



## Don't Buy Teck Resources Ltd. Unless These 2 Things Happen

### Description

Analysts have been steadily trying to pick a bottom for **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK), which has plunged 65% this year alone. This has proven to be a dangerous game—coal and copper, Teck's main products, have fallen to decade and six-year lows, respectively.

These price declines have occurred because China (the biggest consumer of Teck's products) is rebalancing its economy from a fast-growing investment and export-led economy to a much slower growing economy driven by services and consumer spending. At the same time, both copper and coal are oversupplied because producers have been slow to cut production.

While Teck has recently made moves to cut its dividend, capital expenses, and operating expenses, one thing remains clear: Teck needs a sustained recovery in the prices of its key products in order to realize its upside potential. By waiting for such a recovery to occur, investors can minimize further downside while still benefiting as Teck starts to trade closer to its historical valuation.

Here's what shareholders should look for.

### Further supply cuts to the coal market

Teck's main product is metallurgical coal, which is a key ingredient used in steel making. China is currently the world's largest user of steel by far, with usage of about 710 million tonnes in 2014 (this is compared to the U.S., which is the second-largest user, using only 106 million tonnes).

China's GDP growth has shrunk from 11.5% in 2011 to 6.9% in the third quarter of this year, as China deals with overcapacity from years of overinvestment in sectors like real estate, infrastructure, and steel production.

As a result, China needs less metallurgical coal from producers like Teck, and imports have fallen from 75 million tonnes in 2013 to an estimated 48 million tonnes this year. Unfortunately, the supply of metallurgical coal has not come down fast enough to meet this declining demand.

It is estimated that the supply of seaborne metallurgical coal will be about 288 million tonnes by the

year end, whereas the demand is only about 259 million tonnes, which means the market will need to cut about 29 million tonnes to bring the market back into balance.

About 30 million tonnes of production cuts have been announced, and these cuts are being implemented. Investors should wait until these cuts come through and until further cuts are announced before considering an investment in Teck.

Lower prices should force further supply out of the market, especially in the U.S., where producers are being hit by both the low commodities prices and the strength of the U.S. dollar. Investors should also be on the lookout for further cuts from Australia, which has contributed to much of the oversupply situation.

### **Signs of copper demand from China**

China is also the biggest user of copper with 45% of global demand. Copper is heavily used in real estate, infrastructure, and manufacturing, and China will need to see improvements in these sectors in order to see a strengthening of price in copper.

Fortunately, there is an easy way to gauge the strength of China's copper demand as well as the future of copper prices. One way to measure the health of a manufacturing sector is through a Purchasing Managers Index, or PMI. When a PMI is under 50, it typically indicates contraction, whereas over 50 indicates expansion.

One key Chinese PMI is the Caixin PMI, which was 48.3 in October. Analysts have found that PMIs and copper prices are very closely correlated, and analysts at Moody's have stated that a PMI of 50-55 for a consecutive three months would indicate a positive outlook.

In addition to this, investors should also be on the lookout for further cuts to copper supply. By waiting for these signs of a strengthening market, investors in Teck can reduce their risk by making sure their investment is backed by a market that is underpinned by improving demand and more reasonable production levels.

### **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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