Will Teck Resources Ltd (TSX:TECK.B) Go Bankrupt in 2019?

Description

Teck Resources Ltd (TSX:TECK.B)(NYSE:TECK) has been the subject of bankruptcy rumors twice over the past decade, and each time the risk of insolvency was very real.

In 2008, shares fell from $50 to just $5 in under six months. The global financial crisis threatened to bring down any company with too much leverage. When the markets snapped back, Teck Resources was able to shore up its balance sheet in dramatic fashion. Avoiding bankruptcy caused the stock to rebound to an all-time high of roughly $60 a little more than a year later.

But the glory days didn't last. By 2016, shares were back to $5. Weak commodity prices combined with a slowing China pushed zinc, copper, and coal producers to the brink. Yet short-sellers were fleeced yet again as shares rebounded to more than $30 over the next 12 months.

Today, Teck Resources appears to be doing well. In 2018, the company had ample liquidity, solid cash flows, and exciting growth opportunities in its energy and copper businesses. But as the past suggests, the company can go from hero to zero in the blink of an eye. Is 2019 finally the year Tech Resources goes under?

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This is not the old Teck Resources

Over the past decade, most bankruptcy fears revolved around Teck's inability to pay off its crushing debt loads. Operating in extremely volatile commodities like coal ensured these fears would resurface continually, even if there were multi-year gaps in between.

For example, in November of 2016, steelmaking coal prices hit $300 per ton. By February, prices had plummeted to just $150 per tonne. Yet in April, prices skyrocketed yet again, back to $300 per ton, only to fall to $140 per tonne by July. These extremes are constants for Teck Resources, yet historically, it's overextended itself repeatedly. And that's too bad, because over the long term, there's plenty of money to be made.

The average selling price over the past 10 years is around $180 per ton, or closer to $190 per ton if you adjust for inflation. That leaves plenty of room to make a profit. But if your balance sheet can't withstand the shocks, it becomes impossible to ride out the storm and make attractive returns over the long run. For a while, it looked like the company's management team had finally learned its lesson.

Currently, the company has more than $5 billion in liquidity, with no major debt maturities until 2024, when it must repay a $600 million loan. Just using its cash on hand, the company could pay back all of its loans until 2035! Surviving the next crisis shouldn't be difficult if management sticks with its current strategy.

Beware periods of exuberance

While it’s usually exciting to see a company buy back stock or pay a dividend, it is a bit concerning with Teck Resources, as these funds can’t be recouped easily once distributed. Currently, the company is authorized to repurchase 40 million shares through October of 2019. This equates to $1.2 billion, nearly 10% of the entire company. The company also announced a $0.15 per share dividend to be paid in December of 2018. This move costs the company more than $80 million per quarter.

In all, bankruptcy appears unlikely for Tech Resources in 2019. Judging by its liquidity and debt maturities, it would take a perfect storm to turn the company insolvent. But it appears that management is making the same long-term mistakes that it’s made so often in the past. While the financials looks solid now, big share buybacks and dividend payments could reverse this quickly. Buy and hold investors beware.

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