Will Teck Resources Inc. Buy Hudbay Minerals Inc.?

Description

To say the least, **Teck Resources Inc.** (TSX:TCK.B)(NYSE:TCK) has struggled in recent years. Falling commodity prices have stalled the company's ambitious growth plans, and have also battered its share price. Coking coal (Teck's biggest line of business) has been the worst hit, falling by more than half since 2011.

So, how should Teck act in these tough times? Well, **National Bank** mining analyst Shane Nagle thinks the company should buy **Hudbay Minerals Inc.** (TSX:HBM)(NYSE:HBM). Investors seem to have noticed, sending shares of Hudbay up by 6.4% on Monday.

Just how realistic is this scenario? Should you buy Hudbay too? Below we take a look.

The argument

Mr. Nagle highlighted a few reasons why Teck should buy Hudbay. The first is that it gives Teck greater exposure to copper and zinc, which have better fundamentals than the coking coal business. Second, Hudbay's assets would help rejuvenate Teck's growth ambitions. He also pointed out the new company would have an improved balance sheet (depending how the acquisition is financed).

Will Teck pull the trigger?

Hudbay is currently valued at nearly $2.5 billion, making it a big fish to swallow. That said, if history is any guide, a big purchase price would not be enough to stop Teck Resources.

Under CEO Don Lindsay, Teck has not shied away from big acquisitions. Back in 2006 Teck tried to buy nickel miner Inco for roughly $20 billion. The next year it bought copper/zinc miner Aur Resources for $4.1 billion. Then in 2008 Teck paid over $14 billion for the stake in Fording Coal it didn't already own. More recently in 2010 Teck paid $1.5 billion for a 20% stake in the Fort Hills oil sands project.

Not so fast

If you think history is about to repeat itself, think again. There are a few big reasons to doubt this transaction will happen.

First, Teck's acquisitions have mostly been a disaster. Most notably, Teck clearly overpaid in the Fording transaction, and the move nearly bankrupted the company at the time. The Fort Hills purchase is also looking dubious, given where oil prices have gone. Consequently, we've seen Mr. Lindsay slow down on the acquisition front recently, with no major acquisitions since Fort Hills.

Second, Teck does not have that much cash to spend. The company has roughly $8.4 billion in debt, causing many investors to wonder if the dividend is safe. Moody's Investors Service downgraded Teck's debt to the lowest possible investment grade rating this month.

Mr. Nagle points out that Teck could finance the transaction with equity rather than debt. This also seems like a bad idea—Teck's shares are down by nearly 50% over the last three years. Is this really a good time to be selling more stock?

What should investors do?

At this point, I would avoid both Hudbay and Teck. The buyout rumours will fade over time, and in the long term any further slowdown in China could kill these stocks. The risk is simply far too great.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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2. NYSE:TECK (Teck Resources Limited)
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bensinclair