This Canadian Miner Is Poised to Unlock Further Value in 2018

Description

It was just over two years ago when Canada's largest miner **Teck Resources Ltd.** (TSX:TECK.B)(NYSE:TECK) was suffering because of the prolonged slump in steel-making or coking coal and base metals, with some analysts speculating the miner was facing a potential cash crunch. Since then, it has staged an impressive recovery, because of a marked rally in coking coal, copper, and zinc. It's worth more than six times its stock price at the end of 2015. While I voiced some doubts as to the outlook for Teck in July 2017 and was bearish on the company for most of 2015 and 2016, there have been some particularly strong signals that indicate it is destined to unlock further value for investors during 2018.

Now what?

Consistently predicting what the future holds for commodities such as coking coal, copper, zinc, and nickel is a complex and difficult task. Many of the key drivers of commodity prices are reliant on the performance of China's economy and policy decisions made by Beijing, because China is the world's single largest export economy and the largest consumer of coal and base metals.

In fact, China is now called the world's workshop. It's responsible for over $2.1 trillion in exports, or roughly 1.5 times greater than the total exports of the U.S. The majority of those exports are manufactured goods, notably machinery, technology, and vehicles. Such a massive manufacturing industry has an inexhaustible thirst for metals.

Then there is Beijing's regular use of credit-led fiscal stimulus to push the construction of much-needed domestic infrastructure, which is also an intensive user of steel, copper, and zinc.

Nevertheless, what many analysts, including me, failed to fully appreciate was the impact of government policies on the domestic supply of those materials, particularly steel.

While Beijing's determination to transition China's economy to one focused on domestic consumption has led to a decline in demand for coal and metals, its policies aimed at removing unprofitable mining as well as steel milling enterprises has reduced domestic supplies and inventories. Recently introduced pollution controls, which have had a sharp impact on China's steel milling and mining sectors, have had a negative effect on supply. That has forced the manufacturing and construction sectors to look offshore to secure supplies.

Meanwhile, improving global economic growth has caused demand for many of China's manufactured products to increase, sparking an uptick in industrial activity.

There is also growing demand from India, which saw its economic expansion overtake China to become the fastest-growing major global economy. This means the subcontinent is experiencing a surge in demand for steel, copper, and zinc as the country rapidly modernizes.

Those events are working in unison to support coking coal as well as metals prices, which is proving to be a boon for miners such as Teck.

You see, copper, which is responsible for a fifth of Teck's earnings, hit its highest price in four years in late December 2017, and the outlook for the red metal is increasingly positive, because analysts are predicting a supply deficit in 2018.

More importantly, some analysts are predicting that coking coal, which accounts for roughly half of Teck's earnings, will average ~US$200 per tonne over the course of 2018. This is well above the average US$159 per tonne received by the miner during the third quarter 2017 and more than double the same quarter a year earlier.

So what?

The positive outlook for coking coal and base metals will boost Teck's earnings and should see its bottom line surge once again. The recent rally in crude, which now sees West Texas Intermediate trading at US$60 per barrel, has made Teck's massive investment in the controversial Fort Hills oil sands project more appealing. When these factors are combined with Teck's earlier moves to reduce debt to a more manageable US$4.9 billion, it is easy to see the miner delivering a solid performance during 2018.

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