Billionaire Hedge Fund Is Betting Big on Teck Resources Ltd.: Should You?

Description

Teck Resources Ltd. (TSX:TCK.B)(NYSE:TCK) might have jumped a nerve-wracking 330% year to date, but some investors believe the rally is far from over yet. Robert Bishop, the founder of The Impala Asset Management hedge fund, recommended investors *buy* Teck when he spoke at the CNBC 2016 Delivering Alpha Conference a couple of days ago.

In fact, as per Impala's latest filings, Teck was its biggest holding in terms of share count with nearly 9.4 million shares–its second-largest holding in terms of value. More importantly, Impala's Teck share count increased by almost 9% sequentially in Q2, indicating that it continues to pump money into the coking coal company. Of course, Teck has climbed another 40% since Impala declared its Q2 holdings, but Bishop believes Teck still has substantial upside left primarily for three reasons.

The big Fort Hills oil sands project

Bishop is optimistic about Teck's involvement in the multi-billion-dollar Fort Hills oil sands project–one of Teck's biggest investments and also a deviation from its core coal-mining business. Fort Hills is projected to go online by the end of 2017 and reach near-full capacity by another 12 months.

Teck has 20% stake in Fort Hills, or roughly 13 million barrels per year of the bitumen produced. Apparently, Teck is already reviewing options to sell bitumen in North America and to overseas markets. Teck expects to spend roughly $960 million on the project this year and have another $1.2 billion left in capital outgo. That's not much of a concern as Teck is a pretty low-leveraged company with ample liquidity to finance projects.

Teck's improving margins

One reason Bishop cited for his optimism about Teck is management's cost-cutting efforts. Teck has reduced its costs substantially since 2012, as evidenced below.

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Image source: Teck Investor and Analyst Day presentation, March 2016
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Teck is targeting $300 million in operating cost savings this year. Low costs combined with a recovery in commodity prices should boost Teck's margins.

China is a positive story

As a key importer of commodities, China has a strong bearing on the fortunes of mining companies. Credit easing and stimulus appears to have boosted infrastructure spending and demand for steel in China in recent months, encouraging mining giants to remain bullish. In fact, **BHP Billiton Limited** (NYSE:BHP) is expanding its coal production further in anticipation of strong demand as it doesn't expect China's steel production to peak before 2020.

Meanwhile, Beijing's decision to limit operating days for local coal mines has been a boon for global producers of steel-making coking coal, including Teck–North America's largest coking coal company. Coking coal prices have exploded this year even as copper and zinc–the other two commodities that Teck deals in–continue to trend north. Bishop believes China's appetite for commodities should continue to drive Teck higher.

Should you buy Teck today?

That brings us to the big question: Should you follow Bishop's advice and buy Teck today? There are plenty of risks. Volatile commodity prices could give up gains just as quickly if global developments turn unfavourable. Teck's turnaround also depends a great deal on the Fort Hills project, which is still far from production and has its share of execution risks.

However, there's no denying that Teck is nowhere as risky now as it was until a year or two ago. If you can stomach the volatility, you might consider Teck while it trades at a price-to-book value of 0.8 and price-to-sales of just over one.

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