# Why Teck Resources Ltd.'s Valuation Appears Inflated

## Description

It has been a stunning year for one-time beaten-down miner **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK). Only eight months ago, the market was pricing a number of miners for failure because of the commodities slump, causing Teck's share price to plunge to its lowest point since 2008.



Since then commodities have firmed, and this coupled with a more positive market outlook has caused Teck's share price to surge by an almost unbelievable 314% for the year to date. There are, however, signs that the rally is overdone with Teck's valuation failing to reflect underlying economic fundamentals.

**Now what?**

A major factor weighing on Teck is China, which is the largest consumer of commodities, including steel-making coal, copper, and zinc. There are signs that demand for commodities from China can only continue to decline with economic weakness set to continue for the foreseeable future.

For July 2016 industrial activity contracted for the fourth straight month. Real estate development also fell, continuing its precipitous decline after improving earlier this year because of Beijing's economic stimulus.

Meanwhile, China's second-quarter GDP only grew by 6.7% year over year, remaining flat from the previous quarter and at its lowest level since the global financial crisis.

Then there is the slump in commodities. Many analysts expect prices to remain weak for some time yet.

Over the last few months the price of steel-making coal has surged to US$140 per tonne–about 80% higher than it was six months ago. Nonetheless, there are signs that this momentum can't be sustained and prices will soften because of the mismatch between supply and demand.

Not only will demand from China falter because of weaker economic growth, but global supplies are expected to grow as other major producers seek to boost steel-making coal production.

Among these is the world's largest miner of basic materials, **BHP Billiton Limited** (NYSE:BHP), which reported record steel-making coal production for the year ending June 30, 2016. It remains focused on expanding its coal production further, forecasting that output will grow by about 3% by the end of June 2017.

This, along with coal mines in China coming back online after long periods of flooding, will place considerable pressure on prices.

Meanwhile, copper, which generates 38% of Teck's gross profit, is close to its lowest price in over six years; there are signs that prices will remain soft for some time because copper supplies are expected to grow significantly over the next year as governments from a range of copper-producing jurisdictions, including Chile, Peru, and Zambia, are determined to boost production.

The world's second-largest copper miner, **Freeport-McMoran Inc.** (NYSE:FCX), is also increasing its copper output. It's already grown output by 16% year over year for the second quarter 2016. BHP is also focused on boosting copper output; the company expects it to grow by 8% between now and 2017.



**So what?**

No matter which way you measure it, Teck's valuation is being stretched. Its 2016 enterprise value to EBITDA of 9.6 times is 35% higher than its five-year average, implying that its earnings will experience massive growth. This is highly unlikely; fundamentals, including soft commodity prices and weak economic growth, certainly don't support this.

Then there are the additional expenditures for its share of the controversial Fort Hills oil sands project, which is not expected to commence operations until late 2017. Even when it does come online, it will be uneconomical. Crude is forecast to remain under US$70 per barrel until at least 2020, and analysts estimate that Fort Hills needs West Texas Intermediate to be at US$90 in order to break even.

**CATEGORY**

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**TICKERS GLOBAL**

1. NYSE:BHP (BHP Group)
2. NYSE:FCX (Freeport-McMoRan Inc.)
3. NYSE:TECK (Teck Resources Limited)
4. TSX:TECK.B (Teck Resources Limited)

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