# Should Suncor Energy Inc.'s Recent Acquisition Trigger Alarm Bells for Teck Resources Ltd.?

## Description



Canada's largest integrated energy company, **Suncor Energy Inc.** (TSX:SU)(NYSE:SU), recently boosted its stake in the controversial Fort Hills oil sands project. It acquired an additional 10% of the project from another partner, Total E&P Canada, for $310 million, raising questions about the project's true value.

As a result, a number of questions have been raised about the viability of the project and what this means for troubled coal and base metals miner **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK), which has a 20% stake in Fort Hills.

**Now what?**

Fort Hills has been touted by Teck's management as a core part of its strategy of diversifying its earnings away from metallurgical coal and base metals mining. This has become particularly important with the collapse in metallurgical coal, copper, and zinc prices in recent months, primarily because of China's slowing economy.

The price of crude has also collapsed, and this has left many questioning the viability of Fort Hills. This is because it requires a breakeven price of about US$90 per barrel, yet West Texas Intermediate is trading at roughly half of that price. There is also no end in sight for weak oil prices, with a daily global supply glut of about three million barrels of crude and signs that global oil production will continue to grow.

However, the key issue that has arisen for Teck is that the sale of Total's 10% stake to Suncor for $310 million values Teck's 20% stake in the project at $620 million. This amounts to less than a third of the carrying value of $2.3 billion that Teck had assigned the project on its balance sheet as at the end of the second quarter 2015.

As a result, there is the potential that Teck could write down the value of this asset, which would cause its debt-to-capital ratio to tumble to 32% and potentially jeopardize its debt covenants.

Furthermore, Teck remains committed to making an additional $1.8 billion in capital expenditures to a project that remains uneconomic in the current harsh operating environment for energy companies. This, in conjunction with declining revenues from its core metallurgical coal and copper operations, is placing the company under considerable financial pressure, and sees it being free cash flow negative for the first six months of 2015.

Then you have the $1.1 billion in debt falling due between now and the end of 2017, which places even further stress on its existing financial resources.

**So what?**

While a write-down of the value of its share of the Fort Hills project may not be imminent, the recent sale of Total's 10% share to Suncor indicates that Teck's view of the project may be overly optimistic. I don't expect the economics associated with the project to improve for as long as oil remains weak, which could be for some time to come.

This, along with the pessimistic view associated with commodities including metallurgical coal, copper and zinc, means that there is little to no upside for Teck's share price for the foreseeable future.



**CATEGORY**

1. Investing
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1. NYSE:SU (Suncor Energy Inc.)
2. NYSE:TECK (Teck Resources Limited)
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