Why the Bull Thesis for Teck Resources Ltd. Is Flawed

Description

The bad news in what has been a horrific year for beleaguered coal and base metals miner **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) continues, as its debt has been downgraded to junk status. Even after two global ratings agencies downgraded Teck's debt to junk because of concerns over ongoing weakness in commodities and its burdensome investment obligations, some analysts remain exceptionally bullish on the company.

However, there are signs that the bull case for Teck is overstated, with a range of risks set to apply considerable pressure to the company for some time.

Now what?

A number of analysts point to Teck's considerable liquidity; the company holds $1.5 billion in cash and undrawn credit facilities totaling $5.4 billion. This, analysts believe, will allow the company to weather the harsh operating environment surrounding commodities as it waits for prices to rebound.

It is extremely uncertain as to whether or not commodities such as coking coal, copper, and zinc, which generate all of Teck's revenue between them, will ever recover to the levels that investors became accustomed to over the last decade. There are signs that China's massive appetite for commodities has come to an abrupt end; it has completed the massive cycle of development that made it a global economic powerhouse.

In fact, it is highly likely that what we are seeing now is the "new normal"; commodities could remain at current levels for the foreseeable future. This certainly doesn't bode well for any improvement in Teck's cash flows or financial situation.

Then you have to consider that Teck still has a massive pile of debt totaling over $8 billion, with $1.1 billion of that debt, along with an additional obligatory $1.8 billion investment in the Fort Hills project, falling due by the end of 2017.

Another concern is that should the Fed decide to raise rates this year, or early next year, Teck's financing costs will increase significantly.

All of these factors could trigger a cash crunch for Teck.

Let's not forget **Suncor's** recent acquisition of an additional 10% stake in the Fort Hills project from partner **Total SA** for $310 million. This values Teck's own 20% stake in the project at $620 million, well below the $2.4 billion it has on its balance sheet. When considered in conjunction with the project appearing increasingly uneconomical because of significantly weak oil prices, there is the likelihood of the value of this asset being written down.

Any significant write-down of this asset has the potential to trigger a breach of Teck's debt covenants, which, while not sending the company into bankruptcy, indicates just how precarious its financial position currently is.

So what?

All of these factors clearly justify Moody's decision to downgrade Teck's debt to junk status, making Teck a stock that investors would do best to avoid. This is particularly the case when considering that commodity prices will not recover as strongly as some pundits claim, and will more than likely remain at current levels for a sustained period.

As a result, there is little to no upside in Teck's share price, making it prudent for investors to look elsewhere for value.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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1. Editor's Choice

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