Wall Street Analysts Don't Know What to Make of Teck Resources Ltd.

Description

Typically, Wall Street expectations for a stock are relatively similar; few analysts want to take the career risk of a dissenting opinion. For this reason, many investors tend to take consensus expectations with a grain of salt. Still, it's rare to see completely opposite ratings on a stock, especially when both opinions were rendered on the same day.

Last month, **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) was upgraded to buy from hold at **BB&T Corporation**, but was downgraded to sell from hold at **Deutsche Bank AG**. What should you make of this?

BB&T takes a bold stance

With a $10 price target (equating to 95% upside), BB&T's stance is perhaps the most aggressive. There are a few factors playing into their decision. It recently raised its 2016 and 2017 earnings estimates, saying that earnings appear to have finally bottomed. A big reason for the potential of earnings turning around is the apparent rationalization of industry supply.

Back in 2001 when the market was just catching on to the massive buying power of China, prices for metallurgical coal were around $50 per metric tonne. Prices then exploded, reaching roughly $250 in 2010. To meet China's burgeoning demand, massive amounts of supply were brought in. With higher prices, operators were able to develop more supply than the market had seen in its entire history.

Due to rising supply and slowing demand growth from China however, prices started to slip in late 2010, hitting a current price of only $130 per metric tonne, a near-decade low.

There are some signs that the market is turning around. Numerous major producers such as **Patriot Coal Corporation**, **Walter Energy, Inc**., **Peabody Energy Corporation**, **Arch Coal Inc.** and **Alpha Natural Resources, Inc.** are all in various stages of financial distress. Eventual bankruptcies and production shutdowns will inevitably help rationalize supply.

But can Teck survive to enjoy better prices?

Deutsche Bank contends that rising net debt levels are a key concern behind its downgrade to sell. Deutsche Bank isn't alone. In September Teck saw its credit rating downgraded to junk status by **Moody's Corporation** because they "expect prolonged commodity price weakness and sizable investment spending will cause Teck's financial leverage to remain well in excess of typical investment-grade thresholds through at least 2017."

Currently, long-term debt stands at nearly $7 billion versus a market cap of only $4.1 billion. With negative earnings and massive spending plans, this situation will only get worse before any relief arrives. Next year, Teck will have an expected cash burn of $1.5 billion, with another $1 billion consumed in 2017.

While there are some reasons to believe that coal can rebound from its historic lows, there isn't anything on the horizon that suggests that things will turn around quickly. The growth in China consumption is flagging, and industry supply is still holding stable as financially precarious competitors are still producing. While there is plenty of upside should industry conditions improve, keep mind that any investment is contingent on the market's willingness to continue providing financing to an increasingly unpopular business.

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1. Energy Stocks
2. Investing

POST TAG

1. Editor's Choice

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