3 Reasons to Avoid Teck Resources

Description

On the surface, shares of **Teck Resources** (TSX: TCK.B)(NYSE: TCK) may appear to be a bargain. After all, they trade below $22, down from $60 in early 2011. But no so fast. Below are three reasons why you should still avoid this company's shares.

1. Weak markets

It's no secret why Teck's fortunes, as well as its share price, have suffered in recent years: a slowdown in China. This has had an especially large impact on Teck's metallurgical coal business (about half of total gross profit), whose fortunes are tied to the steel market. As China's building activity has slowed, so has demand for steel, hurting Teck's metallurgical coal margins.

To illustrate, in the first quarter of this year, Teck sold its coal for an average price of $143. In the third quarter of 2011, this number was close to $300. Gross profit from coal has sunk from over $1 billion in the third quarter of 2011 to under $300 million in the first quarter of 2014.

Things could get worse from here. The biggest contributor to China's growth in recent years has been investment spending on things like apartment buildings. If this market crashes, as so many believe it will, then demand for steel and prices for metallurgical coal will sink a lot further.

2. Poor track record

It's nice to see management doing the right things in this tough environment, such as deferring expensive projects and cutting costs. But management hasn't always done what's best for shareholders.

Back in 2008, Teck spent about $14 billion to acquire about half of its current coal business. Unfortunately, this was done at the peak of the market, financed mostly by debt, and nearly bankrupted the company. To management's credit, it did do a good job rescuing the company. But today, the company's total market capitalization is still less than the $14 billion purchase price.

If you're looking to make a bet on mining, you may want to consider **First Quantum** (TSX: FM) instead. First Quantum has a reputation for buying mines at a discount, then running them efficiently. The company's share price history tells the story: Over the last 10 years, First Quantum's shares have returned 22% per year, 10 percentage points better than Teck.

3. Just say no to mining

There's a reason why Warren Buffett hates mining companies. High capital costs, extreme cyclicality, poor records of capital allocation, consistent cost overruns, commoditized pricing, and geopolitical risks have plagued mining companies for decades. So why even take chances in this sector? After all, trying to emulate the Oracle of Omaha is never a bad strategy.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:TECK (Teck Resources Limited)
2. TSX:FM (First Quantum Minerals Ltd.)
3. TSX:TECK.B (Teck Resources Limited)

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