Teck Resources Ltd.: Buy or Sell?

Description

Teck Resources Ltd. (TSX:TECK.B)(NYSE:TECK) is treading water after the recent pullback, and investors are wondering if this is a good time to start a position in the stock.

Let's take a look at the current situation to see if you should own Teck today.

Coal

Teck's largest product is metallurgical coal. The met coal market had been in multi-year downturn heading into 2016, and most analysts expected the weakness to continue.

That's not what happened.

A decision by China last March to restrict the number of days a coal mine can operate in a year had an oversized impact on the market in the following months.

How big was the effect?

Changing the limit to 276 days per year restricted production enough to shift the market from a position of oversupply to one that was relatively tight. Unexpected supply interruptions in Australia compounded the effect and coal prices rallied from US$90 per tonne in the summer to above US$300 per tonne in November.

Teck sells most of its coal on quarterly contracts, so the benefits of the price surge have lagged the price changes. Teck's average realized coal price in Q4 2016 was slightly above US$200 per tonne. The Q1 2017 number should be close to US$285 per tonne.

Based on that, you would think Teck's stock should be rallying, but the market is looking ahead and doesn't like what it sees.

Why?

China reversed its policy change in November, setting the operating limit for mines at 330 days per year. This has had the desired effect of cooling the met coal market, sending prices down as much as 45% from the November high.

Copper and zinc

Teck also produces copper and zinc. The base metals enjoyed strong rallies through 2016 that continued into the current year, although the trend has been downward for the past month.

Pundits have mixed opinions on whether or not copper and zinc are at the beginning of a longer-term rally, but the indication for moment is that they are taking a break.

Oil

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

The project has been a cash drain for several years, so investors will be happy to see Fort Hills start to generate revenue.

The concern, however, is connected to the site's ability to turn a profit. Oil prices remain much lower than they were when Fort Hills got the green light, and another plunge in the crude market could draw more attention to this part of Teck's operations.

Should you buy?

Teck is a low-cost producer and is taking advantage of the commodity rally to pay down debt. That's why the stock has rallied so much over the past year and is attractive for the long haul.

At this point, however, I think investors should remain cautious. Coal, copper, and zinc could go either way in the near term, and volatility has returned to the oil market.

Add this to the uncertainty surrounding the broader equity space, and you have a situation where there could be significant additional downside pressure if things get ugly in the coming months.

As such, investors who bought the stock near the lows should probably take some profits. Those looking to start a new position might want to stay on the sidelines until coal, copper, zinc, and oil confirm another strong move to the upside.

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Date
2025/07/28
Date Created
2017/03/16
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