Why Now Is the Time to Sell Teck Resources Ltd.

Description

There are growing signs that the rally in steel-making coal and base metals miner **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) is overdone; Teck is up by 153% for the year-to-date. Much of this rally can be attributed to firmer base metal prices, an improving outlook for steel-making coal, and growing optimism surrounding China.

Nonetheless, the fundamentals fail to support this increasingly positive outlook, and it is only a matter of time before Teck's shares slump once again.

Now what?

The outlook for China continues to worsen with signs that the world's single largest consumer of steel-making coal and base metals is caught in an economic slump that will continue to deepen.

For April 2016, China's exports and imports (key indicators of economic activity) fell far more than was expected. Exports were down by 1.8% year over year, while imports fell for the 18th straight month to be down by a whopping 11%. This sharp slump is attributed to falling demand for commodities including iron ore, steel-making coal, and copper from the world's largest commodities consumer.

Even the uptick in China's industrial activity for March and April 2016, after a seven-month decline, has had little to no positive effect on the demand for commodities. This in part can be attributed to China's construction industry, which is among the largest consumers of metals globally, being caught in a protracted slump with no sign of a recovery for the foreseeable future.

Then there is Beijing's focus on transitioning the economy away from investment- and export-led growth to an economy focused on growth from domestic consumption. As this transformation gains momentum and the economy matures, construction and manufacturing activity will fall, causing demand for metals and other commodities to decline further.

These macroeconomic factors don't bode well for a sustained long-term rally in commodities prices.

There are also specific signs indicating that the situation for Teck won't improve any time soon.

The steel market is becoming increasingly turbulent; demand for steel is expected to fall over the course of 2016. This is in part because of China's cooling economy and also because of a supply surplus with global excess capacity standing at about 400-700 million tonnes.

With steel-making coal being responsible for around 40% of Teck's revenue, this doesn't augur well for higher revenues or a stronger bottom line.

Base metal prices are also caught in a slump. **Goldman Sachs** is expecting copper to remain in a protracted bear market until at least 2018 because of China's slowing economy and global oversupply. With copper responsible for almost 30% of Teck's revenue, any further weakness will impact Teck's revenues and bottom line.

Teck's ongoing financial obligations regarding the increasingly uneconomic Fort Hills oil sands project, in which it has a 20% interest, appear more and more like an albatross around its neck. It has already poured billions into the project and needs to make another $1 billion investment for production to start in 2017.

However, the problem is that Fort Hills needs West Texas Intermediate (WTI) to be at $96 per barrel in order to break even, according to Citi Research, and with oil caught in a protracted slump, there is no sign of that happening any time soon.

In fact, industry consultants McDaniel and Associates estimate that WTI will average US$45 a barrel in 2016, US$51 in 2017, and only $70 a barrel by 2020, thus indicating that it will be a considerable amount of time before Teck is able to generate a return on the multi-billion dollar investment it has made.

So what?

It is difficult to see any further upside in Teck with the price of commodities, including crude, set to remain under considerable pressure for some time. This makes now the time for those investors who had the courage to take a position when it was languishing at under $5 per share to lock in their profits and for other investors to look elsewhere.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

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