Do Teck Resources Ltd. Shares Have 600% Upside Potential?

Description

In 2008-09, many different companies were seemingly on their deathbeds.

In hindsight, we know that many of them not only survived, but thrived. The market is prone to overreacting in the short term, especially when all we see is chaos around us. It takes a special kind of investor to look past that and see a rosy future.

That's exactly what happened with **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) back in late 2008. The company was heavily in debt in a world where commodity prices were falling off a cliff. Investors acted accordingly, and shares fell from over $40 each to less than $5 each in just a few months. That kind of decline usually spells the death of a company.

But Teck wasn't about to go that easily. The company managed to secure financing to roll over some of its debt. China started building, the price of metallurgical coal, copper, and zinc recovered, and bankruptcy was no longer on the table.

The stock surged, recovering from $5 per share back to $40, and just a couple of years later ended up above $60 per share. That's quite the recovery for any stock, and represents the kind of return most investors can only dream about.

These days, Teck's shares are again flirting with the lows of 2008-09. Does this mean the stock has another 600% rally in store?

A very cheap company

Teck is cheap on a number of metrics. Let's look at book value first.

According to the company's most recent balance sheet, book value is $32.62 per share. The current share price is $6.35. Based on book value alone, there's a potential upside of more than 400%.

There's just one problem with that. It's obvious the market has no confidence that Teck's assets are worth what Teck thinks. The point is valid. These assets were bought at much higher prices than they could fetch today.

But at the same time, Teck does have some of the best reserves out there, especially in metallurgical coal. Based on current production, it has approximately 100 years of reserves left in the ground. These are long-term assets.

From a price-to-earnings standpoint, the stock is cheap as well. Over the last 12 months, Teck has made $0.59 per share in normalized earnings, which puts shares at a price-to-earnings ratio of just over 10. The company is also on pace to deliver approximately $300 million in free cash flow in 2015.

What about Fort Hills?

Teck owns 20% of the Fort Hills oil sands project, along with **Suncor Energy** and **Total Energy**. Suncor recently made headlines by buying a portion of Total's interest, bringing its ownership stake to 50.8%.

Over the next two years, Teck has committed to fund $1.8 billion for development of the project. With only $1.3 billion worth of cash on its balance sheet and a total debt load exceeding $9 billion, it's easy to envision a future where Teck can't live up to its commitment.

Reality isn't so bad. Teck has $6.8 billion in liquidity, including a revolving credit facility of $3.8 billion, and an additional revolver for $1.5 billion. That's not even counting the cash. In short, the capital it needs to contribute to Fort Hills won't be a problem.

Cash flow from the project should be solid, even if the price for oil remains relatively weak. If crude hovers at $60 per barrel and the Canadian dollar is worth US$0.80, the project will still spin off $258 million per year in cash flow, according to Teck's most recent investor presentation. That's a return of approximately 9% on capital, which isn't bad for oil being beaten up.

There's a number of things that have to happen for Teck's depressed shares to recover. Coal and copper have to head higher, and so does crude. Investors also want to see improvements to the balance sheet.

If these things happen, Teck shares have some nice upside potential. They might not surge 600% like they did last time they were this depressed, but there's definitely potential for this turnaround story.

CATEGORY

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