Is the Teck Resources Ltd. Rally Over?

Description

After hitting lows of $3.65 in January, shares of **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) have rocketed upward over 200% to $11.28 on March 17. Shares have since drifted downward to about $10.

As Canada's largest integrated mining company—with major interests in coal, copper, zinc and oil—many investors have paid close attention to the rally to gauge the health of the raw materials industry. The company recently turned cash flow positive but is still stuck with $9.6 billion in debt.

Can the rally be sustained?

tck chart

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What's caused the pop?

After one of the longest slumps in history, commodity prices are finally rebounding. Since January nearly every commodity has seen pricing bumps, including copper, zinc, and oil.

Teck has been relentless in cost cutting, allowing many of its major mines to remain cash flow positive. Last year the company beat its guidance for full-year production costs and capital expenditures.

"We've achieved significant sustainable operating cost reductions through our CRP, the cost-reduction program, and our results have been helped by lower oil prices," said CEO Donald Lindsay. "At the mine level, we've reduced our cash unit costs at all operations year-over-year and, importantly, all of our major operating mines are cash flow positive after sustaining capex in Q4 in 2015".

Not bad for a company operating in some of the worst conditions in decades.

Not so fast

Zooming out, the macro situation is still fairly difficult. Coal remains in its worst slump since the 1950s; copper is down roughly 50% since 2012; zinc prices just hit 1975 levels.

Deutsche Bank released a report this month stating that the “commodity price rally appears to be driven by incrementally positive data from China. We do not expect this trend to continue and still believe supply cuts across most commodities are required … We expect further equity issuances and debt refinancing ahead as the sector continues to re-shape.”

If the bank is right, the recent pop could be a mere blip in what has been a downward spiral for Teck. Since hitting all-time highs of roughly $65 in 2011, the stock has seen multiple short-term rallies, all of which proved to be short-lived.

A $9.6 billion debt load (of which $600 million is due in 2017) also presents a major hurdle. While the company drove positive free cash flow last quarter, it still broke even on the year.

In 2015 Teck generated $1.95 billion in operating cash flows versus capital expenditures of about $2 billion. Overall, liquidity remains strong; Teck has cash levels of $1.8 billion and $3.0 billion in a revolving credit line. With rising commodity prices and cost-cutting initiatives taking hold, things look good for now.

Is the worst over?

The recent correction looks to be pricing in a sustained rebound in raw materials. While Teck’s strong liquidity position should allow it to navigate another downturn, it won’t prevent the stock price from collapsing again.

According to **National Bank of Canada** analyst Shane Nagle, “the stock is now at a substantial premium to its trading range over the past three years, and appears to be pricing in at least a 10% increase in base metal prices.”

With a rebound already priced in, commodities need to continue surging for shares to be undervalued. With persistent macro headwinds, Teck may not be an attractive bet.

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Author
rvanzo