What's Next for Teck Resources Ltd.?

Description

It's been one heck of a run for **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK).

After hitting a low of less than $5 per share when the TSX bottomed in January, Teck has been one of the best investments out there. Shares currently trade hands at $26.55–a 580% increase in less than a year.

That's the kind of return that can really make a difference to a portfolio.

Back in February, I wrote there was still a lot of potential for Teck Resources, and that shares could easily head higher even after more than doubling after recent lows. The company had plenty going for it, including hitting maximum pessimism, sharply lower costs thanks to oil's decline, and an ever-weakening Canadian dollar.

What's next for Teck Resources? Can the company continue this magnificent run, or should investors sell before the inevitable slide? Let's take a closer look.

The bull case

The bull case is simple. Teck has made a series of smart moves that are really paying off now that commodities are recovering.

Back when things were looking really tough, Teck was aggressively cutting costs, especially in coal production. It laid off thousands of employees. It shut down production in higher-cost mines. It even slashed its dividend to ensure it would have plenty of capital going forward.

It was also helped by a number of factors. Oil, a key input cost, remains cheap. The price of coal rallied significantly. So did zinc. Copper didn't do quite as well, but at least it stopped falling.

These commodities could easily keep rallying. Even after its big move, the price of zinc is still down significantly over the last decade. And although many say the future of coal is increasingly bleak, a significant amount of supply has been taken off the market as bankrupt coal producers shut down operations, especially in the United States.

These are the kinds of conditions that could lead to a further price spike.

Finally, there's Fort Hills, the oil sands project Teck has a 20% stake in. Fort Hills will have operating and sustaining costs of $25-28 per barrel, which doesn't look so bad now that crude has recently gone over $50 per barrel. It'll look even better when crude hits $60, $70, or $80 per barrel.

The bear case

Although Teck's outlook is looking pretty darn good, there are still some things that could trip this company up.

The big one is a downturn in the price of commodities. Teck has huge operating leverage. When the price of coal and zinc went up, it was a very good thing for Teck's bottom line. Its costs stayed mostly the same, but it got substantially more for its products.

When prices go down, the opposite happens. Things can go from good to poor very quickly. We've all seen how fast these commodities can crash when investor sentiment turns the other way.

Teck also has a lot of debt. It owes more than $9 billion, which is offset somewhat by $1.3 billion in cash. It also has $3 billion in unused credit facilities. At this point the debt looks stable. However, debt just adds risk to a business that already has a lot of built-in leverage from commodity prices.

Finally, Teck investors might start to take their gains. It would be silly not to take at least some profit off the table after such a huge run.

The bottom line

Teck Resources could head higher here. The company did smart things when it was forced to and is now reaping the rewards. The trend could easily continue.

But at the same time, I'd be cautious if I held Teck shares. After such a big move, taking some cash off the table is probably a good idea.

One thing is for sure. Investors expecting another 580% rally are going to be disappointed. The big money has already been made.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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