The Pros and Cons of Investing in First Quantum Minerals Ltd

Description

There are very few miners with a better track record than copper miner **First Quantum Minerals** (TSX:FM). In fact, there are very few companies overall that have done as well. The company's historical stock returns tell the story; over the past 15 years, First Quantum's shares have returned 40% annually! Does that mean you should buy the shares?

Below, we look at two reasons to buy, and two reasons to stay away.

Why to buy

1. Best-in-class operator

As shown above, First Quantum has done tremendously well for investors. How has the company managed to pull this off?

Quite simply, it has come from doing two things very well: buying assets for a cheap price, and developing them within budget. These skills are not found very often in the mining sector. In fact the company has developed over $2.4 billion worth of projects within 6% of budget. This allows First Quantum to get a lot more out of the mines than it has to put in.

One example is its Kansanshi mine in Zambia. First Quantum originally spent $1.7 billion back in 2001 to buy and develop the mine. And that mine is still going strong, expected to produce over 250,000 tonnes of copper this year. To put this in perspective, other miners would have to spend upwards of $5 billion to develop this much production.

2. Longer term possibilities for copper

First Quantum acknowledges that the copper market is currently in surplus. But longer term, the situation looks very different. More specifically, the supply situation looks dicey – exploration companies are having trouble getting funding, mine projects are getting canceled, and even projects that get the go-ahead are rarely finished on time or on budget.

One only has to look back to the late 90s for some context. Back then, commodity prices were depressed, so supply was held back. Then when China took off and demand increased, supply struggled for years to catch up. If history were to repeat itself, the outlook will eventually look very good for First Quantum and its shareholders.

Why to stay away

1. China risk

China is easily the biggest risk for most mining companies, and First Quantum is no exception. The country consumes far more copper than any other country, but many observers are worried about its prospects. More specifically, its real estate market seems to be in bubble territory.

If China's real estate market were to crash, then that would be very bad news for copper prices, and for First Quantum.

2. Price resiliency is strong

Concerns about China have caused many mining shares to plummet – the **S&P Global Mining Index** has fallen 8.5% per year over the last three years (despite a healthy 26% gain in 2014). Yet First Quantum's shares have held up extremely well over this time, returning close to 0%.

The fact is, First Quantum's strengths are no secret. As a result, its shares trade at a premium, and investors are willing to forgive things like a slumping commodity environment.

So at this point, the shares are unsuitable for most portfolios – the risks are too great. On the other hand, if you believe in the Chinese economy, and are looking to make that bet, First Quantum shares make for a compelling option.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:FM (First Quantum Minerals Ltd.)

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bensinclair