits.

What's it worth?

Once mining execs clear their heads and are ready to get back to business, Major's shares should begin to lift. Major Drilling has put up some impressive numbers in the past. Peak return on equity (ROE) has been in the 25-30% range. If we assume the present storm blows through and Major Drilling is able to earn an ROE of 20%, this company could generate EPS of \$1.37 based on the current book value per share of \$6.84.

In its prime, Major Drilling traded with an earnings multiple north of 20. Even if we scale this back and apply a 15 multiple to the EPS estimate, we arrive at a target of \$20.50 for this stock. That's more than double the current price of \$9.28. And, you'll collect a dividend yield of 2.2% along the way.

Regardless of how bad it gets for the mining industry, Major is unlikely to trade below its financial crisis low price/book multiple that bounced around 1. With a book value of \$6.84 per share, this represents potential downside of 26%.

Shares of Major Drilling offer a very appealing risk/reward scenario.

The Foolish Bottom Line

Mining is not a great business. However, the global economy is reliant on the materials that these companies dig out of the Earth, therefore, it's a business that will endure. Major Drilling offers a way to eliminate much of the risk that surrounds a direct investment in mining stocks and still leaves plenty of upside for when the sun once again shines on this industry. An investment in Major Drilling may require some patience, but over the long-term, should prove to be worth the wait.

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Fool contributor Iain Butler owns shares of Major Drilling. The Motley Fool has no positions in the stocks mentioned above.

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Author
tmfohcanada

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