Teck Resources Ltd.: Big Upside for the High-Risk Investor

Description

Up to this point, investors who have tried to pick a bottom for **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) have ended up deeply in the red. Prices of Teck's key products—copper, metallurgical coal, and zinc—have been in a free fall as plunging demand from China meets oversupply, and Teck's shares have followed suit.

While Teck shares could certainly fall further (and they did during the last crash in 2009 when Teck's shares dropped to the 20-year low of $4.47 per share, which is slightly lower than the current price of about $5 per share), one thing seems certain—Teck is now in a position where the upside potential exceeds the downside risk.

With prices just slightly off 20-year lows and most analyst forecasts predicting a slow and gradual price recovery from current levels, Teck could have big upside. Here's why now may be a good time to consider entering Teck for investors with a good risk appetite.

Teck has slimmed down its cost structure

Teck has taken a number of steps to slim down its cost structure and, as a result, the company is prepared to withstand the current pricing environment and benefit more from a price recovery.

Teck has seen its realized price of coal drop from CAD$153 per tonne in 2013 to CAD$116 per tonne at the end of the recent quarter. Currently, coal prices are sitting at US$73 per tonne, or CAD$99. Fortunately, Teck has reduced its operating costs over the same period.

Teck had operating costs of about CAD$88 per tonne in 2013, and at the end of the most recent quarter, Teck's operating costs were $81 per tonne. This reduction is due to Teck's cost-reduction initiatives, which include labour and equipment productivity improvements, reduced use of contractors, and reduced costs of inputs.

Just recently, Teck announced that it would be laying off 1,000 workers, which would reduce operating costs by about $300 million annually in 2016. This will further drive down Teck's cost base.

In addition to this, Teck is cutting its capital expenditures by $350 million. It's also cutting its dividend by about $115 million. The end result is that if commodity pricing next year remains close to pricing this year, Teck would be very close to having positive free cash flow in 2016.

Potential for improved pricing makes Teck seem undervalued

There are several different analyst forecasts for coal pricing for next year, but they all paint a more optimistic picture for Teck. For example, **RBC** is predicting metallurgical coal prices of US$105 per tonne in 2016, $115 in 2017, and $125 in 2018. This is well above current levels.

TD Bank has a more conservative forecast of US$85 per tonne in 2016, US$90 in 2017, and US$105 in 2018. Both banks are projecting an upward trend in pricing over the next three years, and this is not an unreasonable assumption since supply cuts are planned and producers have largely exhausted cost cutting as a means to keep production online. This should lead to more shutdowns, which has already been occurring with 34 million tonnes of cuts taking place between 2014 and the end of this year.

If these increases in coal prices do occur, the effect on Teck's earnings would be positive. RBC's price forecast (which also includes slight increases in copper and zinc prices) would lead to Teck's EPS growing from $0.61 in 2015 to $1.31 per share in 2016.

Even TD's more conservative price outlook would lead to Teck growing its earnings by an impressive 28% in 2016. For potential Teck investors, this represents an opportunity.

Currently, Teck is trading at a trailing price-to-earnings ratio of about 8.6. This is well below the five-year average of 16.3, despite the fact that Teck's growth trajectory is more positive today than during most of the past five years. Teck certainly has some room to expand this multiple.

In addition, Teck's net asset value (the value of all of Teck's assets after netting out debt) is around $31 per share, which means Teck is trading at a discount of over 80% to its net asset value. These levels have not been seen since 2008, giving Teck plenty of potential room to move up.

CATEGORY

1. Investing
2. Metals and Mining Stocks

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:TECK (Teck Resources Limited)
2. TSX:TECK.B (Teck Resources Limited)

Category

1. Investing

2. Metals and Mining Stocks

Tags

1. Editor's Choice

Date
2025/07/30
Date Created
2015/12/07
Author
amancini