Why 2016 Will Be Another Tough Year for Teck Resources Ltd.

Description

The outlook for commodities in 2016 remains extremely pessimistic with oil, iron ore, steel-making or coking coal, and base metals' prices remaining under considerable pressure. This makes coking coal and base metals miner **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) an unattractive investment despite the claims of some analysts that it is undervalued and poised to rebound strongly as commodities recover during the course of 2016.

Now what?

While base metals copper and zinc are starting to show some life because they are integral components in a range of industrial processes and products, the demand for steel remains in the doldrums. This is particularly unfortunate for Teck because the company relies on mining steel-making coal to generate roughly a third of its revenue.

There are signs that the demand for steel will continue to fall because of China's slowing economy and a sharp drop in demand from two of the world's largest steel users: China's construction and manufacturing sectors.

You see, at the height of China's economic boom, the country massively overbuilt, leaving considerable housing that will remain unoccupied for years.

On top of this, there is the slowing rate of rural to urban migration, which is further exacerbating the oversupply of urban housing.

Beijing also remains determined to transition China from an export-oriented industrial economy to one that is focused on services and economic growth through domestic consumption.

This has already triggered a shift from manufacturing to services that will only continue to grow in momentum, which will cause manufacturing activity and demand for steel and base metals to decline.

The marked decline in demand for steel is being exacerbated by a growing global supply glut.

Major coking coal producers such as **BHP Billiton Ltd.** (NYSE:BHP) are focused on boosting their output of steel-making coal, while reducing costs through increased efficiencies and economies of scale. This, along with considerable steel inventories in China, means that any rebound in the demand for steel-making coal is highly unlikely for some time to come.

I believe that Teck has been overly optimistic when valuing its coal assets by assuming a price of US$96 per tonne now and US$130 per tonne in 2020. As a result, Teck will have to incur further impairment charges against the value of those assets during 2016.

For some time now Teck's management has trumpeted that its 20% stake in the Fort Hills oil sands project will deliver for the company, but there are signs that this project may in fact be a costly red herring. Teck remains on the hook for a further $1.5 billion in capital expenditures for a project that needs West Texas Intermediate to be between US$80 and US$90 per barrel to be economical.

There are signs that this is a long way off.

Then there are the additional costs for oil sands producers caused by new regulatory regime for carbon emissions in Alberta. These will also impact the economics of the project and, along with the Paris climate change accord, which aims to phase out the use of fossil fuels, may see Fort Hills become a stranded asset.

So what?

The deck is certainly stacked against Teck. Even if there is a moderate bounce in commodities, I can't see any real long-term upside for investors as the company is on the wrong side of the developmental and technological curve. For these reasons, this is a stock that investors should avoid.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

1. NYSE:BHP (BHP Group)
2. NYSE:TECK (Teck Resources Limited)
3. TSX:TECK.B (Teck Resources Limited)

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