

3 Reasons to Steer Clear of Teck Resources Ltd.

Description

Troubled commodities miner **Teck Resources Ltd.** (TSX: TCK.B)(NYSE: TCK) has had a nice bump over the last month with its share price spiking 9% on the back of China's recently announced stimulus measures. But I still believe investors should avoid Teck with the negative outlook for commodities set to weigh heavily on the company's fortunes for some time.

Let me explain why.

1. China's government is focused on transitioning the economy away from unproductive investment to boosting domestic demand.

This now sees the economy slowing as the government reins in a dangerously overheated property sector and pushes investment into more economically productive activities. As a result, the property sector continues to slow, with October 2014 investment in property development declining for the ninth consecutive month to be down 35% year-over-year.

This in conjunction with a range of other issues now sees China's economy slowing so rapidly that it will miss the government mandated GDP growth target of 7.5% for 2014. This is having an impact on demand for commodities, with the ongoing slump in property development driving demand for steel even lower.

But how is this relevant to Teck Resources I hear you ask?

Metallurgical coal is a key ingredient in the steel-making process and generates around a third of Teck Resource's revenue. This slump in demand for steel has caused metallurgical coal prices to slump to a six-year low. I expect this trend to continue not only because of declining demand from China's property sector, but also because of oversupply.

The world's largest resources company, **BHP Billiton Ltd.** ([NYSE: BHP](#)), is growing its metallurgical coal output in order to compensate for lower prices and to drive higher cost marginal players out of the market. This is applying considerable downward pressure to metallurgical coal prices in an already depressed market.

The end result for Teck is its margins continue to fall, with its third-quarter 2014 gross profit margin dropping 5% year over year to 18%, while its gross profit margin for the same period for metallurgical coal was a mere 1%.

With metallurgical coal prices expected to fall further these margins can only become further depressed.

2. Declining industrial activity in China and the Eurozone is further depressing base metal prices.

For October 2014, China's industrial activity declined for the third consecutive month, while industrial activity in the Eurozone fell sharply with the region now on the cusp of a triple-dip recession. This has already seen 2014 GDP growth figures for a number of member countries being revised, with the largest economy, Germany, now expecting 2014 GDP growth of 1.2% instead of the 1.8% previously forecast.

This is set to also have a significant impact on Teck, with copper and zinc generating 64% of its revenue. While it remains profitable at current prices with a third-quarter gross profit margin of 27% for copper and 29% for zinc, I see little to no future upside, not leaving much opportunity to grow earnings.

3. The Fort Hills oil sands project is not the magic bullet it is claimed to be.

Teck holds a 20% stake in the Fort Hills oil sands project, which is expected to produce first oil in 2017. But it still needs to make significant investments in the project before it receives any return on that investment. This continues to be a burden on a company which is already seeing its margins squeezed and has a massive pile of debt, with net debt totalling \$6.2 billion.

Even more worrying is after the recent crash in oil prices, the project now appears uneconomic, with the price of Brent at \$80 per barrel, well below the \$100 per barrel required. I believe this currently makes Fort Hills a liability for Teck, rather than an asset.

While Teck Resources remains profitable at current commodity prices there is little margin for error and virtually no growth prospects. I believe this makes it dead money and investors would do better to look elsewhere.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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

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Author

mattdsmith

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