



Don't Be Fooled by Teck Resources Ltd.'s Bargain Share Price

Description

There has been little in the way of good news for **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) shareholders since 2011. Since shares peaked at over \$60 in January 2011, they have fallen 85%, and are currently trading at some of the lowest levels in the company's history.

This decline is due to a massive slowdown and rebalancing of China's economy as it transforms from an investment to service-based economy. Since China is the biggest buyer of Teck's coking coal, copper, and zinc, the fact the Chinese economic growth has been declining annually means that Teck's coal prices fell from over \$300 per ton in 2011 to about \$85 per ton now.

Despite the fact that Chinese GDP is estimated to decline continually as the economy matures, there is still a bullish case for Teck being made. The basic idea is that even though demand is weak and the coal market is expected to be 10-15 million tons oversupplied, there are about 15 million tons of production cuts being announced from global producers—including Teck—which should help to bring the market back into balance.

With coal at a decade low and copper at a five-year low, and with prices for coal approaching the cost of production, many investors are considering Teck a rebound play. Here's why this may be a mistake.

Teck may seem undervalued, but check your assumptions

Currently, many different analysts are suggesting Teck is undervalued. According to analysts at **TD Bank**, Teck is expected to produce earnings per share of \$1.50 in 2016, and \$0.85 this year. This would give Teck a 2016 forward price-to-earnings ratio (P/E) of 6.22. By most standards, this seems quite low.

This is a discount to fellow copper producer **First Quantum Minerals Ltd.**, which is trading at a 2016 forward P/E of 7.44, and a discount to its large-cap producer peer group average of 7.55. It is significantly below large coking coal producer **BHP Billiton Ltd.**'s estimated forward P/E of 25.

While Teck does seem undervalued compared with its peers, it is also trading below its own historical average trailing P/E. Teck's current trailing P/E of 12.7 is well below its five-year average of 15.8, and

is the lowest valuation the company has seen since 2012. This means that Teck shareholders are current valuing the company's past earnings at a lower multiple than at any point during the past two and a half years, despite the fact that commodity prices were declining during this period and the outlook was also negative.

Even more convincing is that Teck is trading at about half of its net asset value, meaning Teck's share price is only about half what the company is actually worth, and Teck shares have seldom traded this low in its history.

While these numbers seem to present a strong case for buying Teck, there is a problem—the earnings used to calculate the forward P/E, as well the net asset value, come with certain assumptions about the future prices of copper, coal, and zinc.

For example, TD's 2016 earnings estimate of \$1.50 is based on coal prices of \$100 per ton and copper prices of \$3.05 per pound. If either of these predictions are off, Teck's earnings per share could come in much lower, making the stock seem overvalued with more downside. For example, if copper prices were to stay near current levels of \$2.40 per pound, Teck's earnings per share for 2016 would be only around \$0.94 per share, using Teck's estimates for the effect of changes in copper prices to earnings.

In short, buying Teck now is a complete gamble on the recovery of coal and copper prices.

Why you should wait

It is important to avoid a falling-knife scenario. For example, in 2009 during a similar crash in commodity prices, Teck shares fell to nearly \$4 per share. China's steel usage (which impacts the demand for coal), is expected to fall in both 2015 and 2016 due a weak real estate market and slumping economy, and consultant group CRU expects the copper market to remain in surplus for the next several years.

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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