



1 Huge Reason to Avoid Teck Resources Ltd.

Description

Normally, if there's a stock that's beaten up, trading at a 52-week low, or just plain unloved, you can find me taking a look at its financials. Warren Buffet does it. Prem Watsa does it. And I do it.

One of these is not like the others

I started taking a closer look at **Teck Resources Ltd.** (TSX: TCK.B)(NYSE: TCK) a few weeks ago, when it was trading at near a 52-week low. Why is it so beaten up? Because of its exposure to coal.

Coming out of the Great Recession, the coal business was great. China was booming, and consuming all of the mineral it could get its hands on. Other producers noticed as well, so the race was on to get new coal projects up and running. Since these take time, a giant glut of production has hit the market over the last couple of years, particularly from Australia.

Coal prices were strong, too. China's demand was high, and a huge flood in Australia took out a bunch of the country's coal production. India has also been forced to import large quantities of coal, thanks to mismanagement of its state-owned coal monopoly.

The coal business was booming — until it wasn't

Countries around the world have started to get serious about curbing greenhouse gases, leading to coal power plants getting shut down and replaced with ones powered by alternate fuels. China has ramped up its own coal production, and experts believe the country will reach peak coal consumption by 2016. And thanks to a weaker dollar, Australian producers aren't feeling the price crunch as much as North American producers are.

According to a report by the Carbon Tracking Initiative, these conditions are leading to Australia pumping out all the coal it can. Since prices have declined, the nation's producers have looked for ways to cut costs. They've laid people off and such, but mostly they've just ramped up production. After all, a mine is most efficient when it's running at full tilt.

Australia is also in the middle of a huge expansion of its coal mining industry. More than \$30 billion

worth of mine expansions and new mines are set to open in the next few years. And unlike North American mines, they're actually profitable at these low coal prices. So even though North American producers continue to cut production in an attempt to increase the commodity's price, it's not going to matter much.

Oh, and according to the same report, Mozambique, Botswana, and Indonesia are spending more than \$35 billion among the three of them to expand their coal production. And that doesn't even include increases in China's domestic coal production.

Not all of this expansion will be profitable at today's low prices, but all this increased production can't be good for the long-term price of the commodity.

It's pretty much the worst-case scenario for North American coal producers. Prices have dipped below \$120 per ton, and China's demand looks to be topping out. There's also rampant speculation that the leaders of the world's most populous nation are going to announce a massive push into green energy during its next five-year plan, starting in 2016.

Considering all this, why would any investor want to be long Teck Resources?

The good news is that the company is working at diversifying its asset base. It has a joint venture planned in the oil sands, along with **Suncor** and **Total**, the French energy giant. Teck's ownership stake is 20%, meaning its share of the 180,000 barrels of oil per day of planned production is 36,000. Diversifying into oil is a good idea, but will it be enough to compensate for continued weakness in coal?

The bottom line

The coal market is going to be very weak for a long time. Until Teck starts getting out of coal in a big way, investors should avoid the stock. The outlook is just too grim.

CATEGORY

1. Investing

TICKERS GLOBAL

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

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