Should Investors Expect Teck Resources Ltd. to Continue Growing?

Description

Investors who bought **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) in January are sitting comfortably right now, with the stock tripling in value since that time. However, with a three times return already on the books, can investors expect that this stock will continue to rise, or should they back out while they're ahead?

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Part of the reason why investors are so uncertain is because Teck Resources has been here before. When the financial crisis hit, economies all around the world plummeted, making commodities such as coal, copper, and zinc irrelevant. Fundamentally, the company should have imploded then and there.

However, it was able to restructure its debt and the economy recovered, pushing commodities higher again. Between March 2009 and early 2011–less than two years–the stock increased from below $4 to $60 per share. Sound familiar? This rally started under $4 and has since increased to $14.

Historical returns, though, do not ensure future returns.

Fortunately, Teck has been able to do okay thus far. Its Q1 2016 earnings were much better than analysts had expected. Its adjusted profit was $0.03 per share, which, at $18 million in total, doesn't sound like much, but is significant when everyone expected much worse.

And the good news for investors is that commodities appear to have hit a bottom. Metallurgical coal, the type used to make steel, has seen its spot prices start to increase, already passing the US$84-per-tonne contract price for Q2. Copper prices have also increased by 10% and, so long as there isn't a sudden influx of supply, the prices should be sustainable. And finally, zinc is up 20% this year, primarily because there are mines shutting down, reducing available supply.

But one of the drivers is the fact that oil has rebounded. Despite not being in the oil business, it owns a 20% stake in the Fort Hills oil sands development. The company is still responsible for paying an additional $1 billion to get it started at the end of 2017. With oil prices increasing, investors are growing more intrigued by the potential for Teck to generate earnings from the oil business.

The ultimate reason, though, why Teck has been doing so well is because it has pushed its production costs much lower. For example, it was able to reduce its copper mining costs by 16%. With coal, it was able to push the cost per tonne to $78. So long as the company can keep these costs down, it should be able to eke out decent margins.

Here's the thing … Teck is carrying $9 billion in debt. And while this debt is not due for quite some time, I'm still concerned the company could experience problems if commodity prices go south again. And more importantly, the last time this rally occurred, it was on a significant investment from China as it stimulated its way out of the recession. There is little sign that China is going to do that again.

While I won't be starting a position in this company, the best money is earned when you go against the flow. I just can't get past the $9 billion in debt and the fact that China isn't buying commodities like it did in 2009 and 2010. Therefore, I am avoiding this stock. However, there could still be some room for growth. It all depends on where commodities go.

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jaycodon

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