Teck Resources Ltd.: Don’t Try to Catch This Falling Knife

Description

The mining boom, or at least its exploration and growth phases, is well and truly over, and this has hit commodity miners hard. Yet I continue to be amazed by investors and analysts claiming there are bargains to be found in the sector as the share prices of miners fall ever lower.

One company that keeps popping up is commodities miner **Teck Resources Ltd.** (TSX: TCK.B)(NYSE: TCK). Over the last year, its share price has plummeted by a massive 35%, and there are signs of further bad news ahead, making it one “falling knife” to be avoided.

Growing global macroeconomic uncertainty

Every day, there are additional signs all is not well with the global economy, with economists now slashing growth forecasts and the IMF stating that global economic growth will never return to pre-GFC levels. The world’s largest economy, China, continues to stumble, with industrial activity for September 2014 remaining flat along with weak job data and a softer housing market. This makes it unlikely China will hit the 7.5% GDP growth target set by Beijing.

Meanwhile, the eurozone, the world’s largest unified group of economies, is stagnating. Industrial activity across its largest economies continues to contract, while economic growth is expected to decline further raising fears of deflation.

Each of these factors is having a significant impact on commodities prices, and I believe it will continue to do so for some time, further impacting Teck’s earnings.

Commodity prices continue to slide

Key commodity prices including metallurgical coal, base metals, and crude continue to slide on the back of weak industrial demand from Europe and China. This is coupled with waning construction activity causing the price of steel to fall, impacting metallurgical coal, which is a key component.

This now sees metallurgical coal, which makes up just over 30% of Teck’s total revenues, trading at a six-year low. I, along with a number of analysts, expect this trend to continue until there is a significant improvement in global economic activity. These low prices are also hurting Teck's margins, with the company only capable of generating a gross profit margin of 3% on the coal it mines.

The outlook for copper and zinc, which generate the remainder of Teck's revenue remains mixed. But with industrial activity continuing to contract, I expect demand and consequently prices to fall at least over the short term.

Is the Fort Hill Oil Sands project really the magic bullet?

However, what continues to attract the interest of bargaining-hunting investors is Teck's 20% interest in the Fort Hill Oil Sands project. This venture is operated by **Suncor Energy Inc.** (TSX: SU)(NYSE: SU), which has a 40% interest, and **Total SA** (NYSE: TOT), which holds the remaining 40%.

The project is touted by some analysts and Teck's management as being the magic bullet, which will diversify its revenue and protect it from softer coal and base metal prices. But oil prices continue to plunge, with WTI and Brent at their lowest points since 2012 and signs that sub-$90-per-barrel crude will be a feature of the global economic landscape for some time to come.

Declining global demand on the back of weaker economic activity and growing supply with the U.S. shale oil boom causing production to grow will apply further downward pressure to oil prices.

Price differentials between Canadian crude blends including West Canada Select (heavy crude) are expected to widen because of transportation constraints coupled with growing U.S. crude production.

These factors are already making oil companies question the economics of investing in high-cost oil sands projects, with Suncor and Total already having shelved the Joslyn oil sands project.

The final concern is how Teck will finance its share of the massive capital investment needed to develop the project and bring it online. Already, the company has seen its earnings crash 70%, and I expect this trend as discussed to continue. It will also be some time before Teck receives any return on this investment, with first production expected until late 2017.

It is difficult to see any upside in Teck with no positive catalysts and a ream of bad news continuing to hit commodities prices hard. This makes it a stock to be avoided.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

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

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