Teck Resources Ltd.: Is the Party Over?

Description

Teck Resources Ltd. (TSX:TECK.B)(NYSE:TECK) is down more than 15% in the wake of the Q4 earnings report, and investors are looking at the plunge and wondering if it might be overdone.

Let's take a look at the current situation to see if the sell-off is justified.

Solid earnings

Teck was expected to deliver strong Q4 2016 number, and it didn't disappoint.

The company reported record profit of $930 million, or $1.61 per share, compared to $16 million, or $0.03 per share, in the same quarter last year.

The rally in coal, copper, and zinc prices through 2016 helped boost margins, and Teck paid down more than $1 billion in debt in recent months with the cash windfall.

As of December 31, Teck's outstanding debt stood at US$6.1 billion. The company has $1.6 billion in cash and US$3 billion available in undrawn credit facilities.

Teck's average realized steel-making (metallurgical) coal price in Q4 was US$207 per tonne, and the company's Q1 2017 contract settlement price is US$285 per tonne, so the numbers for the first quarter of this year are going to be very strong.

Teck is also a partner in the Fort Hills oil sands project which is scheduled to begin production by the end of 2017. Capital cost estimates have been revised upward by 10%, so Teck had to book a $222 million pre-tax impairment charge in the fourth quarter.

Why the big sell-off?

Markets are always forward-looking, and there are indications the big commodity party might be due to take a break. In the case of coal, the hangover is already beginning.

What’s the scoop?

Metallurgical coal prices surged from US$90 per tonne in the summer to above US$300 per tonne in November. The rally came as a result of new Chinese mine restrictions put in place last March.

The change stipulated mines could only operate for 276 days per year. That curtailed production enough to shift the market from being oversupplied to quite tight.

In November, the restrictions were eased, setting the number of operating days at 330 per year. As a result, there has been an upswing in production and a steep drop in metallurgical coal spot prices.

How steep?

At the time of writing, met coal trades for about US$155 per tonne. Investors are reacting as if the coal spot price just dropped out of the blue when that’s simply not the case, and things could get worse.

Prices still remain quite high despite additional production from existing facilities and a number of mine restarts, so more pain could be on the way.

Is this a buying opportunity?

Teck also produces copper and zinc.

Copper continues to drift higher, despite mixed opinions among analysts as to the sustainability of the rally. Zinc is viewed more positively, but the metal has enjoyed a spectacular run and might be getting ahead of itself.

There is little doubt the Q1 2017 numbers are going to shoot the lights out, but I’m more concerned about where coal, copper, and zinc might be headed in the back half of the year.

As such, I would wait for the latest reversal to run its course before buying this stock.

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