Teck Resources Ltd. Just Jumped 15%: Should You Buy Now?

Description

Teck Resources Ltd. (TSX:TCK.B)(NYSE:TCK) jumped more than 15% in early trading on February 4, and investors are wondering if the rally will continue.

Let's take a look at the current situation to see if Teck deserves to be in your portfolio.

Tough times in the commodity sector

The fallout in commodity prices has hit Teck hard, and anyone who bought the stock in early 2011 is sitting on some serious paper losses.

How bad?

The shares traded for more than $60 just five years ago. Today they are $6, and that's after a 50% rally off the January lows.

Prices for steel-making coal, copper, and zinc remain near multi-year lows, and most investors are completely avoiding the space, but contrarian investors know these commodities run in cycles and the bottom could be in sight for Teck's core products.

Steel-making coal is now in a record-setting slump with the latest downturn being the longest since 1950. China's economic slowdown is a big reason for the pain, and that might not reverse course in the near term, but production cuts across the industry should start to bring the market back into balance next year.

The copper slump should also be nearing its bottom, and the zinc market is already showing signs of a recovery.

Oil impact

Teck holds a 20% stake in the Fort Hills oil sands development. The project is due for completion in late 2017 and Teck is obligated to cough up another $1.5 billion to get the plant finished. With WTI oil lingering around $US30, the market is concerned that all of this money is being ploughed into an asset that will never be profitable.

Time will tell, but oil sands facilities are built to produce for decades, and it is very possible that current prices won't last. In fact, the downturn is great for the Fort Hills partners because construction costs are much cheaper than they would have been if oil remained at $100 per barrel.

If oil recovers just as Fort Hills goes into production, Teck's shares could surge. The company has the cash on hand to meet its Fort Hills obligations, so investors don't have to worry about any surprises on that front.

Will Teck survive and thrive?

Contrarian types are betting that Teck will recover just as it did after the financial crisis. Whether or not the stock will deliver the same spectacular return is anyone's guess, but the upside potential probably outweighs the downside risk at this point in the game.

Why?

The company remains one of the lowest-cost producers in all of its core business segments, and management has done an excellent job of reducing costs through the downturn, and that process continues. In November the company announced a further $650 million reduction in 2016 spending as a measure to conserve capital, lower operating costs, and maintain financial flexibility. If the slump continues, Teck is capable of riding it out.

The company is sitting on $9 billion in long-term debt, which is definitely a concern, but none of the notes are due before 2017 and Teck has access to about $6 billion in credit facilities. For the moment, there isn't a risk of a cash crunch.

Assuming the commodity rout is near a bottom, the upside potential in the stock could be significant, and investors are already seeing how big the move can be on a change in sentiment.

Producers tend to overshoot on both overproduction as well as output cuts, and there is a real possibility that the current oversupplied positions could switch to shortages once demand improves.

If you have a bit of cash sitting on the sidelines, it might be worthwhile to buy a small position in the stock.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

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