Will Teck Resources Ltd.'s Monster Rally Continue?

Description

Steel-making coal and base-metals miner **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) has experienced an incredible rally since the start of 2016. Its share price has rocketed upwards by an incredible 172%. This has triggered considerable interest in the miner; a number of analysts have stated that the rally has further to run because of the growing optimism surrounding commodities.

Nonetheless, the outlook for commodities is not as rosy as many analysts would have investors believe, and there is a real danger of the rally in commodities miners running out of steam sometime soon.

Now what?

One of the primary drivers of higher commodity prices in recent weeks has been the weakness of the U.S. dollar and the Fed's increasingly dovish approach to interest rate hikes.

You see, commodities and the dollar share an inverse relationship, while rising interest rates typically cause commodity prices to move lower.

Now with Fed deciding earlier this month not to raise interest rates because of slowing U.S. economic growth, the dollar has weakened and commodities prices have firmed.

As a result, steel-making coal prices have stabilized and the free fall in copper has halted.

However, fundamentals indicate that any recovery in commodities will be short-lived and the long-term outlook remains bearish. This is because economic growth in the world's largest consumer of commodities, China, continues to slow, with first-quarter 2016 GDP growth of 6.7%–its lowest level since the global financial crisis.

Meanwhile, activity in the two economic sectors that are among the largest domestic consumers of commodities, the construction and manufacturing sectors, remains flat.

Then you have the massive stockpiles of raw materials in China that continue to grow, thereby keeping a lid on demand.

Meanwhile, Beijing has stated that it intends to implement tax cuts for domestic commodities producers as it attempts to stimulate economic activity. And this can only cause coal and metals output to grow from a mining sector that is already plagued by overcapacity.

These factors certainly don't bode well for the long-term outlook for coking coal and base-metals prices. These commodities are responsible for generating the majority of Teck's revenues.

Then investors need to consider that Teck is on the hook to make a further $1 billion investment in the Fort Hills oil sands project. This project appears increasingly uneconomic; it's estimated by Citibank that it needs West Texas Intermediate to be at US$96 per barrel just to break even.

There are signs that it will be some time for crude to return to these heady heights with one industry consultancy, McDaniel and Associates, estimating that oil won't move to over US$90 per barrel until at least 2025. This means that a significant amount of time will elapse before Teck is able to recoup a return on the multibillion investment it has made.

Along with the remaining investment in Fort Hills, Teck is facing other balance sheet pressures; it has just over $2 billion in debt falling due between now and 2019. While this won't trigger a liquidity crunch because it has $5.4 billion in available funds, it will apply pressure to its heavily leveraged balance sheet, which has $8.6 billion in debt.

So what?

Teck's rally, along with growing bullishness over commodity prices, has attracted considerable attention, and while it has made tremendous strides in cutting costs and bolstering its balance sheet, Teck remains heavily indebted and vulnerable to any further weakness in commodities. This means the current rally is running out of steam, and any further weakness in commodities will cause its price to fall.

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1. Investing
2. Metals and Mining Stocks

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1. Editor's Choice

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