Why I'm Finally Buying Teck Resources Ltd.

Description

Teck Resources Ltd. (TSX:TCK.B)(NYSE:TCK) shares approached a grim milestone on December 9—they closed at $4.77 per share. This is the lowest point for Teck shares since 2009 during the economic collapse when prices briefly fell below $4.50.

Before this, Teck shares very briefly touched that level again in early 2000. The last time Teck shares consistently stayed in the $4.00 range was the mid-1980s. Does this mean Teck shares cannot fall further? Definitely not. But when you combine this knowledge with the current state of coal and copper markets, Teck's valuation, and Teck's strong balance sheet and cost base, there is much more upside than downside risk.

For this reason, I think now is finally a good time to add Teck shares. While Teck certainly shouldn't occupy a large portion of a portfolio (since it has a growth trajectory that is far from certain), a small position can protect your portfolio while offering a big growth opportunity.

Coal and copper markets are set for a very slow recovery

Teck's major two products are metallurgical coal and copper, and Teck's fortunes depend on the pricing of these products. Coal prices have fallen from $300 per tonne in 2011 to $73 recently and copper sits at a six-year low. Many analysts are now predicting a slow recovery with coal prices returning to about $100 per tonne over the next three years.

Coal prices have been affected mainly by collapsing steel production in China. China consumes more steel than the next 10 largest consumers combined and also produces half the world's output. Metallurgical coal is necessary to make steel and, as a result, China also consumes about half of the world's metallurgical coal.

There are some bright spots though. Part of the coal-price problem has been oversupply, with supply cuts not exceeding the pace of demand cuts. Current prices mean many producers are underwater and so production cuts are happening.

Teck estimates that 50 million tonnes in production cuts have been announced, with about half of that being implemented already and half being underway. Currently, over 44% of Chinese coal producers are producing at a cash loss, and U.S. producers are under heavy pressure as well due to the strong U.S. dollar (compared to Canadian and Australian producers).

While demand in China is expected to be poor, there is strength elsewhere to add to the reduction in supply, especially in India. India has just exceeded China as the world’s fastest-growing economy, and Chinese imports of metallurgical coal are expected to grow since the country produces very little coal that is of poor quality.

Teck seems very undervalued

Most analysts are predicting gradual recoveries in price. **TD Bank** expects prices to $105 per tonne in 2018, and Wood Mackenzie predicts that prices for coal will be $100 in 2017. **RBC** is even more bullish; prices are expected to be $105 in 2016. A similar slow recovery is expected for copper.

This means Teck’s earnings could finally grow after several years of declines. Despite this, Teck is currently trading at a discount of over 80% to its net asset value. Teck has not traded at such a massive discount to its net asset value since 2009. Given that the worst may be over for Teck, the company should be trading at more than half of its net asset value.

In addition to this, Teck also has a very strong balance sheet and is able to weather the current crisis well. Teck will end the year with $1.8 billion in cash on its balance sheet and $5.8 billion of unused credit facilities that it can use.

Combining Teck’s liquidity with a slow recovery in commodity prices and Teck’s undervalued position means that its prospects as an investment seem lower risk than it has been at any point over the past several years.

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1. Investing
2. Metals and Mining Stocks

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1. Editor's Choice

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