Teck Resources Ltd: Why This Fallen Angel Is Doomed

Description

One investment myth that traps many investors is “fallen angels” that will eventually return to their previous highs. This couldn’t be further from the truth. A range of internal and external factors drive the performance of companies, even those that once dominated the market.

One company that continues to attract this type of attention is coal and base metals miner **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK). It seems that the further this one-time darling falls, the ever louder the chorus of voices yelling “buy” becomes.

Now what?

It wasn’t long ago that Teck was delivering stellar results as it cashed in on China’s insatiable demand for steel-making coal, copper, and zinc. This helped to drive its share price ever higher as investors flocked to what appeared to be a sure thing.

Late in 2010 at the height of the resources boom Teck’s share price soared to over $60, but since then has declined to about a sixth of that. As a result some pundits believe that Teck is attractively priced and will bounce back when the cyclical downturn ends.

Commodities such as coal, copper and zinc are cyclical by nature, but what investors fail to realize is the global economic landscape has fundamentally changed because China’s insatiable demand for these and other commodities has abruptly ended.

Not only has it reached a point where its rapid economic growth has plateaued, which is common for emerging economies, but its economic development was poorly planned. This resulted in China overinvesting in infrastructure, urban housing and office space, which are large consumers of steel, copper, and zinc. As a result, construction activity has fallen to a virtual standstill, causing demand for these and other commodities to plunge.

Then there is the industrial sector, which is also a tremendous consumer of those commodities. It is also in terminal decline. Manufacturing activity for July 2015 slumped to its lowest level in six months.

The severity of China's economic downturn is evident. Beijing recently devalued the yuan to a four-year low against the U.S. dollar as it desperately tries to stimulate economic activity by making exports more attractive.

If this wasn't enough bad news for Teck, another major problem is that at the height of the resources boom, commodities miners hurriedly expanded output so as to take advantage of higher commodities prices. The market is now awash with excess output for steel-making coal, copper, and zinc, putting even greater pressure on their prices. Steel-making coal is trading at its lowest price in a decade, while copper and zinc are both hovering around five-year lows, with no sign of a recovery in sight.

Then there is the additional $1.8 billion Teck is committed to investing in the Fort Hills oil sands project. With an estimated breakeven price around US$82 per barrel of crude, it appears to be increasingly uneconomic with oil at less than US$50 per barrel.

So what?

This is all considerably bad news for Teck, which is reliant upon these commodities for the majority of its revenue. What is more worrying is that the economic situation in China continues to worsen, and this will only push commodity prices lower, boding poorly for Teck's future financial performance. For all of these reasons, Teck's outlook is pessimistic at best, and it offers investors little to no upside, making it a stock they should avoid.

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1. Investing
2. Metals and Mining Stocks

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1. Editor's Choice

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Date
2025/08/01
Date Created
2015/08/17
Author

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