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Is This the Start of a Big Turnaround at Teck Resources Ltd.?

Description

It’s safe to say that **Teck Resources Inc.** (TSX:TCK.B)(NYSE:TCK) has seen better days.

The company has been battered by falling prices for coking coal, which accounted for nearly 40% of revenue last year. Back in 2011 the benchmark price reached US$330, but has now fallen all the way to US$85.

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Of course this has hurt all producers, not just Teck, and some of these companies are now operating at a loss. So, it’s quite clear what the industry needs: big production cuts.

And earlier this week, Teck threw its hat into the ring, announcing 1.5 million in production cuts for the third quarter. Could this be the beginning of a long-awaited turnaround, or the beginning of the end?

Is this a prudent move?

At first glance, Teck’s actions look like a clear negative for the company, with production guidance being cut by 22%. But there are a couple of reasons to like the move.

First of all, it demonstrates some discipline, a nice sign from a company that had a growth-first strategy in years past. As put by CEO Don Lindsay, “Rather than push incremental tonnes into an oversupplied market, we are taking a disciplined approach to managing our mine production in line with market conditions.”

Secondly, Teck is planning to make up the production shortfall by selling more inventory. So, supply contracts will still be met, and cash flow will not take a hit. In fact, lower costs should give a nice boost to the bottom line.

Is this the start of a turnaround?

Don’t count on it. This is a market that remains very oversupplied. According to Mr. Lindsay, the industry still needs to cut about 45 million tons of supply.

And that won't happen quickly, even though over half of seaborne coking coal is "under water." In Australia, easily the biggest coking coal exporter, rigid contracts make it more costly to shut down a mine than operate at a loss.

Furthermore, costs are coming down across the industry. **BHP Billiton Limited**, the number one player, just reported first half unit costs of US$71. So, it has practically no incentive to cut production.

If that wasn't bad enough, new supply is set to come on the market from Australia and Mozambique. This coal ranges in cost from US$50-80 per ton.

Will higher demand bail everyone out? Don't count on that either. In years past, coking coal prices have been propped up by growing Chinese steel production. And that is expected to peak this year or next.

So, if you think Teck is a turnaround story waiting to happen, you're likely going to be disappointed.

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Date
2025/07/22
Date Created
2015/05/29
Author
bensinclair

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