What Is a Safer Turnaround Play: Teck Resources Ltd. or First Quantum Minerals Limited?

Description

Teck Resources Ltd (TSX:TCK.B)(NYSE:TCK) is in its fifth year of a downtrend. From its high of $60 per share in 2011, it has gone down to its current price of under $10 per share. **First Quantum Minerals Limited** (TSX:FM) has done better in that it traded in a sideways channel between 2012 and 2014. Still, it is close to its 52-week low.

Both miners' business performance is dependent on the prices of the commodities they mine, so it only makes sense to consider an investment in them when they're priced significantly below their intrinsic values. They're both priced at cheap valuations. Which one should you buy today for a turnaround?

Let's compare them.

Which has the cheaper valuation?

The book value is the value of assets shareholders would theoretically receive if the company were liquidated.

Teck Resources's book value is over $32. So, at under $10 per share it's priced at a price-to-book ratio (P/B) of 0.3. In the past decade, its P/B has priced between 0.3 and 3.3. So, it should be able to trade at a P/B of 1.0 again, implying a price of about $32. This implies an upside of 220% excluding dividends.

First Quantum's book value is over $21. So, at close to $10 per share, it's priced at a P/B of close to 0.5. This is the cheapest it has been in the past 10 years since it hit a low P/B of 0.7 in 2008. Assuming it trades at a P/B of 1.0 again, that would imply over 100% upside excluding dividends.

Teck has the cheaper valuation and implies less downside.

Ability to survive: credit rating, debt levels, and interest coverage ratio

The interest coverage ratio indicates whether a company can pay off the interest on its loans in a timely manner. Generally, an interest coverage ratio below 1.5 is a warning sign that the company could default. So, the higher the ratio, the better.

Teck has a S&P credit rating of BBB-, debt-to-cap of 30%, and interest coverage of 4.3. On the other hand, First Quantum has an S&P credit rating of B, debt-to-cap of 33%, and interest coverage of 105.

Teck has a higher credit rating, but First Quantum has a higher interest coverage ratio. So, I'll call them even in their ability to survive.

Profitability: operating margin, net income, earnings per share, and free cash flow

Teck's trailing 12-month (TTM) metrics are as follows: the operating margin is 12.4%, the net income is $344 million, the earnings per share (EPS) is $0.60, and free cash flow (FCF) is -$115 million.

First Quantum's TTM metrics are as follows: the operating margin is 5.8%, the net income is U$391 million, the EPS is U$0.64, and FCF is -U$1.5 billion.

Both have capital spending of over $2.1 billion, but Teck is generating more operating cash flow.

It's hard to say whether the capital spending is wrongly spent presently because it depends where the commodity prices go in a few years' time. So, it depends on how long you plan to invest for, but I say for these speculative plays, don't buy if you don't intend to hold for three to five years.

In conclusion

Both companies are speculative plays because a lot of capital spending is required for their mining operations while profits are dependent on commodity prices. Before their share prices go up, there needs to be some sort of stimulus for higher commodity prices. Foolish investors who just started investing should avoid these stocks as they're much more risky and volatile than the likes of **Royal Bank of Canada** and **Fortis Inc.**

I went with Teck Resources when it was under $9 because it has the higher credit rating and lower valuations, implying less downside and more upside. Further, it only makes up less than 1% of my portfolio.

CATEGORY

1. Dividend Stocks
2. Investing
3. Metals and Mining Stocks

TICKERS GLOBAL

1. NYSE:TECK (Teck Resources Limited)
2. TSX:FM (First Quantum Minerals Ltd.)
3. TSX:TECK.B (Teck Resources Limited)

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