Why I'm Not Buying Teck Resources

Description

The outlook for beaten-down diversified metals and minerals miner **Teck Resources** (TSX: TCK.B)(NYSE :TCK) continues to become gloomier as time passes by. Not only is the company's share price under pressure, having dropped a spectacular 28% over the last two years, but there appears to be no respite on the horizon, with demand for Teck's key products — base metals and coal — continuing to soften.

There is now considerable downward pressure on the company's earnings, which are tied to demand for metallurgical coal, copper, and zinc. This in turn is driven by industrial activity, predominantly in what is the world's largest economy, China. China's May 2014 Purchasing Managers Index grew only 40 basis points compared to the previous month to be 80 basis points above the critical 50% threshold that represents growth.

What is the outlook for base metal prices?

This indicates that Chinese industrial activity remains flat, affecting the demand for a range of commodities, including copper, zinc, and coal. Copper generates around a third of Teck's revenue. I expect Teck's copper revenue to fall throughout 2014 as a result of rising supply and declining Chinese demand driving copper prices down over the course of the year. It is estimated by some analysts that copper prices will soften by 5% over the course of the year to U.S.$6,350 per ton.

This decline in Chinese demand is also having a similar impact on zinc prices, which are expected to fall 7% by the end of 2014 to $1,980 per ton. This doesn't bode well for Teck's earnings, as copper and zinc combined make up 58% of its total revenue.

The outlook for metallurgical coal is particularly gloomy

Teck derives a massive 42% of its total revenue from metallurgical coal. This factor is having a significant impact on the company's bottom line as the outlook for metallurgical coal remains grim.

There are a number of factors behind this, but with metallurgical coal being a key ingredient in steelmaking, demand is expected to continue declining. China is expected to reduce steel production because of overproduction, declining demand due to less construction, and environmental concerns.

Another factor was the growth in the price of coking coal, which could be primarily attributed to a lack of supply. With that issue now firmly addressed, coupled with softening Chinese demand, oversupply is emerging as an issue. In some cases, this has seen the marginal costs of mining metallurgical coal exceed its price per ton, with a number of analysts expecting no upside for the remainder of the decade as supply comfortably meets demand.

As a result, I don't see any upside in Teck's revenue, cash flows, or earnings for the remainder of 2014, and this will continue to place downward pressure on its share price.

This difficult operating environment is highlighted by Teck missing consensus analyst earnings for the last two consecutive quarters by 9% and 25% respectively. Despite this, the company appears expensive, with an enterprise value of eight times EBITDA and a price-to-earnings ratio of 15 times its consensus estimated 2014 earnings. These are all reasons to avoid Teck at this time.

CATEGORY

1. Investing

TICKERS GLOBAL

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

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