Despite Weak Coal Markets, Business Is Booming for Westshore

Description

Canada's largest coal export terminal seems to be on a roll despite waning demand and weaker prices for the commodity. **Westshore Terminals Investment Corp.** (TSX: WTE) operates the coal export terminal located at Roberts Bank, Delta, British Columbia — and business is booming.

The company continues to set records for tonnes shipped. In 2010, it shipped a record 24.7 million tonnes (mt), which then increased to 27.3 mt in 2011. Unfortunately, the streak ended last year, when in addition to two planned multiple-week-upgrade shutdowns, a vessel ran through a trestle at Berth 1, shutting it down. Shipments fell to 26.1 mt.

Fortunes have changed in 2013. Even with Berth 1 shut down for nearly half of the first quarter, shipments were down only 0.3 mt from 2012 levels. With Berth 1 back up and running, the second quarter easily blew past last year's results, shipping 8.2 mt compared to only 7.0 mt in 2012. Cash flows from operations soared 41.8% (to $41.4 million). The company expects to ship a record 28-30 mt in 2013.

To support this growth, Westshore completed a five-year, $100 million upgrade plan at the end of 2012, which raised nominal capacity from 23.5 mt to 33mt. Further significant capacity increases are not considered economic and with this major upgrade behind it, the company can focus on increasing efficiencies and improving the current site. To this end, the board has approved $230 million in further capital expenditures to be completed over the next four to five years. Once completed, the terminals' incremental capacity could increase by as much as 1-3 mt.

Reliable sources

Things seem to be hitting on all cylinders for Westshore, but in order to satisfy the demand for exported Canadian coal, the company requires reliable sources. It has found one in resource giant **Teck Resources** (TSX: TCK.B). Teck is the largest supplier of coal to the terminal and accounted for 57% of the volume during 2012. Teck draws from six different mines to make it the second-largest supplier of seaborne hard coking coal in the world — and a reliable customer.

In addition to the Teck mines, the company also counts global resource company **Sherritt International** and metallurgical coal miner **Grande Cache Coal Corporation** as customers. Sherritt operates the Coal Valley mine located south of Edson, Alberta and the Obed Mountain mine east of Hinton, Alberta. Grande Cache is owned by a joint venture between Asian miner **Winsway Coking Coal Holdings** and Japanese conglomerate **Marubeni**. Grande Cache controls approximately 29,000 hectares in the Smoky River Coalfield in west central Alberta and has been producing on this property since 2004.

More recently, Westshore has expanded its marketing efforts to attract coal from the Powder River Basin in the United States and has found some success. Clients now include U.S. miners **Peabody Energy**, **Cloud Peak Energy**, and **Signal Peak Energy**.

From the mine to the terminal
Transporting coal from the mine to the export terminal can be challenging. In many cases, coal must be transported over long distances to reach the export terminals, and in large quantities to be economical. From an environmental standpoint, it is also important that the coal is properly treated or covered in order to prevent leaving excessive coal dust along the countryside.

Trains are the overwhelming choice to haul large amounts of coal over long distances. Currently the mines located in Canada are served by **Canadian Pacific Railway** and **Canadian National Railway**. Canadian Pacific is responsible for hauling the huge resources from the Teck mines located in southeastern British Columbia. Canadian National brings in the loads primarily originating in Alberta.

There's also an increasing amount of coal being brought in from the Powder River Basin in the U.S. Burlington Northern Santa Fe serves the terminal, hauling coal more than 2,500 kilometers to its destination.

Final thoughts
Westshore seems well-positioned to remain one of the top terminals exporting North American coal. The weakened demand for coal may have actually been a positive for the company, as several planned export terminals along the West Coast of the U.S. were shelved due to poor economics. Proposals still remain to construct coal export terminals in the Pacific Northwest region of the U.S., but these still have a steep hill to climb to get the necessary approvals.

In addition to the use of metallurgical coal to produce the world's steel, the abundant supply of thermal coal as a cheap source of energy should keep demand for seaborne coal growing at a steady clip. In 2011, the total seaborne coal trade exceeded 1 billion tonnes for the first time; it's expected to grow to 2 billion tonnes by 2023.

Most of the demand for Westshore's coal is in Asia. Japan has been the No. 1 buyer of Westshore coal for the past 10 years, but that has changed. While China has been the fastest-growing buyer, South Korea now holds the mantel as the largest buyer.

Westshore also has long-term contracts with the producers it's entered into agreements with over the past two years. These new contracts require volume commitments and provide for more than 80% of the terminals' estimated current capacity through 2021. In addition, much of the variable pricing — based on coal prices — has been eliminated. Prior contracts with Teck, the largest supplier, called for variable loading rates based on the price of coal. Beginning in April 2011, none of the Teck contracts contain variable pricing.

The current strong market position of Westshore and a current dividend yield of 4.6% based on expected payouts make the stock a strong candidate for income-oriented investors.

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Fool contributor Alex Gray does not own shares in any of the companies mentioned at this time. Motley Fool co-founder David Gardner owns shares of Canadian National Railway.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:TECK.B (Teck Resources Limited)
2. TSX:WTE (Westshore Terminals Investment Corporation)

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