Is it Time to Buy Teck Resources Ltd.?

Description

Teck Resources Ltd. (TSX:TCK.B)(NYSE:TCK) is up 30% in the past two months and investors are wondering if the stock is in the early stages of a broad recovery.

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Let's take a look at the current situation to see if you should add Teck to your portfolio right now.

Commodity prices

Teck produces metallurgical coal, copper, and zinc.

Met coal prices are currently trading below US$120 per tonne, which is a level that puts about 30% of global producers under water. Broad-based production cuts by North American suppliers are slowly working their way through the system, but it will take some time for the market to come back into equilibrium. Predictions for a rebound in the second half of 2015 could get pushed out to 2016 due to weak Chinese demand and higher production by Australian miners.

On the copper front, prices bottomed out in late January around US$2.60 per pound but the metal has recently moved higher. It's too early to say copper is in recovery mode and investors shouldn't get too excited until the price moves back above $3.20.

Zinc prices have also been on a nasty slide, dropping from $1.05 in early October to their current level of US$0.90 per pound. At this point, it looks like the downward trend could continue.

Financial stability and dividend safety

Despite the difficult commodity markets, Teck is still profitable in all three divisions. Management has done a good job of reducing operating costs through the downtrend and the company's balance sheet is healthy. Teck finished 2014 with roughly $2 billion in cash and cash equivalents and an undrawn line of credit of $3 billion. The 4.8% dividend should be safe through 2015.

Oil prices

Teck owns a 20% stake in the massive Fort Hills oil sands development that is scheduled to go into production in 2018. Many analysts are concerned that the project is too expensive, and these worries have been a huge drag on Teck's stock.

There are two schools of thought on this. The skeptic camp says oil prices are unlikely to return to high enough levels to make Fort Hills profitable. Some estimates suggest the break-even price is as high as $90 per barrel.

The optimists see the current oil rout as good opportunity to reduce development costs because lower prices can be negotiated with contractors and suppliers. They also believe crude prices will return to $90 per barrel in the next three to four years.

Teck is committed to spending about $3 billion to get Fort Hills completed.

Lower oil prices might be tough on producers but they are great news for Teck's mining operations. The company recently said every US$1 drop in the price of oil translates into $5 million in additional profits.

The oil rout is also affecting the Canadian dollar, and Teck says it picks up an extra $52 million in annualized earnings for every one-cent drop in the loonie compared to its U.S. counterpart.

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Should you buy?

Teck is a contrarian pick right now. If you believe oil and the other commodities are near their cyclical lows, the upside potential in the stock is quite compelling, but you should be prepared for more volatility in the near term. At the current price, I'm happy to collect the dividend and wait for better days.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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