5 Reasons to Place a Contrarian Bet on Teck Resources Ltd.

Description

Teck Resources Ltd. (TSX: TCK.B)(NYSE: TCK) might be the most unloved stock in the mining sector. As Canada's largest diversified resource company, Teck is in the unenviable position of being one of the world's largest miners for a couple of commodities that are currently oversupplied.

Teck produces metallurgical coal, copper, and zinc. Met coal and copper are battling low market prices and putting pressure on earnings. Zinc is seeing some strength.

With Teck's stock price now hitting daily new lows for the year and not far off its low for the past five years, the market is avoiding the shares.

Here are five reasons why I think long-term investors should consider Teck Resources right now as a contrarian bet.

1. Cost reductions

Teck is doing a good job of streamlining its operations and finding areas to improve efficiency and cut costs. In its Q2 2014 earnings statement, it reported it is exceeding stringent cost reduction objectives. In the first half of 2014, it achieved operational cost savings of $150 million and capital reductions of another $150 million.

The ability to manage costs is critical at this point in time. When prices for met coal and copper begin to rebound, Teck should see significant increases in free cash flow.

2. Metallurgical coal turnaround

The met coal price is hovering near six-year lows. Teck said in its Q2 2014 report that it had reached agreements with quarterly contract customers for 5.5 million tonnes at US$120 per tonne. Analysts believe this price is unsustainable for the long term because most production is unprofitable at current levels.

Teck is a low-cost producer at many of its mining sites. Its coal mines are operating at less than capacity, and North American production has slowed significantly in the past two years. However, a continued slowdown in demand from China coupled with output increases from Australia are offsetting the North American cutbacks, resulting in increased pressure on the global met coal price.

Further supply cuts and a better demand environment should put a bottom under the market in 2015 and Teck could start to see a better pricing environment through the middle of 2016.

3. Fort Hills oil sands

Teck's future cash flow bonanza and hidden gem is its significant oil sands stake through a 20% holding in the Fort Hills project, operated by **Suncor Energy Inc**. Teck is still committing significant capital toward the Fort Hills project, but the switch from heavy expenditure to production is expected to happen in 2018.

Free cash flow should get a double boost at this point from the reduced capital outlays and the new income stream from the sale of the crude production. Fort Hills is expected to produce 160,000 barrels per day by the end of 2018.

4. Profitable at low prices

Despite the low average realized prices for its core products, Teck is still profitable. In Q2 2014, the company reported gross profit margins of 3% for coal, 21% for zinc, and 25% for copper. The average realized coal price was US$111 per tonne, the copper price was US$3.08 per pound, and the zinc price was US$0.94 per pound.

5. Safe dividend

Teck pays a dividend of $0.90 per share that yields about 4%. The company also announced in the Q2 report that it plans to buy back up to 20 million shares over the next 12 month. This suggests the dividend is probably safe.

The bottom line

Teck has a strong balance sheet, is a low-cost producer, is managing costs well, and is capable of riding out the current tough times. I think the dividend is safe and investors willing to be paid 4% to wait for better times could see a significant increase in the share price once met coal and copper prices start to climb.

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