Teck Resources Ltd.: Should You Buy the Pullback?

Description

Teck Resources Ltd. (TSX:TCK.B)(NYSE:TCK) has chalked up a fantastic rally in 2016, and investors are wondering if the recent pullback is an opportunity to buy.

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

Commodities meltdown

Teck produces metallurgical coal, copper, and zinc. That mix has been a toxic one over the past five years as all three markets have suffered a total meltdown.

Why?

Countries around the world went on a spending spree after the Great Recession and that drove demand for coal, copper, and zinc sky high. As a result, Teck went from being one of the market's most-hated stocks to one that was absolutely loved.

In fact, the stock's epic two-year rally from $4 per share in March 2009 to $60 per share in early 2011 is still on the minds of market watchers, and the recent surge to start 2016 has investors wondering if the performance is about to be repeated.

As we all know, the last party quickly fizzled out. Governments eventually turned off the tap just as producers flooded the coal, copper, and zinc markets with additional supply, and the result has been the worst downturn for Teck's core products in decades.

The current outlook

The metallurgical coal market is in its deepest slump since 1950, and there is little reason to believe things will turn around in 2016. Weak Chinese demand and strong output from Australia continue to offset production cuts by North American suppliers.

Copper is faring a bit better on the back of falling stockpiles. Pundits are split on whether copper has truly bottomed or not, but the 15% bounce in the price from mid-February to mid-March has brought investors back into the metal.

Zinc is showing the most promise with a nice 20% surge off the January low. Most market observers see further strength as production cuts are finally starting to bring the market back into equilibrium, and there is even talk of a potential shortage by the end of 2016.

What about oil?

Crude prices are also a factor in Teck's spectacular slide and the recent rebound.

The company is not a producer, but Teck holds a 20% stake in the Fort Hills oil sands project, which is expected to begin production in late 2017. Fort Hills has been a massive cash drain on Teck, and the threat of an extended slump in crude prices has investors wondering if the project is simply a big, ugly money pit.

We'll have to see how things play out, but the rout in the oil sector has actually been good for Teck and its partners up to this point because they have been able to negotiate lower costs from contractors and suppliers.

When oil dropped below US$30 per barrel, the market pretty much threw in the towel on Teck and Fort Hills. Now that oil prices have recovered somewhat, pundits aren't quite so negative, and the stock has enjoyed a nice bounce.

Should you buy?

Teck remains a risky bet. The company is saddled with $9.6 billion in debt and commodity prices remain volatile. If WTI oil takes another run at US$25 per barrel, Teck is going to get hit again.

Having said that, copper and zinc are probably in the early innings of a recovery and coal could bottom out next year. Teck is a low-cost producer and has done a good job of controlling costs through the downturn, so there is still some strong upside potential when the cycle finally turns.

I wouldn't back up the truck, but contrarian investors who believe oil and the base metals have hit their lows might want to consider a small position in the stock.

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1. Investing
2. Metals and Mining Stocks

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1. Editor's Choice

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