Why Teck Resources Ltd. Will Continue to Languish

Description

The recent bounce in commodity prices and an upbeat outlook from a number of analysts has been a boon for struggling coal and base metals miner **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK). The struggling miner's shares spiked a very impressive 39% for the year to date, and some analysts believe there is still plenty of room to run with a solid rebound in commodities on the horizon.

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This, however, couldn't be further from the truth. A range of indicators highlight that weak commodity prices are the new norm.

Now what?

Any sustained rebound in commodities would require a sharp uptick in demand and a decline in global supplies, and there is no sign of either happening soon.

You see, a key driver of demand for commodities is economic activity in China. With its economic growth slipping to its lowest level in 25 years and signs that it will slow even further, there is little hope of any significant rise in demand occurring any time soon.

Then there is the issue of supply. Many commodities, such as steel-making coal, iron ore, oil and copper, suffer from a global supply glut.

During the height of the commodities boom, miners invested heavily in developing new assets and expanding production to take full advantage of ever-higher commodities prices. As a result, global productive capacity for commodities now sharply exceeds demand, and there are signs that this will continue for the foreseeable future.

Many major miners, including global mining giant **BHP Billiton Ltd.**, have adopted a strategy of boosting output to compensate for declining prices. BHP has adopted this strategy with steel-making coal, focusing on a range of productivity improvements that will boost output with no additional capital spending.

This doesn't bode well for Teck as steel-making coal earns about a third of its revenues.

The same is happening with copper. **Freeport-McMoRan Inc.** is expanding its Cerro Verde copper mine in Peru. On completion, the mine will produce one billion pounds of copper annually, or roughly 3% of the world's copper production. This doesn't bode well for copper prices, which are now hovering around six-year lows because of the glut in metals and declining demand.

With Teck generating 30% of its revenue from copper, any further declines in the price of copper will hit its earnings hard.

As a result of weak commodity prices, Teck has already taken a series of impairment charges on its coal, copper, and oil assets during 2015, totaling $2.7 billion. With the outlook remaining poor, this can only continue through 2016.

Another factor weighing heavily on Teck's performance is its exposure to crude through its 20% interest in the Fort Hills oil sands project. Teck is liable for an additional $1.2 billion investment in the project, which is appearing increasingly uneconomic; it needs crude to be US$90 per barrel, or almost three times higher than its current price, to break even.

As a result of weak crude prices, Teck has incurred impairment charges on this investment, which totaled $598 million for the fourth quarter in 2015 alone. Given that Teck's carrying value for the asset is above its market valuation, there will be further impairment charges against the asset as markedly lower oil prices will likely remain throughout 2016.

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These are not the characteristics of a flagship asset meant to reduce risk for Teck by diversifying its revenues away from volatile steel-making coal and base metals.

So what?

With the doom and gloom surrounding commodities and a growing global supply glut for coal, metals, and crude, it is extremely difficult to see any long-term upside in Teck. It appears increasingly likely that Teck's rally has come to an abrupt end, and its share price will lose all of the gains made since January this year. For these reasons, investors would do best to avoid the mining industry.

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1. Investing
2. Metals and Mining Stocks

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