Teck Resources Ltd.: Should You Buy the Current Pullback?

Description

Teck Resources Ltd. (TSX:TECK.B)(NYSE:TECK) is trading close to its lowest point in three months.

Let's take a look at the current situation to see if Canada's largest diversified mining company should be in your portfolio.

Commodities outlook

Teck produces metallurgical coal, copper, and zinc. All three of these products enjoyed stellar rallies in 2016 and helped Teck rebound from $4 per share last January to $35 at the peak in November.

The stock is now back down to $27 per share amid a drop in coal prices.

What's the scoop?

The met coal market wasn't expected to do much in 2016, but a policy shift in China last March sparked a dramatic rally.

The Chinese government restricted the number of days a mine can operate in a year to 276. That move reduced output enough to shift the market from an oversupplied position to one that was becoming a bit tight. Supply issues coming out of Australia also contributed to the situation.

As a result, met coal prices surged from about US$90 per tonne in the summer to more than US$300 per tonne in November.

In an effort to take some heat out of the market, China changed the policy again and set the mine operating limit at 330 days.

The move has had the intended effect, cutting spot prices nearly in half by the middle of February.

Copper and zinc remain near their 12-month highs, but have shown signs of topping out in recent weeks. Pundits are mixed on whether or not copper deserves to trade at current levels, and while the zinc story appears to be better, the magnitude of the rally over the past year warrants caution.

What about oil?

Teck is a 20% partner on the Fort Hills oil sands development, which is scheduled to begin production by the end of 2017.

The project has been a cash drain in recent years, and investors remain concerned that oil prices could stabilize at a point that would make the project unprofitable to operate.

The upside news

Teck has taken advantage of the surge in commodity prices to reduce its debt load. The company eliminated $1 billion in debt in the closing months of 2016 and recently announced a buyback offer for an additional US$650 million in outstanding notes.

Balance sheet risks were a big reason for the meltdown in the stock price in 2015, so getting the debt down should provide investors with more confidence to hold Teck in their portfolios.

Teck reported impressive Q4 2016 results, and the Q1 2017 numbers should come in even better. Copper and zinc prices remain high, and the company's Q1 met coal contracted price with its customers is US$285 per tonne.

To put that into perspective, Teck's average met coal sale price in Q4 2016 was just over US$200 per tonne.

Should you buy?

The market is forward-looking, and investors are nervous that copper and zinc might have peaked, at least in the near term. Coal prices have picked up a bit in the past week or so, which is a positive sign, but another leg to the downside is still a risk, as suppliers ramp up production.

Oil could be the big story in the back half of 2017. As Fort Hills gets closer to its start-up date, crude prices might begin to have a stronger impact on market sentiment for Teck's stock. If oil gives up its recent gains, Teck might come under additional pressure.

Given the extent of the run-up in the share price and the near-term market uncertainty, I would stay on the sidelines until the current pullback has clearly run its course.

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