Teck Resources Ltd.: Has the Ship Finally Been Righted?

Description

Like so many other metals and mining stocks, **Teck Resources Ltd.** (TSX:TECK.B)(NYSE:TECK) has been a bit of a roller coaster. From early 2012 to 2016, the stock trended down — a long and slow drop from the high $30s to under $5 a share. But then 2016 hit, and the company started to appreciate again. And by the end of November, shares were nearly $35.

Since then, the stock has pulled back to a more respectable $27.16, which is a fairly valued share price. Based on the tangible book value of $28.29, the shares are just a little under that. Now, what needs to be determined is whether the value of the commodities the company mines will increase or decrease; if it goes up, this stock will continue rising, and if the opposite occurs, the stock will go down.

Teck's commodities have increased quite aggressively already, which contributed to shares appreciating in 2016, thanks to China. In March 2016, China restricted metallurgical coal mine operations to only 276 days a year. This cut supply, which sent the price of coal much higher. After increasing that number to 330 days, the price of coal dropped under US$200.

However, Teck hasn't been in a position to capitalize on this increase in price because of its long-term contracts. For example, despite coal being over US$300 before China eased its restrictions, Teck was only selling it for US$90 because of its contracts. Fortunately, the company is now signing new contracts that allow it to generate increased margins.

Its Q4 2016 earnings release showed just how aggressive those rates will be. According to Teck, its average realized metallurgical coal price in Q4 was US$207 per tonne. And its Q1 2017 contract settlement price is US$285 per tonne, so I expect Q1 2017 to be even better.

In Q4, the company reported profit of $930 million compared to $16 million in Q4 2015. While this alone is very exciting, and a big part of it is because of the increase in commodities prices, there's another signal in the earnings report that makes me even happier.

As of December 31, the company's outstanding debt was US$6.1 billion with $1.6 billion in cash and US$3 billion available in credit facilities. In 2015, Teck was sitting on a giant pile of debt to the tune of US$9 billion. In a year, it trimmed debt by nearly US$3 billion. Debt reduction is clearly high on the company's priorities because the CEO, in an interview with *BNN*, said, "we could be debt-free in six quarters" if commodity prices stay where they are.

One negative is that Teck had to book a $222 million pre-tax impairment charge for its investment in the Fort Hills oil sands project. The good news is that Teck should begin production by the end of 2017, so if oil prices stay up, Teck could see additional returns from this investment, which many considered a complete failure.

Teck's ship is finally being righted, albeit with some choppy waters still occasionally occurring. Shares currently trade at fair value, and if commodities settle, Teck could be a great pickup. But we don't yet know where prices will settle, so while the company is trimming debt and making the right moves, there remain macroeconomic uncertainties.

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Date
2025/09/03
Date Created
2017/02/28
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