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CHUCK JAFFE

Stupid Investment of the Week

Commodities pumped up Bucyrus to point it's overblown

By Chuck Jaffe, MarketWatch

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BOSTON (MarketWatch) -- Floating on a bubble can be a great ride, right up to the moment when it ends and there's no place to go but down ... and the descent promises to be hard and fast.

So when investors are looking for something to buy and are gravitating to the hottest sectors, they run the risk of confusing a long-term winner with a company that's been floating along.

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Bucyrus International has the look of a stock that has been pumped up by the commodities bubble and that has no long-term means of support. While it's easy to make a buying case for the stock (BUCY) , it's harder -- but more important -- to recognize why the company is the Stupid Investment of the Week.

Stupid Investment of the Week highlights the concerns and characteristics that make a security less than ideal for the average investor, and is written in the hope that showcasing danger zones in one issue will make trouble easier to avoid elsewhere. While obviously not a purchase recommendation, this column is not an automatic sell signal, as there are times when dumping a worrisome investment may create a new set of problems.

For investors in Bucyrus, a Milwaukee-based manufacturer of mining equipment, the immediate problem would be one of dealing with past success, as their company has been a winner during the prolonged run-up in commodity prices. Capital gains will be an issue for any investor who bas been in this stock for awhile; Bucyrus stock gained 30% in 2005, 48% in '06, 93% a year ago and is up about 30% so far this year.

The year-to-date gains are particularly impressive because Bucyrus opened the year taking a 30% haircut, then bounced back hard to peak in mid-June, only to fall about 12.5% from that new peak. That volatility, however, is a part of the problem, because the trend is more likely to be negative in the future.

While average investors might look at Bucyrus as a way to play commodities without investing in the more speculative, metal or ore businesses or exchange-traded funds, there's no denying that the company's ability to sustain those great growth numbers rides almost completely on commodity prices, something company management can't control.

Bucyrus' mining machines are used for extracting coal, copper, oil sands and iron ore, and as the prices of those commodities have bounded higher mining companies have thrown a fortune into new equipment. The moment the commodities situation changes -- prices don't have to crater, they just need to get off the current growth path -- the new-contract music stops; the ride up is fabulous, but a past bankruptcy is proof that the fall can be murder.

Out of control

To its credit, Bucyrus has shifted some of its attention to the service side of the business, reducing its dependence on new sales; there has also been more focus on international sales and efforts to broaden a client list that is top-heavy with a few big names. Those things are positives, but this company is still floating on bubble power, rather than making a controlled ascent.

"The bottom line is that this company has minimal ability to control its own fate," says Joel Bloomer, who follows the stock for Morningstar Inc. "Bucyrus' prosperity is primarily controlled by commodity prices. When oil and copper prices are very high, the stock will do well, but they have no control over those prices. When those prices are down and no one is demanding mining equipment, they will do poorly."

"They have done very well, it took a lot of forces to make that happen and we don't think it's sustainable," Bloomer added. "Trying to justify its current valuation using our cash-flow models is absurd."

Morningstar gives Bucyrus a one-star rating, suggesting that investors should sell the stock because it is wildly overvalued. It carries a fair-value estimate on the stock of $33 per share, which would represent about a 50% decline from current levels.

Independent research firm New Constructs of Nashville, Tenn., goes much further, having put Bucyrus on its list of the "20 most dangerous stocks" before the company's June swoon.

David Trainer, president of New Constructs, says that Bucyrus has a long way to go because its current valuations are so extreme, noting that "the current price implies next
year's profits will be 1,400% higher ... few, if any, commodity bulls expect commodity prices to rise much more than they have already. I'd be surprised if any thought prices could surge 1,400%.

Getting scorched

In terms of discounted cash-flow, Trainers aid BUCY would have to grow profits at 25% compounded annually for each of the next 25 years to justify the future cash
flow expectations embedded in the current stock price. As such, someone buying the stock today should believe the company will actually exceed that kind of growth for the next quarter-century if they want to see any real upside.

And that's the part where Trainer and others are being kind. There's an underfunded pension obligation, and New Constructs shows "misleading earnings," where Bucyrus' reported $66 million increase in net income, but digging into the footnotes and statements shows that profits actually fell by $93 million.

In the end, Bucyrus has become much more of a trader's stock than an investor's purchase, the kind of issue that a speculator trades as a play on commodity prices, but that fries the long-tem investor who is looking for what might seem like a safer play on a hot sector.

In a market that has been highly imperfect, this is a stock that is priced for perfection. While it may be able to continue its strong run for a while longer, it's easy to forecast an abrupt stop to this ride in the not-too-distant future.

Chuck Jaffe is a senior MarketWatch columnist. His work appears in dozens of U.S. newspapers.

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