Teck Resources Inc.: Is it Time to Double Down, or Cut and Run?

Description

Teck Resources Inc. (TSX:TCK.B)(NYSE:TCK) has taken a beating in recent years, and its stock price has fallen in turn. So, that leaves the all-important question: is now the time to double down, or cut and run?

We take a look below.

Why now is a good time to double down

Teck's problems can mainly be traced to a building slowdown in China. This has flat-lined the country's demand for steel, which previously had been growing at 15% per year since the turn of the century. This, in turn, has crushed demand—and prices—for coking coal.

To illustrate, Teck's average coal selling price was US$285 per tonne in the third quarter of 2011. That number fell to US$106 in the first quarter of this year, and has, in all likelihood, fallen since then. This has forced Teck to slash its dividend by two-thirds.

So, why should you buy Teck? Well there's one principle reason: the company is well positioned to outlast its competitors. The company has cut its per-unit coal operating costs by over 20% in the last year alone (in USD terms) thanks to improved efficiency initiatives and a weaker Canadian dollar. Importantly, the company is able to keep making a profit in this environment, while more than 50% of seaborne coking coal is produced at a loss.

Eventually, supply should fall to match demand. And when that happens, coking coal prices would likely rebound. That would give a nice boost to the profits, dividend, and share price of Teck.

There's another interesting reason to buy Teck. A recent study shows that recent dividend-cutters—a description that fits Teck—tend to outperform the market. The reasoning is very simple: a dividend cut often prompts a massive sell-off in a stock, leaving it undervalued for those that remain.

Why now is a good time to duck and run

Teck's stock has fallen mightily, but make no mistake, there's still plenty of room for the stock to fall further.

To start, there's no sign that global oversupply will end anytime soon. This is somewhat understandable—mining operations can be very costly to shut down, especially when supply contracts and unionized labour are involved. And no one wants to be the first to cut production, only to see competitors benefit from higher prices. The result is typically a game of chicken, one which no one wins.

There are also problems on the demand side. China has a massive portfolio of empty properties, and thus needs less and less steel. In response, the country is exporting more of the metal. Last year alone, steel exports jumped by 50%. And this was in a year when world steel consumption fell by 3%.

Even more worryingly, Teck is cutting back production. It's hard to see why—perhaps the company is hoping to start a trend. But rather than set an example for competitors, Teck's moves are more likely to embolden them.

The verdict

Teck has faced a lot of problems over the past four years, and these issues are as serious as ever. Your best bet is to stay away.

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