Will Teck Resources Ltd. Rebound in 2015?

Description

With 2014 coming to a close, shareholders of **Teck Resources Ltd.** (TSX: TCK.B)(NYSE: TCK) are likely wondering if the 53% share price decline this year alone marks the end of the downside for the troubled miner, and if 2015 will bring a rebound in share price and a return to the stellar performance noted between 2000 and 2010, where Teck's price topped at nearly $60 per share.

The answer depends largely on a factor outside of Teck's control, namely the price of metallurgical coal, which is one of Teck's top products, comprising 47% of gross profit in 2013.

Unfortunately for Teck shareholders, there are numerous signs that metallurgial coal, which fell from highs of near US$300 per ton in 2011 to the US$110 realized by Teck in Q3, will languish for some time to come.

Metallurgical coal prices will likely remain weak through 2015

Metallurgical coal prices (also known as steelmaking coal) are currently at a seven-year low, and this may lead investors to think the commodity cycle has bottomed out. While further downside may be limited, there seems to be numerous factors in place that will keep prices low, or limit recovery, throughout 2015.

Since China is a main importer of Teck's coal, demand from China plays a large role in the prices obtained. Unfortunately, several changes in China's steel industry point to weaker demand long-term. As China's economy matures, it is slowly noticing a shift from fixed-asset investments in construction and infrastructure, to household consumption. This shift will be marked by a reduced demand for steel, and in turn for metallurgical coal.

This is already becoming evident, as Chinese steelmakers are producing less steel and beginning to shift toward domestic coal suppliers — a move foreshadowed by China's recent introduction of import tariffs on coal. The result has been a mere 2.3% steel production growth in China for the first two quarters of 2014, down from 6.6% in 2013, alongside a 19% reduction of metallurgical coal imports year-over-year.

Things on the supply side also don't bode well for metallurgical coal prices in 2015. Producers in Australia, one of the world's largest coal producers, have boosted production, with exports expected to grow 6.5% from last year. This will only continue over the next several years, as Australian producers plan to 30 million tonnes of capacity over the next four years as projects complete construction.

Although some mine closures have been announced globally, few have been implemented thus far, keeping the market in an overall surplus. The bottom line? An analyst report by Raymond James is predicting metallurgical coal prices of $130 by the end of 2015, a slight improvement over current prices, but not enough to see large increases in earnings for Teck.

Increasing coal production costs will not help margins

In a weak price environment, controlling costs is essential to maintain margins and earnings. Although Teck has undertaken with some success cost reduction initiatives, including reducing the number of contractors, several offsetting factors such the stronger U.S. dollar on diesel fuel, supplies, and parts, have resulted in no change in unit costs, with costs remaining at $88 per tonne year-over-year.

Over time, these costs can be expected to increase as Teck implements its Elk Valley Water Quality plan, which was created to treat selenium released into the water supply by mining activities. A previous draft of this plan projects approximately $600 million of total capital spending over a five-year period, and one analyst estimates that unit costs will rise to $106 by 2018, when full costs of water treatment are factored in.

Although value investors are certainly salivating over the Teck's historically low price multiple, with costs rising, and minimal coal price improvement anticipated over 2015, its unlikely 2015 will be the year Teck sees a massive rebound.

That is not to say Teck is a bad long-term play, but for investors seeking near-term capital appreciation, it is best to look elsewhere.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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Author

amancini