How Teck Resources Ltd. Is Avoiding Disaster

Description

It would not be incorrect to say that **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) is in survival mode. Coking coal prices have plunged from $300 per tonne in 2011 to $74 per tonne this week, and several U.S. coal miners, including Alpha Natural Resources and Walter Energy, have filed for bankruptcy recently.

This is also good news though because low prices force supply out of the market. Wood Mackenzie estimates that 65% of global coal is currently operating at a cash loss. Another year of loss-making production will result in further supply cuts, which leads many analysts to suggest that a bottom for prices is near.

Fortunately for Teck, the company has positioned itself very well to survive any further weakness and benefit from upside when the market strengthens, just as it did in 2008. Here is how Teck has been weathering the current weakness and how it plans to weather future weakness.

1. Cuts to operating and capital expenses as well as dividends

Teck has been very successful in bringing down its costs along with falling prices. As of Q3 2015, Teck had costs in U.S. dollar terms of $64 per tonne. This is a reduction of $20 per tonne from the same quarter last year and is thanks to Teck's cost-reduction program, lower fuel prices, and increased weakness in the Canadian dollar.

This would mean that at current coking coal prices of US$74 per tonne, Teck is cash positive. It also means that Teck has some of the most competitive costs in the industry. Currently, Teck is on the low end of the cost curve, with costs that are competitive with low-cost Australian and Russian producers.

Since the Q3 report was released, Teck made moves to further reduce operating costs, announcing that it would be cutting operating costs by $300 million in 2015, which includes a round of 1,000 layoffs. This combined with a weak loonie and lower oil prices should bring down Teck's cost basis even more.

In addition to this, Teck is cutting its capital expenses by $350 million and has also slashed its dividend, which should save $115 million annually. These changes should help Teck to keep free cash flow losses to a minimum.

2. Teck has made streaming deals and has options to sell assets

One way that Teck has strengthened its balance sheet and raised cash has been through streaming deals. A streaming deal refers to a miner selling future production of precious metals for a lump-sum payment. Teck made two of these deals this year, raising a total of about $1 billion in cash.

This increase in cash was important for Teck, as it allowed Teck to pay off $400 million in debt that was due in October. It also allowed Teck to end the year with a strong cash position, despite the fact that the company had a major free cash flow loss due to low prices, high capital expenditures, and debt that was due.

Should weak prices continue, Teck has options. For example, the company could enter into another streaming deal for its Red Dog operation, which could raise half a billion or more in additional cash.

Teck also has options to sell assets. Teck has infrastructure it could sell, such as its ownership in terminals, dams, wind turbines, and water treatment plants. Teck could also sell projects that are in development.

3. Teck has a strong balance sheet

As a result of these cost-reducing and cash-raising moves, Teck currently has a strong balance sheet. Teck plans to end the year with $1.8 billion in cash, down only $200 million from where it started the year. This cash position will help Teck weather the downturn and, as previously mentioned, Teck has plenty of options to boost its cash position.

If necessary, Teck has $5.8 billion of available credit lines to draw on.

CATEGORY

1. Investing

TICKERS GLOBAL

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

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