Don’t Buy This Cheap Mining Stock Today

Description

In general, I have an aversion to commodity companies. They are price takers, meaning that no matter how good the company is, it can be thrown to the wolves if the global order changes and commodity prices fall. They are extremely volatile in nature, and are as likely to destroy wealth as to create it.

That said, not every commodity is doing poorly at the moment. Although oil continues to be a drag on many investors’ portfolios, companies that produce certain commodities have been doing fairly well. The real question, however, is whether these remain good investments or if the good times are close to over and these companies will get smoked again sometime in the near future.

Teck Resources Ltd. (TSX:TECK.B)(NYSE:TECK) is certainly one example of a company that has come back with a vengeance after being slaughtered in 2016. I remember reading many analyst reports discussing what seemed like the very real possibility of the stock going under. At that time, Teck had dropped to below five dollars a share. No one wanted to touch this company with a 10-foot pole.

Now, things are much different for the diversified commodity producer. With operations across North and South America, Teck is producing respectable results its copper, zinc, metallurgical coal, and energy projects. Unfortunately, the diversification is hindered somewhat by the fact that Teck is highly leveraged to coal, with around 50% of its revenues coming from that commodity.

It’s not expensive on a valuation basis, trading at under six times trailing earnings and below current book value with a price-to-book ratio of 0.8. At first glance, this company looks attractive to new investors hoping to make some money in commodities.

It has also had some decent financial results. Full-year revenues for Teck increased by 5.5% over the 2017 full-year report. Full-year profit also increased by 27% over the previous year. Cash flow from operations was down 12% over 2017, but remained positive. Teck’s balance sheet also grew stronger, with its cash position almost doubling in 2018 and its debt decreasing by 13%.

One of the big downsides to the company in 2015-16 was the amount of debt it had on its books. During the commodity bull run following the 2008 financial crisis, Teck had taken on a large amount of debt that significantly weakened its balance sheet. When commodity prices collapsed, the large debt-load became a major liability. Since that time, Teck has been working to reduce its debt and has been very successful on that front, bringing its debt down an impressive 43% since 2015. This is not the same company that was hammered back then.

Another debatable negative was the dividend cut that occurred a few years ago that has left investors with a paltry 0.64% at the current price level. But as distasteful as that cut was to income investors, the cash flow that was retained was used to strengthen the company by reassigning the money to pay down debt, which was the right choice in the long run. With the company in a better financial position, management has once again begun to consider using its free cash to either increase the dividend or buy back shares.

But should you buy today?

To my mind, the only time you should buy commodities is after they have been hit hard by a sector-wide collapse in the stock price. The time to buy Teck was when no one wanted it back in 2016. Teck looks cheap, but cyclical stocks always look cheap when times are good and commodity prices have risen. If you didn't buy it in 2016, you've probably already missed the boat.

The good news is that commodity stocks have a way of collapsing regularly enough that you should get another chance to buy this company. Until that day, sit on the sidelines or sell your shares if you were wise enough to get into this stock when it was down.

CATEGORY

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2. Investing
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