



## Teck Resources Ltd.: Undervalued or Value Trap?

### Description

**Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) has been on a continual decline since 2010, when shares topped out at nearly \$60, before falling continually to current prices of around \$16 per share. This decline was mirrored by a fall in metallurgical coal prices — Teck's top product— from US\$300 per tonne, to current levels of about US\$119.

It is clear that Teck's revenues are deeply correlated with coal prices (along with zinc and copper prices), with a 10% change in coal prices equating to a 22% change in earnings per share. Having said that, commodity prices go in cycles, and with commodity prices (and share-price multiples) being at multi-year lows, the bottom seems to have arrived.

Is this the time to buy Teck at a bargain before prices climb? Or is this a classic value trap? Let's take a look.

### The commodity price outlook is essential to Teck's valuation

With a 10% change in coal, copper, and zinc prices affecting Teck's EPS by 22%, 37%, and 12% respectively, the outlook for these commodities is essential to Teck's value. If a commodity price rebound is imminent, Teck's projected earnings growth-rate would increase, and its current price-to-cash flow ratio of 4 would seem low.

On this front, there is both good, and bad news. Beginning with metallurgical coal, the 2015 outlook appears stable with some mild price appreciation expected. Although demand from China (a main importer of Teck's coal) will remain weak as economic growth falls to 5.5% over the next five years (down from 15% in 2002-2012), the supply situation will improve slightly.

Many producers are operating at negative margins, and these high-cost producers may close operations as price weakness maintains. In addition, 20 megatons of metallurgical coal closures have been announced, which should ease the current oversupply situation. As a result, analysts at Raymond James expect coal prices to be around US\$130 per tonne by the end of 2015, up from US\$119. This is not a significant jump, but should provide some earnings appreciation for Teck.

Copper prices are expected to remain roughly stable throughout 2015 due to oversupply, but zinc prices are expected to improve in 2015 as the market moves into a deficit, moving up to an estimated US\$1.16 per pound, from the current \$1.04 Teck realized in Q3 2014. Comprising 33% of gross profit in Q3, Teck's zinc business segment is already seeing the benefits of an improved market, posting a 48% increase in gross profit.

Although commodity prices will not appreciate substantially in 2015, they are expected to remain stable, or grow slightly. This should increase earnings in 2015, along with Teck's cost reduction program and its growth initiatives, such as the restart of its Pend Oreille zinc mine, which should allow the company to take advantage of improved zinc fundamentals.

The result? Analysts are anticipating a \$1.22 EPS for 2015, up from \$0.81 for the trailing 12 months.

### **Teck has an attractive valuation**

Slightly improving commodity prices should provide some earnings appreciation for Teck in 2015, which supports the idea that Teck's share price may have bottomed, and that appreciation can be expected in 2015. But what about the companies valuation?

Currently, Teck has a price-to-cash flow ratio of 4, and a price-to-book ratio of 0.5 Both of these ratios are at seven-year lows, which implies Teck is historically undervalued. In addition, the TSX Capped Diversified Metals & Mining Index is currently trading at a 79% discount to overall TSX based on P/E ratio, which is similar to the discount during the overall sector bottom in July 2013.

With earnings expected to grow in 2015, and valuations being at historical lows, there is plenty of room for multiples, and the share price, to expand. Due to this, Teck does not seem like a value trap, and although price appreciation may not be immediate, Teck is a reasonable buy for patient, long-term focused investor.

### **CATEGORY**

1. Investing
2. Metals and Mining Stocks

### **TICKERS GLOBAL**

1. NYSE:TECK (Teck Resources Limited)
2. TSX:TECK.B (Teck Resources Limited)

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amancini

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