Is Teck Resources Ltd. Oversold?

Description

Low commodity prices have pummeled **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK), and there is little indication that relief is in sight.

That’s normally the end of the story for most investors, but contrarian types are looking at the company and wondering if the sell-off has gone a bit too far.

Let’s take a look at Teck to see if it should be in your contrarian portfolio right now.

Commodity rout

Teck’s stock is down nearly 90% in the past five years. That’s a pretty tough pill to swallow for investors who have held the name for a long time.

The crash is frustrating because the company is actually one of the most efficient operators in the sector, but a perfect storm in the commodity space is hammering its core products as well as a major project.

Fans of the name say Teck has survived previous routs and the current malaise will soon pass. Other analysts suggest the downturn is likely to be longer than previous cycles and Teck might not to make it through as an independent player.

What’s the issue?

China remains the core driver of the commodity space, especially in the markets for steel-making coal and copper. At the moment, the country is working through a period of slower growth, and there is little evidence to suggest things are turning the corner.

Coal, copper, and zinc

Teck produces steel-making coal, copper, and zinc. As a low-cost producer, the company hasmanaged to generate operating profits despite the massive slump in prices, but things are getting tight.

Teck earned $29 million, or $0.05 per share, in Q3 2015.

Realized coal prices fell 20% in the quarter as compared with the same period in 2014, but lower production costs and the weaker Canadian dollar helped Teck improve Q3 gross profits in the division from $10 million to $27 million.

Copper is really taking it on the chin. Teck's Q3 average realized price dropped from US$3.17 per pound in 2014 to US$2.39 per pound this year. That knocked gross profit down by more than 50% to $82 million.

Zinc was more stable, with Q3 gross profit coming in at $231 million, about the same as last year.

Oil

Teck holds a 20% interest in the Fort Hills oil sands development. The project has put severe pressure on Teck's balance sheet, and the 60% drop in the price of oil over the past 18 months has investors wondering if all the money being pumped into Fort Hills is going to be a write-off.

Teck is committed to spending the remaining $1.5 billion needed to get Fort Hills completed over the next two years. Once the facility goes into full production in 2018, Teck's share of the output will be 36,000 barrels per day.

Balance sheet situation

Teck had $1.8 billion in cash and cash equivalents at the end of Q3, so there should be enough funds to see the Fort Hills project through to completion. The company also has $5.8 billion in available credit, which gives management some extra flexibility.

The bigger issue is the $8.2 billion in long-term debt. None of the debt is due before 2017 and the weighted average maturity on the portfolio is 14.5 years, so Teck has some time to hope for a recovery in the commodity markets, but the clock is still ticking.

Should you buy?

The company has done a good job of reducing costs through the downturn and is positioned well to profit from better prices. If commodity prices are at the bottom of the cycle, Teck looks seriously oversold and the upside could be significant on a coal and a copper rebound.

The big gamble is time. If coal and the base metals remain under pressure for another year or two, Teck will probably get taken out and investors won't see the benefit of better days.

If you have a contrarian style, it might be worth starting a small position, but Teck is still a risky bet.

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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