Will Teck Resources Ltd. Go From Hero to Zero?

Description

Since the year began, **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) has been one of the best-performing stocks in the TSX. From lows of just $4 in January, shares have exploded higher, breaching the $20 mark in recent weeks.

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Still, trouble could be on the horizon due to an overstretched run-up. Earlier this month **Royal Bank of Canada** downgraded Teck shares to "sector perform" from "outperform" due to their rich valuation.

When you look at the state of the mining industry, most of the upside already appears priced in. According to RBC's report, "Teck should continue to benefit from the strong zinc market we are forecasting. However, we believe much of our positive 2016 zinc forecast is already discounted in the share price."

Even the run-up in coal appears overdone: "To the extent that the Chinese cuts (to coal production) are maintained, we believe the gains in coking coal prices are likely sustainable," RBC's report continues. "However, recent record Chinese steel output seems unlikely to continue, suggesting a weakening demand for coking coal, limited further upside potential for prices in the near term."

Are Teck's best days behind it?

Investors are rewarding diversification efforts

For years Teck has been punished by volatile swings in its core commodity exposures (zinc, copper, and coal).

However, its 20% interest in the upcoming Fort Hills oil sands project—which is 60% complete and expected to come online in 2018—could provide the company with a much-needed level of diversification. Located in the Athabasca region of Alberta, the project should eventually produce 180,000 barrels of oil equivalent per day. Management has coined this project its "fourth leg."

Moving away from its core businesses wasn't cheap. To become a partner, it needed to post $2.9 billion in capital to construct the project with $960 million of that coming in 2016 alone. That massive cost put major pressure on shares earlier in the year, especially considering Teck's $9 billion in long-term debt.

The market was wary, but Teck's management never blinked. "We have all the cash on the balance sheet now that we need to complete that and we haven't touched the US$3 billion credit facility that we have," Teck's president and CEO Donald Lindsay recently commented. "And we don't intend to touch it this year and I think we have a reasonable shot of finishing the project without ever touching it."

With no major bond maturities coming until 2021, he's probably right.

Inching towards progress

While the Fort Hills project shouldn't warrant an investment on its own, it does represent the type of company Teck is attempting to be. While it's still completely exposed to the commodity markets, Teck will soon have four offsetting revenue streams.

Besides oil, Teck is seeing improvements in its other three areas of operation. Zinc has already exploded past $2,150 per tonne this year, copper has seen increased demand from India and increased use in electric vehicles, and coal has experienced its first uptick in prices in nearly a decade.

For long-term investors, Teck Resources is slowly becoming less risky to invest in. The latest run-up is likely overdone, but the company could be positioned to rise with some long-term secular tailwinds.

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