Can Teck Resources Ltd. Ever Bounce Back?

Description

The outlook for beleaguered coal and base metals miner **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) has just moved from gloomy to outright pessimistic. Not only has its price fallen off a cliff, plunging by a whopping 70% over the last year, but its debt has been downgraded to junk status.

There are now signs that Teck will never be able to bounce back.

Now what?

Teck is facing a range of headwinds that continue to have a marked impact on its finances. Chief among these is the sharp collapse in commodities that now sees steel-making coal trading at its lowest point in 10 years and copper at a six-year low. Both of these commodities generate just over 60% of Teck's revenue between them, and any weakness on their part hits Teck's bottom line particularly hard.

What is more worrying is that the outlook for commodities, particularly steel-making coal, remains bleak.

You see, the global demand for steel continues to decline. Demand from the world's largest consumer, China, has evaporated at an unprecedented rate. This is because China's economic growth is slowing as construction and manufacturing activity continues to contract.

There is also a global supply glut for steel. Production cuts have failed to keep up with the rapid contraction in demand. This means that the price of steel as well as its key ingredients, steel-making coal and iron ore, remain under considerable pressure, with no likelihood of the situation improving for the foreseeable future.

As a result, Teck has moved to slash costs and cut capital expenditures. It announced that it is implementing cost reductions of $650 million across its business. These measures include cutting 1,000 jobs globally as well as withdrawing its Cold Mountain Phase 2 project from the environmental assessment process and suspending work on the project.

Mining at Cold Mountain will cease during the fourth quarter 2017 and will have a marked impact on Teck's coal output. The Cold Mountain Phase 2 project was expected to produce 2.25 million tonnes of coal annually on completion, and its suspension will leave a large hole in Teck's future revenues, further exacerbating the earnings shortfall caused by weak coal prices.

However, it just isn't significantly weak steel-making coal and copper prices that are having an impact on Teck's fortunes.

The company is committed to investing a further $1.5 billion in the Fort Hills oil sands project, where it has a 20% stake. This couldn't come at a worse time for Teck, with oil prices now close to their lowest level in six years.

In fact, some analysts estimate that Fort Hills requires West Texas Intermediate (WTI) to be at US$90 per barrel in order to break even, which is more than double WTI's current price.

It also appears that the carrying value for Teck's share of the project on its balance sheet is significantly overstated. When this is coupled with likelihood of commodities prices falling further, it means that Teck may have to take further impairment charges on its mining and oil assets. This will follow the $2.2 billion of after-tax impairment charges made during the third quarter 2015.

So what?

None of these factors bode well for Teck's outlook, and while its shares do appear cheap, it seems that there is more pain to come. When this is considered in conjunction with the gloomy outlook for commodities, it makes Teck a particularly unappealing investment.

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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