

## Will Teck Resources Ltd. Report Strong Fourth-Quarter Earnings?

### Description

Investors are probably wondering when the bad news for diversified miner **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) will end. With a share price that declined 42% in 2014 alone and valuations for the S&P/TSX Diversified Metals & Mining Index in line with the sector bottom of July 2013, downside seems limited if Teck can post strong fourth-quarter earnings this week.

For Q4 2014, analysts are predicting a \$0.22 earnings per share, which would be an increase of 57% over Q3 2014 but a sizable decline from the \$0.46 per share reported in Q4 2013. If Teck can meet or beat earnings estimates, it would likely provide some support for the recent rally in Teck shares from roughly \$13 to \$18 per share since the start of 2015.

### Coal prices have seen a slight improvement

Unfortunately for Teck shareholders, Teck's earnings are deeply tied to the prices of the three major commodities it produces: coal, zinc, and copper. Much of Teck's share price weakness can be attributed to massive declines in the price of metallurgical coal, which is Teck's top product, comprising 47% of gross profit in 2013.

Teck saw metallurgical coal prices fall from a high of US\$300 per ton in 2011 down to US\$110, which was the average price realized in Q3 2014. This decline has been on the back of declining steel production in China as the economy shifts from fixed-asset investments to household consumption.

For Q4 2014, Teck has agreed upon coal prices of US\$119 per ton with the majority of its customers and sales of 6.5 million tons or greater, which is in line with Q3 2014's 6.7 million tons. Assuming Teck can keep costs in line, Teck's coal business should see an improvement over last quarter.

### Copper prices have declined substantially

In Q3 2014, copper contributed about 41% to Teck's gross profit. Teck has been aiming to gain stronger leverage to the zinc and copper markets in order to avoid the weaker coal markets, but this strategy may prove problematic for Teck's Q4 2014 earnings since copper prices have declined substantially since the beginning of the quarter.

In Q3 2014, Teck realized US\$3.17 per pound for copper. Since then, copper prices have declined over \$0.50 and are currently sitting at US\$2.55 per pound. This decline is partially attributed to weakness in the Chinese real estate market as copper is used for wires and pipes.

Currently, Teck estimates that a US\$0.01/lb decline in copper prices will reduce approximately \$5 million from earnings. With this kind of sensitivity, and relatively high cash costs of \$1.60 per pound, the recent decline in copper prices will likely weigh on earnings since it is Teck's second most important product.

## **The weak Canadian dollar and low oil prices can support earnings**

While Teck will experience some weakness from its copper business, there are also tailwinds present from the weak Canadian dollar and low oil prices.

The U.S. dollar is currently trading at a nine-year high, and the dollar has climbed substantially since the beginning of Q4, gaining almost \$0.15. This, in turn, implies a weaker Canadian dollar, which is of great benefit to Teck since its 50% of its operating expenses are in Canadian dollars, and its products are sold in U.S. dollars.

The result is that every \$0.01 change in the Canadian dollar/U.S. dollar exchange rate affects Teck's earnings by \$40 million. With the exchange rate moving in Teck's favour over the course of Q4, this should provide a strong boost to earnings.

In addition to the weak Canadian dollar, low oil prices also provide a major boost to Teck. The company estimates that each US\$1/bbl decline saves \$6 million in operating expenses. Since oil prices have also dropped substantially over the course of Q4, Teck should see substantial cost savings.

### **What does this mean for Q4 earnings?**

Although Teck will likely see weakness from its copper business, the weak Canadian dollar, combined with low oil prices, should work to provide support for earnings. As a result, investors should expect earnings in line with consensus estimates, assuming no unexpected expenses emerge.

### **CATEGORY**

1. Investing
2. Metals and Mining Stocks

### **TICKERS GLOBAL**

1. NYSE:TECK (Teck Resources Limited)
2. TSX:TECK.B (Teck Resources Limited)

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amancini

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