You Have to Read This Before Buying Teck Resources Inc.

Description

At this time in 2011, the China story was very appealing for a lot of investors. Its economy had grown by 10.4% the year before and this was driving ever-increasing demand for natural resources.

Now the story is very different. Its economy has slowed down, only growing by about 7% today. Many observers think the story will get worse thanks to a giant property bubble and scary shadow banking sector. Along the way, the prices of natural resources have gotten crushed. Of course, the stock prices of commodity producers have been hit hard too.

Teck Resources Inc. (TSX:TCK.B)(NYSE:TCK) is a perfect example. Back in 2011, its shares traded for more than $60. Today its stock price is below $15. Does this mean the shares are in bargain territory?

A slowdown in steel production

Teck is one of the world's largest producers of metallurgical coal, a key ingredient in steel production. This makes the company especially reliant on China—the country produced over 800 million tonnes of steel last year, over half the world's total.

Here's the bad news: analysts at **Morgan Stanley** believe the country's steel production will peak this year and start declining in 2016. The head of China's Iron and Steel Association believes this peak has already arrived.

Meanwhile, supply of metallurgical coal has continued to ramp up, resulting in a dramatic fall in price. To be more specific, Teck's coal sells for little more than US$100/tonne today, down from ~US$300 per tonne in 2011.

Unfortunately, Teck's biggest competitor is a lot more optimistic on China. **BHP Billiton**, an Australian mining giant, expects Chinese demand for steel-making materials to grow for years. So, I wouldn't expect supply to come crashing down any time soon. For that reason, the metallurgical coal price could easily keep falling.

Other problems

Let’s face it: this is the last thing that Teck needs. Years of pricey acquisitions have resulted in over $8 billion in debt. S&P recently downgraded this debt to one level above junk status, signaling just how precarious the situation is. Making matters worse, the company has committed over $2 billion to building the Fort Hills oil sands project, which won’t start producing until 2017.

A likely dividend cut

Despite all these issues, Teck’s dividend has remained very robust, even increasing by 50% since 2011. The company now has a dividend yielding more than 5%, good enough to place it fourth on the **S&P/TSX 60**. The payout costs the company roughly $500 million per year.

With all this in mind, I would expect the dividend to get cut, and this could cause Teck’s stock price to tank (we’ve seen this with a few oil companies). So, before you go buying Teck shares, just think about this risk and ask a very simple question: Why would you do this to yourself?

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

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

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