Teck Resources Ltd.’s Profits Nearly Triple in Q3

Description

Teck Resources Ltd. (TSX:TECK.B)(NYSE:TECK) saw its share drop 7% on Thursday, as the company released third-quarter earnings, which failed to impress investors and also forecast weaker coal prices for Q4. Despite posting adjusted earnings per share of $1.08 in Q3, those results fell short of the $1.19 per-share earnings that were expected by analysts.

Revenue of $3.1 billion was also up 36% from last year when Teck Resources posted sales of $2.3 billion.

I’ll have a closer look at whether or not these results make Teck Resources a buy today, despite the earnings miss.

The company sets records as commodity prices continue to rise

Commodity prices have been strong this year and assisted in the company’s improved Q3 earnings, and we saw a similar effect in Q2. In its earnings release, the company noted that “third-quarter prices for steelmaking coal, copper, and zinc rose by 73%, 33% and 31%, respectively, compared with the same period a year ago.”

Even over the past 12 months, steelmaking coal prices have averaged US$185, while the company notes that “the realized steelmaking coal price for the past 10 years has averaged US$164 per tonne, or US$180 on an inflation-adjusted basis.”

Steelmaking coal sales drive the company’s top-line growth

In Q3, the company’s steelmaking coal revenues of $1.5 billion were nearly double the $868 million that Teck Resources posted a year ago. Quarterly sales for steelmaking coal were also the second highest ever with 7.5 million tonnes sold — an increase of 4% from 2016.

The higher commodity prices also enabled steelmaking coal to see its gross profit (before depreciation) to reach 56% this quarter compared to just 35% a year ago.

Other segments have shown strong sales growth as well

Copper-related revenue was up 20% this quarter, despite a year-over-year decline in the amount of copper sold as higher prices more than offset the 11% drop. Zinc saw a similar story with higher prices pushing its sales up 10%, despite volumes being down from the previous year.

Profits more than doubled due to a strong gross margin

Gross profit of just under $1.1 billion for the quarter was more than double the $452 million the company posted a year ago. As a percentage of revenue, gross margins of 20% in 2016 rose to 35% this past quarter.

With low operating expenses, the company was able to see much of the improved gross profit flow through to pre-tax income, with just 12% being eroded away by administrative costs and other indirect expenses. Income before tax was up 176% year over year and was 31% of revenue compared to just 15% a year ago.

Is the stock a buy?

Teck Resources has done an excellent job this year of growing sales and profits, but the results could easily be in reverse without the strength of rising commodity prices. This is the biggest risk to investors, and it's all the more important that the company minimize its overall risk by bringing debt levels down, as it did in Q1.

Although the company didn't have a big pay down of debt this quarter, year over year its debt has dropped more than $2 billion, or 26%. As a result, even if commodity prices were to fall, Teck Resources would be in a good position to weather the storm and would also be able to continue to capitalize if prices remain strong.

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Date
2025/08/20
Date Created
2017/10/27
Author
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