



Why the Worsening Outlook for Coal Means Investors Should Avoid Teck Resources Ltd.

Description

Last year was a bumpy ride for commodities miner **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) and I believe that trend will continue through the remainder of 2015.

Contrary to some industry insiders who believe that metallurgical coal prices will rebound in 2015, the outlook continues to worsen. According to a forecast by Australia's **ANZ Bank**, coal prices will remain depressed for far longer than originally anticipated. In the report, ANZ analysts downgraded their original price forecasts to between 7% and 17% over the next four years, with the metallurgical coal price now expected to fall to US\$115 by the end of 2015 and US\$130 by 2018.

The reasons for this reappraisal are twofold. First, the economy of the largest user of metallurgical coal globally, China, continues to slow, and its construction industry is caught in a deep structural slump. Many analysts believe this will cause China's demand for steel in 2015 to fall for the first time in 35 years. Such a dramatic change in the outlook for steel demand in China certainly doesn't bode well for metallurgical coal demand.

Industrial activity in China is also waning, and in January 2015, contracted for the first time in two-and-a-half years. I expect this trend to continue because manufacturing activity in China is now at the same depressed levels that followed the global financial crisis.

Second, despite declining demand and weaker prices, supplies of metallurgical coal are growing. This is because significantly lower input prices for the mining process, particularly oil prices, are seeing higher cost producers return to profitability, thereby allowing them to continue operating instead of shuttering uneconomic production.

Lower input prices are also allowing lower cost producers to boost production as a means of generating further cost savings through economies of scale. This is the strategy being used by the world's largest miner **BHP Billiton Ltd.** to boost the profitability of its coal mining operations.

I believe that because of these factors, the price of metallurgical coal could fall even lower than the

prices predicted by ANZ, with no signs of global demand rising in the foreseeable future.

The impact of significantly softer metallurgical coal prices on Teck can be seen in its 2014 results, where its profit of \$362 million was just over one third of its 2013 profit. This is because almost 40% of Teck's revenue is generated from metallurgical coal production. In 2014 Teck received an average price of US\$115 per tonne for metallurgical coal, and if average coal prices for 2015 fall below that, its profit will decline further.

Another concern is that a strong U.S. dollar continues to see Teck's costs rise because all of its debt and interest expense is U.S. dollar-denominated. Analysts expect the U.S. dollar to remain strong throughout 2015, so this will have further impact on Teck's profitability.

Now what?

Despite markedly softer coal and metals prices, Teck remained profitable in 2014, but I don't believe this makes it a good investment because there are too many headwinds affecting its fundamentals. These limit the returns available, particularly because the commodities boom created by China's insatiable appetite for coal and metals over the last decade has ended. As a result, I believe investors are better off seeking opportunities in other industries that aren't dependent on China.

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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