Can Teck Resources Ltd. Ever Come Back?

Description

To say it's been a tough year for **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) would be an understatement.

The company is dealing with lower commodity prices across the board. Thanks to lower demand from China and a general aversion to the commodity in general, metallurgical coal prices have fallen off a cliff. The market for zinc and copper isn't exactly strong either, and investors are punishing Teck for its ill-timed investment in the Fort Hills oil sands project.

Perhaps this is just a temporary drop. Remember, the last time Teck traded at such low levels was during the first part of 2009 when it dropped as low at $5 per share. By 2011, shares had rebounded with a vengeance, hitting a high of $60 each.

Is Teck poised for that kind of rebound? Or are the problems much worse this time around?

Turning the corner?

Teck recently came out with third-quarter earnings that looked positively dismal on the surface. It reported a loss of more than $2.1 billion, or $3.72 per share.

But the vast majority of that loss was caused by management writing down the value of various assets. Once you take out the $2.8 billion write-off, the company actually posted an operating profit of $229 million. That's only $9 million less than the quarter before, which saw an $0.11 per share profit after taxes.

There are a few factors that are helping to offset lower prices for Teck's commodities. The Canadian dollar is weak compared to the U.S. greenback. Teck's input costs are in Canadian dollars, while it gets paid in U.S. dollars.

Costs are also down. The decrease in crude prices means the large equipment needed to mine costs less to operate. And Teck has been shutting down some of its operations, which is also helping the bottom line.

The company is comfortably free cash flow positive. Over the first three quarters of the year, it has generated more than $215 million in free cash flow. Based on the new $0.30 per share annual dividend–Teck cut its payout earlier this year–there is enough free cash flow available to service the 4% yield.

Of course, that doesn’t mean the dividend is safe. Teck is facing a large bill for its share of developments of the Fort Hills oil sands project, and it might choose to conserve cash by cutting the payout.

Will Fort Hills make the difference?

There are two ways an investor could look at Fort Hills.

Right now, it’s not looking like a very attractive project. Teck’s share of capital expenditures going forward is approximately $1.5 billion, which is a lot for a project that isn’t viable with oil at $45 per barrel.

But oil won’t be at $45 per barrel forever. If crude recovers to just $60 per barrel and the Canadian dollar settles in at US$0.80, Teck is looking at $258 million annually in pre-tax cash flow. If crude recovers to $80 and the Canadian dollar trades at US$0.90, the pre-tax cash flow jumps to $335 million.

Teck also shouldn’t have a problem funding its share of the project. It currently has $1.8 billion in cash and the ability to borrow $3 billion more on its revolving credit line. That’s plenty of liquidity to fund $1.5 billion in commitments. And remember, Teck is cash flow positive. It should be able to add $100 or $200 million to its cash pile between now and 2017.

If coal recovers as well, Teck could be quite profitable. In 2014 Teck managed to sell each tonne of metallurgical coal for US$115. In the last quarter, it only managed to get US$97 per tonne. If coal prices rise moderately, it’s not unreasonable to expect the company to be able to repeat its 2014 profit, which was $0.63 per share. That’s quite cheap compared to the $7.56 share price.

And remember, commodities are a boom-and-bust business. Back in 2011 Teck managed to earn an eye-popping $4.50 per share. I’m not saying a return to that kind of profitability is imminent, but it is something for investors to keep in the back of their mind.

Teck Resources is a cheap stock; that much is obvious. If you’re a believer in the price of coal and oil heading higher, it’s probably a good idea to pick up shares at this depressed price.

CATEGORY

1. Dividend Stocks
2. Investing
3. Metals and Mining Stocks

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1. Editor's Choice

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