



Is it Time to Sell Teck Resources Ltd.?

Description

Diversified steel-making coal and metals miner **Teck Resources Ltd.** ([TSX:TECK.B](#))([NYSE:TECK](#)) experienced a massive surge in its stock price over the last year as coal and metals prices rose. This gave investors hope that the once beaten-down miner would return to the halcyon days when its stock traded at over \$50 per share and paid an annual dividend of \$0.90 per share.

There are, however, growing concerns that the best days could be over for Teck and the massive rally that it has experienced thus far has significantly outpaced underlying fundamentals.

Now what?

When it comes to mining stocks, it essentially boils down to one thing: China.

This is because China is the world's single largest consumer of commodities, apart from crude, including iron ore, steel-making or coking coal, nickel, zinc, and copper. The tremendous recovery in commodity prices witnessed over the second half of 2016 can, in part, be attributed to Beijing's credit-led economic stimulus which focused on substantially boosting activity in the construction and manufacturing sectors.

The positive effect this had on commodity prices was magnified by a marked decline in domestic metals and coal production as Beijing sought to rationalize the mining industry, reduce excess supply, and shut down unprofitable state enterprises.

What has sparked considerable concern among market pundits is the sharp downturn of iron ore prices in recent weeks.

You see, iron ore is a key barometre of the health of China's economy and activity in the all-important construction and manufacturing sectors. This is because iron ore, like coking coal, is a key ingredient used to manufacture steel, which is a core product consumed in construction and industrial activities. The marked weakness in iron ore prices has sparked fears that the effects of Beijing's stimulus are waning, creating anxiety that the demand for coal and metals is once again in decline.

Nonetheless, the recent weakness in iron ore can be attributed to a surge in supply caused by an upswing in shipments from Australia and swelling domestic production rather than diminishing economic activity.

In fact, March 2017 data shows that investment in real estate development is at its highest level in years and that manufacturing continues to grow.

There is also still a massive shortfall in infrastructure in China, which Beijing has recognized as a limitation in its plan to transition the economy from one driven by export-oriented manufacturing to domestic consumption. By addressing this deficiency, Beijing hopes to stimulate economic growth and speed up that transition.

This means that demand for steel, copper, zinc, and nickel will remain strong, boding well for Teck, which earns 45% of its revenue from mining steel-making coal and the remainder from copper and zinc.

Investors should also not forget that Trump has promised to deliver a trillion-dollar infrastructure-investment plan in the U.S. which, if successfully implemented, could cause the demand for metals to outstrip supply.

This would be a boon for Teck because it would sharply boost demand for steel, copper, and zinc in an environment where supply constraints caused by the deep slump in commodities would rise exponentially.

So what?

There is certainly justification for exercising caution with regard to Teck. The outlook for China over the long term remains unclear, and, inevitably, coking coal as well as base metals production will grow as long as prices are favourable.

Furthermore, steel-making coal has already softened from its 2016 highs, but even after allowing for this, there are signs that Teck has yet to fully benefit from higher coal and metals prices. Even a slight uplift in profitability will more than likely mean that management will hike the miner's dividend, giving its share price a healthy shot in the arm.

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