Why Teck Resources Ltd.'s Share Price Will Tumble Again

Description

The rally in commodities and the announcement of further economic stimulus by Beijing has buoyed commodities markets and mining stocks in recent months. These factors were the key drivers of **Teck Resources Ltd.'s** (TSX:TCK.B)(NYSE:TCK) recent rally that saw its shares pop by an impressive 84% since the start of the year.

Despite the promise this holds for investors, there are growing signs that the rally is unsustainable as the fundamentals for commodities highlight that lower prices are on the way.

Now what?

One of the biggest problems facing Teck is its reliance on metallurgical or steel-making coal and copper to generate revenue; they're responsible for 62% of Teck's total revenue.

You see, both commodities have been severely punished because of China's slowing economy and significant global overcapacity.

Steel-making coal, while having recovered in recent months, still remains not much higher than its lowest price in a decade. And despite copper's rally, it is only marginally higher than its lowest price in five years. The biggest headwind facing both commodities is China's rapidly slowing economy; it is the largest consumer of steel-making coal well as copper.

In fact, China consumes roughly half of all steel-making coal produced globally and 42% of global copper production. This means that as China's economy slows, with GDP growth predicted to fall to 6.5% during 2016 and taper off to 6.2% in 2017, so too will demand for steel-making coal and copper.

Then there is China's construction industry, which remains caught in a protracted slump, while manufacturing activity actually contracted for the seven months from August 2015. This is bad news for both commodities; those sectors are among the largest consumers of steel and copper in China.

It indicates that the collapse in commodity prices is not cyclical. Rather, lower prices are a “newnormal” because of slow economic growth in China.

The supply side is also daunting. Global excess capacity for copper and steel-making coal is arguably at its highest level ever. This has occurred because as the commodities boom grew in momentum, miners and governments invested tremendous sums in finding and developing new sources of copper and coking coal.

In fact, this phenomenon is still occurring. Chile’s government is planning to invest an additional US$81 billion in new copper mining projects over the next decade in spite of weak copper prices.

Then you have industry heavyweights **BHP Billiton Ltd.** and **Rio Tinto Plc.**, which are continuing to ramp up their output of steel-making coal in a bid to gain market share by pushing higher-cost producers out of the market.

Each of these factors indicates that a sustained rally in either commodity is extremely unlikely. This doesn’t bode well for Teck, which indicates that its share price will fall from recent highs.

There are also growing concerns over Teck’s involvement in the uneconomic Fort Hills oil sands project. Teck is on the hook to invest a further $1.2 billion in the project, which is due to commence production in 2017 and needs crude to be at about US80 per barrel to be economic–wishful thinking with the global supply glut being exacerbated by Russia and Iran, which continue to boost oil output.

This is of significant concern. Teck carries a mountain of debt totaling $7.7 billion–a considerable pile of debt for company that has considerable financial obligations and is battling declining cash flows.

So what?

Teck is a risky bet. The fundamentals for commodities indicate that a sustained rally is highly unlikely, and this coupled with Teck’s declining cash flows and considerable financial obligations makes it one bet not worth taking.

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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