Avoid Teck Resources Ltd. and First Quantum Minerals Ltd.

Description

Weaker than expected economic growth in China and ongoing structural problems in the Eurozone continue to drive commodities prices to new lows. Along with growing concern about a global recession in 2015, the outlook for commodities including iron ore, metallurgical coal, thermal coal, copper, and zinc continues to grow even more pessimistic.

This decline in commodity prices is set to hit miners like **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) and **First Quantum Minerals Ltd**. (TSX:FM) particularly hard.

First, the downturn in residential construction in China continues to drive demand for steel and its key ingredients, including metallurgical or coking coal, lower.

This because the single largest consumer of steel globally is China and its steel consumption continues to decline because of a downturn in residential construction, which accounts for half of all of China's steel demand. By the end of November 2014, investment in China's real estate sector had declined for the tenth straight month and this trend is expected to continue with the real estate market still appearing overly frothy.

This makes the outlook for metallurgical coal particularly bleak, with 70% of total global steel production relying directly on inputs of metallurgical coal.

As a result, a number of investment banks including **Citigroup** have slashed their outlook for metallurgical coal. Citigroup expects its 2015 average price to be US$113 per tonne. That doesn't bode well for Teck, which derives around a third of its total revenue from metallurgical coal.

Even more worrying for Teck is Australian metallurgical coal producers like **BHP Billiton Ltd.** are expected to continue growing production despite softer prices as a means of maximising economies of scale and driving higher cost producers out of production. This will apply further pressure to metallurgical coal prices and may see them fall below forecast prices.

Second, analysts expect a copper supply surplus in 2015, which will push copper prices lower.

Declining manufacturing activity, slower economic growth in Chin, and the increased risk of an economic hard landing in the world's largest copper consumer are expected to drive demand lower over the course of the year. In addition, the global supply of copper is increasing, making the outlook for copper increasingly bleak.

Already, the metal, which is used in a wide range of industrial applications, construction, and manufacturing, has slumped to a five-and-a-half year low of US$5,353 per tonne and is expected to fall further over the course of the year.

This is a double whammy for Teck when considered in conjunction with the poor outlook for metallurgical coal prices, with it obtaining around 28% of its revenue from copper.

It will also have a significant impact on First Quantum, which generates 65% of its revenue from copper, particularly with the company struggling with lower ore grades, which are negatively impacting costs and production.

These softer commodity prices and increased global economic volatility certainly do not bode well for the financial performance of either Teck or First Quantum. Furthermore, it is likely it will take some time for commodities prices to recover and this will have a significant impact on the share price of both companies. Based on this outlook I believe prudent investors would be best to avoid commodities miners and related stocks for the foreseeable future.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

1. NYSE:TECK (Teck Resources Limited)
2. TSX:FM (First Quantum Minerals Ltd.)
3. TSX:TECK.B (Teck Resources Limited)

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