



Why It's Time to Avoid Teck Resources

Description

Slowing industrial activity in China and diminished construction activity coupled with contracting European economies don't bode well for the demand for iron ore, steel, coking coal, or base metals as prices are expected to contract further. This is significantly impacting the bottom lines of commodities miners like **Teck Resources Ltd.** (TSX: TCK.B)(NYSE: TCK), whose share price plunged a massive 17% year to date on the back of weak financial results.

While some analysts claim the company is undervalued, I believe there is further pain ahead for investors.

Falling commodity prices and a grim outlook

Around 42% of Teck Resources' revenues are derived from coking coal, a key ingredient in the steel-making process, but the news couldn't be worse. It was only earlier this month that coking coal hit its lowest price in four years, at US\$113.50 per ton, and prices will remain depressed for the foreseeable future. This is because of oversupply and softening demand.

Declining construction activity in China is also having a significant impact on the demand for steel. As demand falls and stockpiles grow, it bodes poorly for coking coal. There are also signs that China's real estate bubble is about to burst, with investment in real estate development in terminal decline since the start of the year. This would further hurt demand for steel and push coking coal prices lower.

The news gets even worse for investors: The declining industrial activity in China is also affecting the demand and prices for base metals, with copper and zinc making up the remaining 68% of Teck's revenues.

For August, China's industrial purchasing managers' index fell 60 basis points compared to July to 51.1 points despite the government's introduction of a range of stimulus measures earlier this year aimed at boosting industrial activity. As China is now the world's largest manufacturer and base metals, in particular copper, are important components in a range of industrial goods, this doesn't augur well for base metals prices.

More concerning is that a key consumer market, the European Union, continues to see economic activity contract, with fears of deflation still growing. Consequently, consumers are delaying purchases and affecting demand for China's manufactured products. These factors are also further fueling a global economic malaise with Brazil, the world's sixth-largest economy, slipping into recession as demand for its commodity and manufactured exports continues to decline.

Despite falling demand for commodities, diversified global resource giants **BHP Billiton** and **Rio Tinto** are expanding production, using their size and scale of operations as a means to create cost savings, generating greater supply and placing more pressure on commodity prices.

Softer commodity prices hit Teck's financial performance

The impact of this declining demand for commodities can be seen in Teck Resources' second-quarter 2014 results, with net income plunging a massive 44% compared to the equivalent quarter in 2013. While there may be some upside as the company focuses on driving down costs, the increasingly softer outlook for coking coal and base metals will only have a deleterious effect on Teck's financial performance.

I expect all of this to continue for the foreseeable future, making Teck Resources a stock to avoid until there are signs of a sustainable uptick in global manufacturing and economic activity.

CATEGORY

1. Investing

TICKERS GLOBAL

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

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