Teck Resources Ltd.: A Contrarian Buy Today?

Description

Teck Resources Ltd. (TSX:TECK.B)(NYSE:TECK) is catching a bit of a tailwind after a 40% drop from the November highs.

Let's take a look at the integrated mining company to see if it deserves to be a contrarian bet right now.

Commodity volatility

Teck's volatile stock moves over the past 18 months are a great example of why it is so difficult to invest in commodity-based companies.

In early 2016, Teck's share price was down to $4 per share as investors feared a $9 billion debt load and that falling commodity prices would bury the company.

As often happens, things suddenly turned around just at the right moment.

Teck's most important product, metallurgical coal, got an unexpected lift from the Chinese government in March 2016 when a policy change on the number of days in a year a mine can operate shifted the coal market from oversupplied to relatively tight.

As a result, metallurgical coal prices soared from US$90 per tonne last summer to above US$300 per tonne in November.

This had a huge impact on Teck's margins and subsequently sent the stock soaring as high as $35 per share.

China reversed its decision in November in an effort to cool the market down, and metallurgical coal dropped back to about US$150 per tonne in early 2017.

Teck sells most of its coal on quarterly settlement contracts, so the realized price can vary significantly from the spot price, especially when the market is so volatile.

The Q1 2017 average realized coal price was US$213 per tonne. The company just came out and said its guidance for Q2 is US$160-165 per tonne.

What about copper, zinc, and oil?

Teck also produces zinc and copper. The base metals enjoyed strong rallies through the end of 2016 and into the first part of this year, but have trended lower since February. Regarding oil, Teck is a 20% partner in the Fort Hills oil sands development, which is scheduled to begin production in late 2017.

The shift from development to production will provide some capital relief, but pundits are concerned the facility might not be profitable for some time, given the current outlook for oil prices.

Should you buy Teck?

Teck is a low-cost producer in its core product segments, and management has taken advantage of the windfall over the past year to reduce the debt burden. When commodity prices start to recover, this stock can really take off, as we saw with the 10% bounce in recent days.

At the moment, I would keep any position small until there is clear evidence that coal, copper, zinc, and oil are headed sustainably higher. For the near term, it's possible more downside could be on the way.

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