Teck Resources Ltd. Is Upgraded: Is This a Signal to Buy?

Description

Investment bank and money manager Merrill Lynch has upgraded troubled commodities miner **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) from "underperform" to "neutral" despite cutting its price target by 32% to US$13 per share.

Teck's shares down by a massive 68% over the last two years, but I don't believe that this upgrade is a signal to buy Teck. Let me explain why.

Why avoid Teck?

A key reason for avoiding Teck is that the outlook for commodities, in particular metallurgical or coking coal used in the manufacture of steel, remains especially grim. This is also the case for copper, which has recently touched its lowest point in five years, with no recovery likely in the short term.

Both commodities make up 40% and 30% respectively of Teck's total revenue, so that weaker prices now and in the future will only further compress Teck's margins and cause its earnings to fall.

The primary reason for these weaker prices is that China, the world's largest single consumer of commodities, continues to experience slower economic growth. In 2014, China's economy grew at its slowest rate in two decades, with the country reporting an annual GDP growth rate of 7.4%. Even more worrying is the International Monetary Fund has predicted that China's growth is set to slow further, with 2015 full-year GDP forecast to be 6.8% and 2016 GDP expected to fall to 6.2%.

Another disconcerting aspect of China's economy is the perilous state of its property sector, which is the single largest consumer of steel and metallurgical coal globally. By the end of November 2014, the property sector had experienced its tenth straight month of declining investment and it is expected that investment, along with prices, will continue to fall. This has led some analysts to conclude that there are significantly worse conditions ahead for China's property market and because China is the largest single consumer of steel globally, this does not bode well for metallurgical coal demand.

The outlook for copper is also quite negative with growing supply and declining demand set to trigger a supply glut that can only push copper prices lower over the course of 2015. This can be attributed to miners increasing production because of lower input costs, including fuel prices, and the declining global economic activity led by a slowing China and struggling Eurozone.

The final nail in the coffin for Teck is the rout in crude prices. This has brought the spotlight onto the viability of the Fort Hills oil sands project, in which Teck holds a 20% interest.

The break-even cost for new oil sands projects is estimated to be between US$54 and US$90 per barrel. Crude prices have fallen well below this to their lowest point in five-and-a-half years, with West Texas Intermediate (WTI) trading at US$49 per barrel and Brent at US$48 per barrel.

There is also no sign of the rebound in crude prices some analysts and industry insiders have expected, which brings the economics of the Fort Hills project into question. Andre Goffart CEO of Total SA's Canadian division, a 39% partner in the project, previously stated that the project needs Brent to be at US$100 per barrel for it to be economic.

Clearly, with Brent now trading at less than half this amount and signs of significantly softer oil prices for the foreseeable future, there are growing concerns that the project could be put on hold until signs of a recovery in crude prices are present.

What should investors do?

Despite assurances from Teck that it remains profitable in the current operating environment, investors are advised to avoid the company. Even if metallurgical coal and copper prices rebound, it is clear they will never again reach the levels seen at the height of the commodities boom. This means Teck's growth prospects are limited and investors would be best advised to look for value elsewhere.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

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Author
mattdsmith