Teck Resources Ltd.: Why Is the Rally so Strong?

Description

Critics have been calling for a crash all year, yet **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) continues to hit new 12-month highs.

Let's take a look at the current situation to see why the surge is picking up steam.

Back from the brink

Teck's stock dropped below $4 per share in January as investors began to throw in the towel on Canada's largest diversified mining company.

Things certainly looked bleak. The markets for Teck's core products, metallurgical coal, copper, and zinc, remained stuck in multi-year slumps, and oil prices had fallen below US$30 per barrel, making the company's Fort Hills oil sands investment look like a disaster.

Then things started to turn around, and the stock hasn't looked back. At the time of writing, Teck is trading for just under $25 per share.

What happened?

Oil's recovery back to US$50 per barrel brought some contrarian investors into the stock on the hopes an extended improvement in the oil market could come just as Fort Hills switches from development to production late next year.

Teck's core products have also staged a rebound.

Zinc was the first out of the gate. The metal took off as investors realized the extensive production cuts in recent years were bringing the market back into balance. Some analysts even believe zinc could move to a shortage position next year, which would potentially add to the 50% price gain already achieved in 2016.

Coal wasn't supposed to do much this year. In fact, the worst slump since 1950 was expected to continue as weak demand out of China combined with strong output in Australia to keep prices at painful lows.

In recent months, however, coal has surged significantly higher. Part of the gain has been driven by better-than-anticipated demand, but the big reason for the rally is a decision by China to restrict the number of working hours for coal miners. This has put a dent in supply and the spot market has gone crazy.

Most producers sell coal on quarterly contracts, so the sharp rise in the spot market doesn't immediately filter through, but Teck's Q3 contract price was better than the first two quarters, and analysts expect a significant jump in the settlement prices going forward.

Copper has been the laggard this year, trading in a narrow range, but investors are starting to get bullish on the metal's long-term outlook. As the world shifts to renewable energy, investors are placing early bets on the potential boom in copper demand.

There's reason behind the bullish thinking. A wind turbine, for example, requires more than three tonnes of copper per megawatt.

Balance sheet

Teck's massive $9 billion debt load is the big reason the stock fell so far. The company is still highly leveraged, but management recently replaced notes that were coming due over the next three years with new bonds, so the risk of a near-term cash crunch has been eliminated.

Liquidity remains healthy with US$3 billion in available credit, and Teck finished Q2 with $1.4 billion in cash. This means Teck has the funds it needs to complete Fort Hills.

Can the rally continue?

China's sagging economy is still a threat, so investors shouldn't assume this stock will automatically rocket straight to $60 the way it did after the financial crisis.

However, pundits are talking about raising Teck's earnings estimates on the continued strength in coal. If Teck surprises to the upside on the Q3 numbers and comes out with positive guidance, the rally could run for quite some time.

Should you hold Teck?

Given the huge run to date, I wouldn't back up the truck, but investors who already own Teck might want to ride this out a while longer.

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