Teck Resources Ltd.: Is China's Latest Move a Signal to Take Profits?

Description

Teck Resources Ltd. (TSX:TCK.B)(NYSE:TCK) has rallied significantly in 2016.

Let's take a look at the current situation to see if there is any fuel left in the tank.

China effect

Teck's largest operation is the production of metallurgical coal, otherwise referred to as coking coal or steel-making coal.

The coal market entered 2016 in its worst slump since 1950, and most analysts expected another tough year as production cuts in North America weren't expected to overpower strong output in Australia and weak demand from China.

As we all know, things have not gone as foreseen.

Supply disruptions in Australia, stronger global demand, and a significant policy change in China have contributed to a massive rally in the spot price of metallurgical coal.

How big?

Metallurgical coal traded for US$90 per tonne in the summer. On November 8, the price broke through US$300 per tonne.

This has supported a rally in Teck's stock from a low of $4 per share in February to above $30 in recent days.

The major boost came from China's decision last March to restrict the number of days coal mines can operate in the country. The National Development and Reform Commission (NDRC) set a maximum limit of 276 days.

The result, when combined with production issues in Australia, was a tightening of the market to the point where China has had to substantially increase imports.

The staggering rally in the met coal price caught everyone off guard, and China has now decided to loosen its restrictions. The NDRC announced November 17 that coal mines can now be open a maximum of 330 days per year.

What does this mean for Teck?

Teck sells most of its coal on quarterly contracts. The company received about US$92 per tonne in Q3 and is expected to get about US$200 per tonne in Q4.

With met coal above US$300 tonne in the spot market, investors have pushed up the stock on hopes of even larger margins in 2017.

The move by the Chinese to allow mines to operate more days should cap the rally in the metallurgical coal market and could trigger a strong pullback in spot prices.

In response, Teck's stock might come under pressure as investors decide to lock in gains on fears of a sharp slide in coal.

Should you own this stock?

Teck's rally is also being supported by strength in its other core products: zinc and copper. Zinc is up more than 60% this year and copper recently broke above its 2016 trading range.

Given the size of the rally in the coal and zinc markets, investors should be cautious about starting a new position right now, and those who have owned Teck through the rally might want to take some profits.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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