Is Teck Resources (TSX:TECK.B) Stock a Buy After Record Annual Earnings?

Description

Canadian mining giant **Teck Resources** (TSX:TECK.B)(NYSE:TECK) released its fourth-quarter and annual 2018 results early on Wednesday. Quarterly performance was weaker than what analysts had predicted, but the company broke some new records for the year. The stock has been a great recovery story over the past three years. Does the latest financial report encourage new investment in the resources giant?

Record revenue and profit records

Teck Resources hit a new annual revenue record of $12.56 billion for 2018, driven mainly by the steelmaking coal segment, which achieved record quarterly production last quarter and fetched firmer market prices, as well as the addition of a new energy segment as Fort Hills started production in 2018.

Annual EBITDA and annual profits attributable to shareholders hit new records for the year, too.

That said, EBITDA and attributable profits were lower than 2017 numbers on an adjusted or normalized basis, and worse, the company missed on market expectations for the fourth quarter, just as it had warned before.

Weaker energy, copper, and zinc prices

Fourth-quarter performance was significantly negatively impacted by record-low Canadian heavy oil prices with the Western Canada Select differential hitting as high as US$52.55 per barrel in October during a period when world oil prices were depressed, too.

Record production at Fort Hills therefore contributed $90 million in quarterly losses to the combined firm, with a negative 105% gross profit margin.

The copper and zinc segments generated 21.6% and 24.6% of total corporate revenues for the year and were negatively impacted by a softer base metals market with average prices for copper 9% lower and zinc prices 19% weaker than comparable market prices during a comparable quarter in 2017.

Fourth-quarter profitability was significantly lower than same period last year, dragged by lower commodity prices in copper, zinc, and heavy oil, although buoyant steelmaking coal prices made up for some of the weakness.

Valuation growth drivers for 2019

A return to general commodity price growth could greatly lift the stock higher in 2019, but fears of a global economic slowdown triggered by trade wars and potential structural recessions this year are significant threats to company's valuation.

The company's businesses are very much susceptible to global economic performance, and a slowdown in China's economic growth could significantly hurt steelmaking coal, copper, and zinc prices. Historically, shares have tumbled below $4 during economic crisis when investors feared bankruptcy in 2009; the valuation hit similar lows under $5 a share in January 2016 for the same reason.

However, the company is sufficiently liquid right now with $1.3 billion in cash and a $4 billion undrawn credit line and debt that matures well in the future, so liquidity is not a concern this time, even if the company faces a potentially stagnating global economy that could result in weaker commodity prices.

Most encouraging, the new Fort Hills asset achieved record plant production of 201,000 barrels of bitumen per day in December, which was in excess of design nameplate capacity of 194,000 barrels per day, and spot Western Canadian Select differentials have narrowed significantly after the Alberta government ordered production cuts effective January.

The energy segment could significantly boost cash flow and profitability growth this year.

Further, copper and zinc prices seem to have stabilized during this quarter, and increased electric vehicle production in China could support strong copper demand in 2019; if this scenario continues undisturbed, then the company could potentially produce stunning earnings numbers in the coming quarters.

Most noteworthy, the company kicked off 2019 at a higher note when it received a significant credit-rating upgrade from Moody's to investment grade in early January. Previously, the company's debt offerings were rated below investment grade at all three major rating agencies, and we may see S&P and Fitch issuing upgrades, as the company further strengthens its balance sheet this year.

An investment grade rating improves access to low-cost credit when the company needs it.

Should you invest now?

The ongoing share-buyback program, improved cash flow generation capacity after Fort Hills's production commencement, strong steelmaking coal demand, and stable copper and zinc prices are all positive factors for Teck Resources's equity valuation today.

The company appears financially solid currently, but investors should be very careful with this highly cyclical mining stock when market volatility has increased due to fears of a slowdown in near-term world economic growth.

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