Teck Resources Ltd.: What a Year!

Description

Teck Resources Ltd. (TSX:TECK.B)(NYSE:TECK) is quite likely the top turnaround story in 2016.

Let's take a look at Teck's stellar year and try to figure out if the good times are set to continue.

From rags to riches

In the middle of January, Teck was in big trouble as an exodus out of the stock sent the share price below $4 amid fears the $9 billion debt load was destined to crush the miner.

The concerns were certainly valid.

Teck produces metallurgical coal, copper, and zinc. Entering 2016, all three were in major multi-year slumps with prices at a point where Teck was making very little money.

Only zinc had started to show signs of a possible bottom. Coal was expected to remain under pressure this year, and copper pundits figured the base metal would simply trade in a narrow range at best.

As often happens in the market, things haven't turned out the way everyone thought they would.

What's the story?

Zinc was the first to take off as market watchers realized extensive production cuts were about to bring the market back into balance. The rally has been impressive with zinc currently trading up about 70% on the year. Analysts expect strong support to continue into 2017.

China is primarily responsible for the coal recovery after it changed a policy to limit coal mine operations to 276 days per year. The resulting production cut was enough to swing the market from a position of oversupply to one that is balanced or even tight.

This has led to a meteoric rally in met coal prices from about US$90 per tonne in the summer to a recent high above US$300 per tonne. China reversed the decision on November 18, setting the new limit at 330 days, and met coal prices are now trending lower. Prices are expected to drop in 2017, and investors are trying to decide how that might impact Teck's share price.

Copper had lagged zinc and coal for most of the year, but it's up 30% in the past two months. Many analysts say the fundamentals don't support the move, so there could be a pullback on the way in 2017.

Financials

Teck posted strong Q3 2016 results, and the next couple of quarters should be even better.

The company sells most of its coal on quarterly contract prices. The company received about US$90 per tonne in Q3 and is expected to report an average sale price of better than US$200 per tonne for Q4.

Analysts are looking for a Q1 2017 settlement price of US$250-280 per tonne, so Teck is going to be flush with cash in the near term.

This will enable the company to continue paying down its debt load, which is actually no longer a major issue given the surge in the company's valuation. At the time of writing, Teck trades for $30 per share and has a market capitalization of about $16 billion.

Outlook for 2017

The big story in 2017 might actually be oil.

Why?

Teck is a 20% partner in the Fort Hills oil sands development, which is scheduled to begin production in late 2017.

When WTI oil was below US$30 per barrel in January, most pundits believed the billions Teck has poured into the facility would eventually be a total write-off. Now, with OPEC looking to cut production and oil moving back above US$50 per barrel, Fort Hills is starting to look like a possible winner.

If oil manages to drift higher through 2017, Teck could get a nice lift from the fourth pillar of its operations.

Should you buy?

Teck has pulled back from its recent high as investors lock in gains and wait to see where the commodity markets will go next.

The last time Teck rallied off a low of $4, it hit $60 within two years. There is no guarantee the same will happen this time around, but there is certainly potential for more upside in 2017.

At this point, however, I think investors should be careful. If coal starts to roll over in response to higher Chinese production, Teck could come under more pressure.

As such, I would wait for the recent correction to run its course before buying new shares.

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