Should Value Investors Buy Teck Resources Ltd. Right Now?

Description

Teck Resources Ltd. (TSX:TCK.B)(NYSE:TCK) slashed its dividend by two-thirds on April 21. Most stocks would have swooned on that kind of news, but Teck has actually rallied more than 20% since the announcement.

Investors had been sitting on the sidelines, or even betting against the stock, as they waited for the cut to happen. But the strong move to the upside is catching them with their pants down and new investors are wondering if they should buy the stock while it is still beaten up.

Let's take a look at Teck to see if Canada's largest diversified mining company deserves to be in your portfolio.

Weak commodity prices

Teck produces metallurgical coal, copper, and zinc. All three have been in a severe slump and low prices have taken their toll on the company's cash flow.

The production of met coal, otherwise known as steel-making coal, is Teck's largest operation. The anticipated rebound in 2015 is looking like it will be pushed into next year or even later as prices continue to slide. North American suppliers have reduced output in an effort to balance the market, but weak demand from China and higher production in Australia are outweighing the cuts.

Copper and zinc both went into a swan dive through the end of 2014 and into the first part of this year, but recent rallies suggest they may have bottomed out. Copper is trading at $2.90 per pound, 16% higher than its price of $2.50 at the end of January. Zinc prices are also on the move, trading at $1.06 per pound, a 15% gain since the middle of March.

Earnings

The company reported Q1 2015 earnings of $0.11 per share. That's a fair bit lower than the $0.18 for the same period a year ago, but Teck continues to focus on cost management and all of its divisions are still generating positive operating cash flows.

In fact, Q1 gross profit margins before depreciation for coal, copper, and zinc were 34%, 40%, and 28% respectively.

Coal sales and production hit a record 6.8 million tonnes in the first quarter and the company has contracts in place for Q2 2015 to sell 5.5 million tonnes at US$109.50 per tonne. Total Q2 sales are expected to be about six million tonnes.

Weak coal prices are being partly offset by the strong U.S. dollar and lower fuel costs. Production costs for Q1 dropped by $18 per tonne compared with the same period last year.

Liquidity

As of April 20 the company had a healthy $1.4 billion of cash and US$3.0 billion available under a revolving credit facility. Teck expects to finish 2015 with at least $1 billion on the balance sheet. The dividend cut provides more flexibility and will save the firm about $340 million.

The largest concern for the market has been Teck's capital commitments to get the Fort Hills oil sands project completed. The company has to kick in a total $2.9 billion for its 20% ownership stake, with $2 billion still remaining. Fort Hills is expected to go into production in 2017.

Should you buy?

Teck is weathering a perfect storm right now, but commodity markets run in cycles the company is well positioned to reap huge rewards when the tide turns.

The stock is trading at a mere 0.6 times book value, so long-term investors will probably do well buying at current levels, but volatility should be expected until coal and oil prices recover.

CATEGORY

1. Investing

TICKERS GLOBAL

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

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