Does a Looming Trade War Make Teck Resources Ltd. (TSX:TECK.B) a Poor Investment?

Description

Trump's increasingly inflammatory rhetoric on trade — particularly with regard to China — has sent jitters through financial markets and caused copper and other base metals, including zinc, lead, and nickel to retreat in recent weeks. There are fears that not only could a major trade war erupt, which according to some economists could shave up to a full percentage point off global gross domestic product (GDP), but it also has the potential to trigger a new financial crisis.

default watermark

Any crisis would also impact the world's two largest economies, the U.S. and China, causing growth and hence consumption of metals to decline. This is all weighing heavily on the outlook for copper and other base metals as well as miners who were benefiting from the end of the commodities slump in late 2016 and firmer prices. One miner that is vulnerable is **Teck Resources Ltd.** (TSX:TECK.B)(NYSE:TECK), which has plunged by almost 12% since the start of 2018 because of fears of a trade war and its impact on base metals.

Now what?

The key problem for Teck is that just over half of its revenues come from mining coking coal, a key ingredient in the fabrication of stainless steel, while the remainder are earned by mining copper and zinc. Any downturn in manufacturing activity in China because of reduced access to the nation's largest export market, the U.S., will have a marked impact on the consumption of steel, copper, and zinc.

This is because China is the world's single largest consumer of metals, with much of that consumption driven by its manufacturing sector. A trade war would only exacerbate the impact of Beijing's existing policies aimed at reining in excessive credit and boosting productivity in an already slowing economy. Even the Chinese governments recently announced economic stimulus would not be sufficient to mitigate the impact on commodities of a trade war.

If these events occur, they will negative effect on Teck, but the erratic nature of Trump's policymaking means that not all proposed tariffs will eventuate.

Teck has also been performing strongly in recent months, reporting some solid second quarter 2018 results. While revenue only rose by 7% year over year, net profit increased by a healthy 9%, which can be attributed to the miner's focus on reducing costs. After such a solid second quarter, Teck remains on track to achieve its 2018 full-year guidance, and its earnings will be given another healthy boost by the Fort Hills oil sands project commencing full production during the fourth quarter of 2018.

Teck also finished the quarter in solid financial shape, with around $1.7 billion in cash as well as additional liquidity provided by an undrawn line of credit totalling US$3 billion. While total debt of $6.6 billion appears daunting, it is not as worrying as it initially appears.

There are no major debt maturities due until 2022, thereby giving Teck considerable time to take advantage of higher coking coal and metals prices to build up its cash reserves. The July 2018 closing of the sale of Teck's two-thirds interest in the Waneta hydro-electric dam will bolster the miner's balance sheet, giving it an additional $1.2 billion in cash. After factoring in the proceeds of that deal, Teck's debt is a mere 0.6 times EBIDTA, thus indicating that it is more than manageable.

default watermark

Such a strong balance sheet and considerable liquidity endows Teck with significant financial flexibility, allowing it to effectively manage the fallout from a trade war.

So what?

The outlook for Teck is uncertain because of a range of geopolitical and economic risks, including Trump's approach to trade. However, this shouldn't deter investors because the miner is generating solid margins and has a strong balance sheet, leaving it well positioned to weather any storm. Teck's latest pullback has created an opportunity for risk-tolerant investors to dip their toes in the water and bolster their exposure to the miner and base metals.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

1. NYSE:TECK (Teck Resources Limited)
2. TSX:TECK.B (Teck Resources Limited)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Investing
2. Metals and Mining Stocks

Date
2025/09/09
Date Created
2018/08/06
Author
mattdsmith

default watermark

default watermark