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Teck Resources Limited (TECK)

Q3 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. Welcome to Teck's Third Quarter 2022 Earnings Release Conference Call. At this time, all participants are in listen-only mode. Later, we will conduct a question-and-answer session. [Operator Instructions] This conference call is being recorded today, Thursday, October 27, 2022.

I would now like to turn the conference over to Fraser Phillips, Senior Vice President, Investor Relations and Strategic Analysis. Please go ahead.

H. Fraser Phillips

Senior Vice President, Investor Relations & Strategic Analysis, Teck Resources Limited

Thanks, Ariel. Good morning, everyone, and thank you for joining us for Teck's third quarter 2022 results conference call. Please note today's call contains forward-looking statements. Various risks and uncertainties may cause actual results to vary. Teck does not assume the obligation to update any forward-looking statements. Please refer to slide 2 for the assumptions underlying our forward-looking statements.

In addition, we will reference various non-GAAP measures throughout this call. Explanations and reconciliations regarding these measures can be found in our MD&A and the latest press release on our website.

Jonathan Price, our CEO, will begin today's call with comments on the strategic focus and priorities. Red Conger, our President and Chief Operating Officer, will follow with operational highlights from the quarter, including a progress update on our flagship QB2 copper growth project in Chile. Crystal Prystai, our Interim CFO, will then provide additional color on financial and operational highlights. We will conclude today's session with a question-and-answer period to address any remaining questions.

With that, I'll turn the call over to Jonathan.

Jonathan Price

Chief Executive Officer & Director, Teck Resources Limited

Thank you, Fraser and good morning, everyone. It's a pleasure to address you today as the CEO of Teck. I'm excited by the opportunities ahead for Teck to build on our existing strong foundation and position the company for long term success. In recent meetings with investors, I've been asked whether they should expect any changes to Teck strategy as I assume the role of CEO. Having been part of the development and articulation of Teck strategy for the past few years, I can confidently say our current strategy is the right one to drive long-term sustainable shareholder value.

Now turning to slide 4, the half of our strategy is copper growth. We remain focused on generating value from our industry leading copper growth profile. QB2 will double our consolidated copper production when it reaches full production next year. And together with the remainder of our portfolio of attractive growth options has the potential to add 5 times the amount of our current copper equivalent production.

Secondly, we are rebalancing our portfolio of high-quality assets towards low-carbon metals, in particular copper where demand is expected to double by 2050 driven in large part by electrification and the low-carbon transition. We intend to capitalize on this market reducing the proportion of carbon in our overall portfolio.

Third, as we have demonstrated this year, we will balance our investment in growth against returning capital to our shareholders while maintaining a strong balance sheet. To this end, I remain fully committed to our capital allocation framework. By growing responsibly, I believe we can strike the right balance between growth and cash returns to shareholders, while ensuring we are well-positioned to weather periods of market uncertainty and volatility.

And finally, we will continue to build on our strong sustainability track record. Sustainability is core to our purpose and values, and we view it as a competitive advantage. Sustainability will continue to be fully integrated into our activities and business processes at all levels of our organization. Together with the entire Teck team, we are focused on the execution of this strategy as we navigate a backdrop of global economic uncertainty.

Now recently, I've also been asked by investors about my priorities as CEO. As outlined on slide 5, my top priority is to continue to advance our long-term copper growth strategy. Our immediate priority is completion and ramp-up of the QB2 project as we build capacity in the organization to advance our suite of high quality copper projects. In doing so, we will rebalance our portfolio to low-carbon metals and reduce the overall proportion of carbon in our portfolio.

Second, we remain laser-focused on operational excellence, including through the deployment of autonomy and digital technologies.

And finally, we're committed to maintaining our industry-leading sustainability performance as we work to deliver on our short and long-term targets. And collectively, these priorities will position us to meet growing demand for copper driven by the global net zero transition while returning significant capital to our shareholders.

Now to that end, we executed on a number of important transactions in the quarter. On July 20, we announced an agreement with PolyMet in which Glencore retains a majority equity interest to advance their NorthMet project and our Mesaba mineral deposit in Minnesota. And on September 16, we announced an agreement with Agnico Eagle to advance our San Nicolás copper-zinc project in Zacatecas, Mexico. Agnico Eagle will subscribe for the first $580 million of shares in the Teck subsidiary [indiscernible] (00:06:10) San Nicolás giving Agnico Eagle a 50% effective interest in San Nicolás. Together, these transactions derisk our positions, provide a pathway to development and will crystallize significant value from our copper growth pipeline.

Closing is subject to customary closing conditions including receipt of regulatory approvals. Further, just yesterday we announced an agreement to sell our 21.3% interest in Fort Hills to Suncor, the gross proceeds of approximately CAD 1 billion in cash. The sale of our energy assets advances our strategy of pursuing industry-leading copper growth and rebalancing our portfolio of high quality assets to low carbon metals. It is the culmination of an extensive process we undertook to evaluate all options to realize the highest value for our shareholders.

The transaction value is consistent with the current outlook for the Fort Hills business reflected in the most recent in-depth review conducted by Suncor and the resulting long range plan for the project and is in line with comparable transactions. As a result of the sales agreement, we recorded an after-tax non-cash impairment charge of approximately CAD 950 million in the third quarter. We will review the use of proceeds in accordance with our capital allocation framework in February of 2023. The sale agreement will be effective November 1. Closing is subject to customary conditions including the receipt of regulatory approvals.

Now turning to our third quarter results starting with key highlights on slide 6. Overall, our third quarter financial results remained strong, primarily due to the continued strength in commodity prices, despite the overall economic slowdown. Gross profit before depreciation and amortization was CAD 2.4 billion, a meaningful increase from CAD 2.1 billion in Q3 of 2021. Adjusted EBITDA was CAD 1.9 billion and adjusted profit attributable to shareholders was CAD 923 million or CAD 1.74 per share on a diluted basis.

Year-to-date, we have returned CAD 1.4 billion to shareholders through buybacks and CAD 468 million through dividends, all the while paying down CAD 1.2 billion of our debt outstanding. During the quarter, we achieved a number of important milestones of QB2, including commissioning of our power transmission system, significantly advancing commissioning of the desalination plant and beginning pre-operational testing of the Line 1 grinding mills, all of which are on the critical path for first copper. Subsequent to the quarter, we announced plans to deploy two electric tugboats at our Neptune Terminal. Collaborating with transportation providers to develop green transportation corridors is part of our climate action strategy and supports our goal of net zero emissions by 2050.

Crystal will provide a detailed run through of our business performance and guidance updates in a few minutes. However, I want to highlight three key changes on slide 8. First, for QB2, we have revised our construction capital cost guidance to $7.4 billion to $7.75 billion based on our current foreign exchange assumptions, cost pressures related to weather and subsurface conditions and other factors. This is an increase from our prior guidance of $6.9 billion to $7 billion.

We continue to target first copper from Line 1 late this year. However, if productivity impacts persist, this will be delayed into January 2023. First copper production is part of the continuous commissioning plan for mechanical completion of Line 1, which will be followed by mechanical completion of Line 2 and ramp up through 2023.

Quebrada Blanca copper production is expected to ramp up over 2023 following commissioning of QB2. We now expect QB copper production to range between 170,000 and 300,000 tonnes per year in 2023 to 2025, compared with the previous range of 245,000 to 300,000 tonnes per year, with 2023 at the lower end of the guidance range.

Second, to steelmaking coal, we have updated our three year production guidance. Our steelmaking coal production capacity across our four operating mines in the Elk Valley is approximately 26 million to 27 million tonnes, and we had operated at those levels for most of the period between 2014 and 2019. However, over the past three years, external challenges largely out of our control and more recently, reliability challenges at our Elkview plant have impacted our ability to operate at those levels. These challenges include severe weather-related events, including rain, flooding, extreme cold and wildfire events in 2021, as well as the COVID pandemic and the associated ongoing disruption to supply chains and labor availability.

As a result, to better reflect the increasing frequency of these adverse events and associated risk of impacts to our operations, we have reduced our three-year production guidance commencing in 2023 to 25 million to 26 million tonnes from 26 million to 27 million tonnes previously.

Third and finally, our outlook for 2023 CapEx. While we continue to expect our capital expenditures for 2023 to be lower than 2022, with the increase in QB2 capital guidance and continued inflationary pressures, we no longer anticipate a reduction of CAD 2 billion as compared to 2022 projected spending levels. We will issue our 2023 capital expenditure guidance in February as usual.

Overall, thanks to our resilience and financial strength, we remain well-positioned to manage through any near-term pressures while staying focused on our copper growth strategy.

With that, I will now pass it over to Red to provide some operational highlights from the third quarter.

Harry M. Conger

President, Chief Operating Officer & Director, Teck Resources Limited

Thank you, Jonathan. It's a pleasure to address you today as President and COO of Teck. I want to give you an update today on the unplanned – planned outage at Elkview, the inflationary pressures that we're seeing and what we're doing about them, building organizational capacity to deliver on our copper growth strategy and our progress at QB2 including a photo tour.

Moving to slide 10, we announced a structural failure of plant conveyor belt on September 20. While this has halted steelmaking coal processing at the site, mining activities have continued. Most importantly, there were no injuries as a result of this incident. A multi-disciplinary team has been assembled from across the organization and we have some of our best people working 24/7 on this [indiscernible] (00:13:48). We are well on our way to getting this plant back up and running.

[indiscernible] (00:13:53) and supports is complete and access has been reinstated to all areas of the plant. We have substantially completed the sourcing of materials and labor to conduct the replacement. The team was able to source suitable prefabricated conveyor tube sections and all tube sections have now been transported to a fabrication shop in Montana and are undergoing the necessary modifications.

Delivery of the ore conveyor tube and support components is on schedule to take place over the next two weeks and we are on schedule and plan to complete commissioning and restart production at the plant in late November. We continue to estimate the impact of steelmaking coal production to be a reduction of approximately 1.5 million tonnes in 2022.

Moving to slide 11, like others in the industry we continue to operate in a period of uncertainty. Across the business, inflationary pressures have increased our operating costs by 14% compared to the same period last year, with similar and persistent pressures on our capital costs. While the rate of inflation appears to be slowing, we continue to experience significant inflation [ph] in the products (00:15:11) of many of our key supplies when compared to the same period last year. Increases in the cost of key supplies, including mining equipment, explosives, grinding media are being driven largely by price increases for underlying commodities such as steel, crude oil and natural gas, as well as rate increases for labor and transportation. While our underlying mining drivers remain relatively stable, inflationary pressures on diesel prices and other key input costs have increased our unit cost.

As we adapt to higher input prices, we're extremely focused on managing our controllable cost. We've realized tangible results today from our continuous improvement and RACE programs reducing unit cost, increasing productivity in the mines and our processing plants across our business.

At our mines, we have successfully driven efficiencies through load and haul improvement initiatives, predictive maintenance initiatives by utilizing equipment sensors to reduce equipment downtime and operational interruptions and cost savings initiatives related to our drill and blast operations.

From a logistical perspective, digital planning applications [indiscernible] (00:16:32) operations with logistics teams that reduce costs and maximize throughput between Teck steelmaking coal operations and our Neptune Terminal. In addition, automated train loading at Fording River has increased loading per car by 2% and loading speed by 40%. Going forward, we will continue to drive further improvements which will enable us to achieve our current and future production targets, reduce the impact of inflationary cost pressures and help keep our cost structurally stable for the long term.

Turning to slide number 12, as we actively progress work to realize value from our suite of copper growth projects, we are building organizational capacity ahead of the next wave of product delivery. To that end, we appointed Tyler Mitchelson as our Senior Vice President, Copper Growth, effective July 4. Tyler reports directly to me [indiscernible] (00:17:34) to Nick Hooper, our Senior Vice President of Corporate Development and Exploration. In this new role, Tyler has broad responsibility over the execution of Teck's worldwide copper development. He's responsible for prioritizing project execution, construction and commissioning of our copper growth assets as well as the expansion or mine life extension of existing operations. This new role and the experience that Tyler brings to it will be a key enabler to advance our copper growth strategy.

Turning to an update on QB2 starting on slide 13, we're very proud of the steady progress we have made through the quarter and remain focused on system completion and handover. In terms of key milestones achieved, we have completed commissioning of the 220 kV transmission system and final testing of the main substation switchgear at the concentrator. In terms of water, we are well advanced in commissioning of the pre-treatment area and pre-ops testing of the reverse osmosis units in the desalinization plant, and we have completed the hydro testing of the water supply pipeline and the water pump station, which is no small accomplishment. 156 kilometers of pipeline have now been all hydro tested.

At the mine area, all sub-systems for Ball Mill No. 1 and SAG Mill No. 1 are in pre-operational testing and we have completed the ore stockpile dome, installation of all the in-plant conveyor belts and the 12 kilometer long tailings launder.

Given the delay in completion of the jetty and shiploader seen here on the right, alternate concentrate shipping arrangements are well advanced as a temporary measure until the shiploader is commissioned. As Jonathan noted earlier, we have updated our capital cost guidance for the project and we continue to target first copper from Line 1 in the latter part of this year, followed by completion of Line 2 and ramp up through 2023.

On slide 14, you see the pre-treatment tanks at the desalinization plant where we continue the commissioning process.

Slide 15 shows the overland conveyor that will transport ore from the primary crusher to the stockpile of the concentrator. Installation and splicing of the belts was completed during this last quarter.

Slide 16 shows the concentrator area where the ore stacker is in the foreground with the stockpile dome then with the mill building and the grinding lines there on the left.

Slide 17 shows the grinding mills themselves. As we mentioned previously, all sub-systems for Ball Mill No. 1 and SAG Mill No. 1 are in pre-operational testing.

Slide 18 shows the flotation area of the concentrator where we're focused on completing the piping and electrical systems.

On slide 19, you can see the concentrate thickeners which are undergoing hydrotesting as part of the pre-operational works.

Slide 20 shows the tailing launder that goes out to the tailings storage facility. 12 kilometers of that launder have now been completed and are ready to be used.

So in summary, we continue to be very pleased with the progress we're making and are excited about building on our construction and commissioning success today with a focus on delivering to the project's key milestones. I encourage you to visit the Investors section of our website to watch the latest progress video and view the most recent photo gallery.

I'll now pass it over to Crystal for additional color on financial and operating highlights.

Crystal Prystai

Interim Chief Financial Officer, Teck Resources Limited

Thank you, Red. We've outlined the key drivers for our profitability in the third quarter on slide 22, including our adjusted EBITDA of CAD 1.9 billion in the quarter. The inflationary cost pressures discussed by Red increased our Q3 operating costs by 14% compared to last year. Approximately half of the increase relate to diesel costs at our operations and in our transportation costs.

The primary cost increases are not related to key mining drivers such as mine productivity and strip ratio, which remain relatively stable. In fact, looking at the items that were under our control during the quarter, including production and operating costs, we generated a net positive impact on adjusted EBITDA compared to Q3 of 2021. We expect inflationary pressures on diesel prices and other key input costs, as well as profit based compensation and royalties to continue to put upward pressure on our unit cost guidance through the balance of the year and into next year and on our capital costs into next year.

Turning now to our operations and starting with our copper business unit on slide 23. Gross profit in the third quarter decreased by 50% compared to last year, primarily driven by an 18% decline in realized copper prices and a 9,000 tonne reduction in sales volumes resulting from the timing of shipments. Realized copper prices decreased to $3.49 per pound from $4.28 per pound last year, but remain above historic averages. Production decreased by 6% to 66,000 tonnes compared to last year, primarily due to a significant precipitation event in July that reduced production at Carmen de Andacollo. This was partially offset by higher production from Antamina due to higher mill throughput.

Total cash unit costs increased by CAD 0.28 to $1.96 per pound. This was primarily driven by higher consumables costs, particularly diesel, maintenance and repair costs and contractor expenses. Looking forward, our 2022 copper production guidance remains unchanged. We've reduced our three-year Highland Valley Copper production guidance range to 110,000 to 170,000 tonnes per year as a result of delayed pre-stripping in the Lornex pit, which reflects maintenance related issues and high rates of absenteeism, particularly in the skilled trades. Our 2022 net cash unit cost guidance for copper remains unchanged.

Moving now to our zinc business unit on slide 24. Gross profit increased by 9% from last year to CAD 311 million. The increase was primarily driven by higher zinc prices and a 45% increase in zinc and concentrate sales volumes, which was partially offset by higher unit operating costs at our Red Dog operations. In the quarter, zinc concentrate production increased by 34% at Red Dog due to increased mill throughput and higher zinc grades. The 13% decrease in Q3 refined zinc production at our Trail operation reflects major work underway to replace the KIVCET furnace hearth and zinc roaster dome. We expect the maintenance work, which started in September, to be completed in November.

Finally, total cash unit costs in our zinc business unit increased by CAD 0.08 to CAD 0.64 per pound. This increase is reflective of higher diesel and consumable costs, transportation costs, as well as smelter processing charges. As we look forward, we have reduced our refined zinc production guidance to 257,000 to 276,000 tonnes due to extended planned maintenance and lower than planned production through the year. We expect Red Dog zinc and concentrate sales of 130,000 to 150,000 tonnes in Q4. Our 2022 net cash unit cost guidance for zinc remains unchanged.

Turning now to slide 25. Our steelmaking coal business unit delivered another strong quarter with gross profit increasing by 37% to CAD 1.2 billion compared with CAD 901 million last year. The increase was primarily driven by higher steelmaking coal prices and was partially offset by the effect of lower production and sales volumes and increased unit operating costs due to inflationary pressures. Notwithstanding a decline of 33% from the second quarter of this year, realized steelmaking coal prices increased by 28% to $304 per tonne compared to last year.

FOB Australia price assessments for steelmaking coal averaged $287 per tonne in the third quarter after a record high of $527 per tonne in Q2 of this year. Sales to our customers in China are based on the CFR China price, which averaged $310 per tonne. Third quarter, steelmaking coal production decreased by 5% to 5.7 million tonnes compared to last year. The decrease was primarily driven by the Elkview plant outage outlined by Red earlier.

Sales volumes decreased by 5% to 5.6 million tonnes, which was within our disclosed guidance range. The decrease was driven by the impact of the Elkview plant outage and the recently resolved labor disruption at Westshore terminal. Our significant investment in the Neptune port materially reduced the impact that the Westshore terminal shutdown would otherwise have had on our Q3 steelmaking coal sales volumes. Neptune operated at design capacity in the month of September.

Compared to last year, adjusted site cash cost of sales increased by 46% to CAD 92 per tonne from CAD 63 per tonne due to lower production and inflationary cost pressures across all major operating cost input categories. A 30% increase in the WTI oil price accounted for 24% of our cost increase year-over-year. And finally, transportation cost increased to CAD 48 per tonne from CAD 46 per tonne last year due to higher rail fuel surcharges and partially offset by lower demurrage costs.

As we look forward, the Elkview outage is expected to impact production and sales in the fourth quarter. Our 2022 steelmaking coal production guidance has been decreased to 22 million to 22.5 million tonnes from 23.5 million to 24 million tonnes as we expect Q4 sales of 5 million to 5.4 million tonnes. The Elkview plant outage is also expected to impact our site and transportation costs. We expect upward pressure on our full year guidance for adjusted site cash cost of sales of CAD 87 to CAD 92 per tonne and we increased our transportation cost guidance to CAD 46 to CAD 49 per tonne due to the expected impact on volumes and demurrage costs. The Elkview plant is expected to restart production in late November and opportunistic plant maintenance is being completed during the outage.

Turning now to slide 26, our energy business unit delivered gross profit of CAD 84 million in the quarter, up from a loss of CAD 28 million a year ago. The increase was driven by significantly higher WCS prices, increased sales volumes and lower unit operating cost as a result of two-train production rates. As Jonathan noted earlier, we announced the sale of our interest in Fort Hills for gross proceeds of approximately CAD 1 billion in cash and recorded an after-tax non-cash impairment charge of approximately CAD 950 million in Q3. The sale agreement is expected to be effective November 1 and is subject to customary closing conditions and regulatory approvals. Our interest in Fort Hills will be reported as a discontinued operation beginning in the fourth quarter of 2022.

Slide 27 outlines our updated guidance for capital investments. As a result of the revised QB2 capital cost guidance, we increased our 2022 capital guidance by CAD 100 million to CAD 200 million. And as Jonathan noted earlier, while we continue to expect our capital expenditures for 2023 to be lower than 2022, we no longer expect a reduction of CAD 2 billion given the increase in QB2 capital and continued inflationary pressures across our business.

Looking now at slide 28, we continue to maintain our strong financial position. We currently have CAD 8.3 billion of liquidity, including CAD 2.9 billion of cash and an undrawn $4 billion sustainability linked revolving credit facility. We have a net debt to adjusted EBITDA ratio of 0.5 times. Investment grade credit ratings from all four credit rating agencies and no major debt maturities prior to 2030. We are very confident in our ability to complete QB2 while successfully weathering this period of macroeconomic uncertainty given our balance sheet strength. And adhering to our disciplined capital allocation framework, Teck continues to uphold our track record of significant cash returns to shareholders, as demonstrated by strong returns in the third quarter.

With that, I'll turn it back to Jonathan for closing comments.

Jonathan Price

Chief Executive Officer & Director, Teck Resources Limited

Thank you, Crystal. Our continued investment in resource developments and acquisitions has resulted in an outstanding copper growth pipeline which is something that many of our peers simply do not have.

Turning to slide 30, we have updated our copper growth pipeline to reflect recently announced transactions, which is subject to customary closing conditions, including receipts of regulatory approvals. Cumulatively, these projects have the potential to add new copper equivalent production of more than 1.5 million tonnes per year.

QB2 is the first step in our transformational copper growth. The next phase of development of QB will be the Quebrada Blanca and mill expansion. The QBME feasibility study, including all environmental baseline activities, is expected to be completed in 2023. QBME is expected to be a significant contributor to our near-term copper growth portfolio with first production targeted for 2026. We're also continuing to progress our other copper growth projects.

At the NorthMet project, updated feasibility and detailed engineering is underway. At San Nicolás, we are targeting completion of the feasibility study work in Q1 2024 and first production in late 2026. And at Zafranal, a feasibility study was completed in mid-2019 and we are in the final stage of the permitting process. We will continue advancing Zafranal on a path to realizing value in 2023.

In closing, Teck is well-positioned to drive long-term sustainable shareholder value. There are meaningful opportunities ahead as global growth and the transition to a lower carbon economy drive new copper metal demand and we have a portfolio of high quality copper growth options that is the envy of our peers.

As we move forward, we'll continue to rebalance our portfolio to copper while reducing the proportion of carbon in our overall business. We will continue to follow our rigorous capital allocation framework, balancing growth and cash returns to shareholders.

At the same time, we will maintain our leadership in responsible resource development, drive best practices in sustainability, and sharing the benefits of mining with our stakeholders. This is consistent with Teck's purpose and the very core of our strategy and vision, setting us up for an incredibly exciting future.

Thank you. I will now turn the call back over to Fraser.

H. Fraser Phillips

Senior Vice President, Investor Relations & Strategic Analysis, Teck Resources Limited

Thanks, Jonathan. Just before we go to Q&A, I just wanted to note for everyone if we don't happen to get time on the call today, we have a fair amount of time left. If we don't happen to get to your question, we're available, myself and my team afterwards for any follow ups that are required.

With that, then, Ariel, I'll just hand it over to you to conduct question and answers. Thanks.

QUESTION AND ANSWER SECTION

Operator: Certainly. [Operator Instructions] The first question comes from Greg Barnes of TD Securities. Please go ahead.

Greg Barnes
Analyst, TD Securities, Inc.

Q

Yeah. Thank you. Jonathan, I just want to get a better handle on CapEx going forward, obviously, with the higher CapEx for QB2 coming into 2023. Sustaining capital, given the inflationary pressures that you've experienced over the past year or so. Should we be looking at a number that's somewhere between or as high as CAD 2 billion on sustaining capital in Canadian dollar terms?

Jonathan Price
Chief Executive Officer & Director, Teck Resources Limited

A

Thanks, Greg, for the question. I'll hand over to Crystal in a moment just to provide some more detail. Generally speaking, we discussed previously the stepdown of CAD 2 billion from circa just above CAD 5 billion to just above CAD 3 billion. Clearly, from the updated guidance we've given you for QB2, there's more capital to be spent in 2023 now on that project specifically.

To your question on inflation, broadly the same factors that have been driving inflation in our unit costs are driving inflation within our sustaining capital costs. These are the sort of factors that would be fuel, for example, or labor related, where that goes to sort of profit linked costs. But let me just hand to Crystal to see if she has anything to add on our expectations for CapEx, which, as we said, we will guide to in the normal course in early 2023.

Crystal Prystai
Interim Chief Financial Officer, Teck Resources Limited

A

Thank you, Greg, for your question. As Jonathan mentioned, we are working towards our guidance in February consistent with our normal practices, and we are still making our way through our budgeting process. So I can't answer your specific question on where sustaining capital will be in 2023, but I can say across our capital portfolio for expenditures, we are still expecting it to be lower than where we came in for 2022, but we'll have to wait until we've finalized our guidance in February.

Greg Barnes
Analyst, TD Securities, Inc.

Q

Okay. I thought I'd give it a try. Just as a follow on, again, Jonathan, on the coal business, the reduction in the three-year guidance to 25 million to 26 million tonnes. So have you permanently lost the ability to get to 26 million to 27 million tonnes given all of the issues you've outlined in the M&A? Or do you think you can get back to that level at some point?

Jonathan Price
Chief Executive Officer & Director, Teck Resources Limited

A

So the – certainly the plant and the mines are capable of achieving 26 million to 27 million tonnes. However, as mentioned over recent years, we've had a series of events, many of them external factors, which have caused this to produce below that level. And therefore, from a planning perspective and to assist the market in understanding a reasonable outlook for production expectations, we've started to factor that in to how we think about this business. Now, if you had a year absent any sort of external events, then the 26 million to 27 million tonnes per annum remains achievable. But what I'll do is just hand over to Robin Sheremeta, the President of our coal business. He'll just give you a little bit more color on some of the factors that we've included in our thinking here and why we've decided to guide future production in the way we have.

Robin B. Sheremeta
Senior Vice President, Coal, Teck Resources Limited

A

Thanks, Jonathan. Just, Greg, kind of I'll walk you back through, say, the last three years, because I think it kind of gives you a sense of where we're at and may be why that opportunity is not lost. But if you go back to 2020, obviously over 2019 was the headliner through that year that we went through all the different issues with that. At the same time, we had a couple of environmental events. And really in 2020 was the start of what became higher absenteeism in the operations due to COVID and due to some of the steps we had taken.

In 2021, we had a lot of mitigation steps in place for COVID-19. We actually saw a strong rebound in our production and logistics performance compared to 2020, despite having continued high absenteeism, which we also still have today. And so we were able to drive inventories down. We got our store plant capacity prioritized and we actually took advantage of a good, strong market. And then we got taken out by the wildfire events in the summer, which took out logistics and caused small production curtailments. Then we're just recovering from the wildfires through the summer and we got hit with the atmospheric river rain and flooding events in November. And that again caused logistics and inventory related production impacts. So those two years were fraught with things well out of our control.

Coming into 2022, we ended up starting the year with maximum inventories again due to the rain event. And then early in the year we had extreme freezing that caused additional production challenges. So we didn't get a strong start to the year. Now fortunately for the most part the remaining year has been less eventful from an environmental perspective, but we do continue to have challenges with labor. We're still trying to rebuild from two years of pandemic and we're still trying to establish levels that help offset that. So that takes time. It takes time to train people, to attract people to the operations. And I will say we're seeing considerable improvement in that over the last couple of months. So I'm getting more and more confident that we're able to rebuild the capacity that we had before, so.

And this latest issue with the Elkview plant, it's a one-off incident, we'll get through it. The team is working really hard to get that plant back. We've got most of the difficult pieces of the reconstruction, I guess, behind us. The foundations are going in now and we've got some of the new tube arriving. So all that remains on track and we should be back in good shape by the end of the month. So if you take all these things into account, many of which are pandemic related, we felt it was important to recommend a range that was more reflective of some of the uncertainty that happens around environmental conditions and things like that. If we have a year where the world doesn't conspire against us, I think we would be quite confident in hitting that upper – our historical levels of production. So the plants are capable, it's just a matter of having a bit of luck on our side, I guess.

Greg Barnes
Analyst, TD Securities, Inc.

Q

Okay. Great. Thanks, Robin. I'll pass it on.

Operator: Our next question comes from Orest Wowkodaw with Scotiabank. Please go ahead.

Orest Wowkodaw
Analyst, Scotia Capital, Inc.

Q

Hi. Thank you. Jonathan, your number two priority seems to be rebalancing the portfolio to low carbon metals. I'm wondering if that if your strategy there is solely around growing the copper business and i.e. diluting the coal business, or do you see the potential for accelerating that transformation perhaps by either divesting some of the coal business?

Jonathan Price
Chief Executive Officer & Director, Teck Resources Limited

A

Yeah. Hi, Orest, and thanks for the question. There's a number of approaches that we've been taking to that. The first as you've seen overnight is the announced divestments of Fort Hills. Clearly oil sands carbon, an opportunity there to reduce weight in the portfolio through that divestment, something we're very pleased to have agreed and have gotten away.

Secondly, as you highlight really the key approach for us is the growth around copper with the doubling of copper production as we bring QB2 online next year. And then with the projects I mentioned being new range being San Nicolás being the QB mill expansion all bring more copper units into the portfolio which further swing us towards green metals and away from carbon. As we've said before, we'll always remain very active and thoughtful in reviewing the shape of the portfolio and the composition of our portfolio. But right now those factors I've mentioned are the key execution priorities and that's what the team is focused on. And that's what we're gearing up to deliver.

Orest Wowkodaw
Analyst, Scotia Capital, Inc.

Q

Okay. Thank you. And as a follow-up, a question for Red probably here. Red, we've seen significant escalation on the CapEx for QB2 in the last two quarters in total about $1.2 billion. I've been surprised just at the magnitude of that increase. Can you give us more color on what you're seeing there in terms of what's driving, because that just can't be simply inflation?

Harry M. Conger
President, Chief Operating Officer & Director, Teck Resources Limited

A

No, no. We're not attributing it to entirely to inflation. Orest, great to be on the line with you again. There is a variety of things that we've been dealing with there keeping you up to date on all those quarter to quarter. First, I just want to emphasize we've got a very robust system [indiscernible] (00:43:50) where we track all of the trends, contractors and everybody involved. Turn in what's happening to them, where work costs are going, what are variances from the initial plans that we made. And we bring that forward every quarter, true it up, we do everything that we can to address issues that occur and don't just incur costs, but what can we do to change the outcome?

Here's an example of the costs that we incurred. Yet overall it's going to be very financially advantageous for us. The 12 kilometers of tailing launder that I mentioned in the presentation, earlier this year, late last year we were very concerned that the method of construction that the contractor was using was not going to allow that piece of the construction to be completed in time for us to get started here at the end of the year, which, if that happens would be a huge cost impact. So we reviewed all of that with them, came up with a different method of construction. We redid the financial terms of their contract in order to acknowledge the deferred construction approach. And now we have a tailing launder that's complete, ready to go. So, good outcome there.

We're making adjustments like that here in the past quarter, significantly another example would be on the jetty. We've now put the electrical room for that on land instead of out on the pier. It's allowed us to accelerate commissioning of the desalinization plant et cetera. And then throughout all of this you've got all of the inefficiencies associated with COVID. I just want to remind everybody we're flying 13,000 people in and out of this remote location every two weeks. We're running five charter planes a day to do that. And at 10% absentee rate, you don't have key employee showing up like crane operators, supervisors whatever, you have to reconstitute your crews on the fly and do what you can with the skills and craft that you have. So we've been adjusting and dealing with all of those things.

And let me just end with I was there last week. Alex Christopher is now there on site this week. It's really exciting to see this thing come together. I walked the entire critical path. You saw the pictures today, it's coming together. We've done it under extremely adverse circumstances the last couple of years, kept everybody safe and healthy doing it. We now for the first time in October have all of our employees on site where masks are optional, they don't have to wear a mask associated with virus protocols, et cetera. So first time I've seen people's faces up there in two years. And it's all very encouraging. And we're going to finish this thing strong and it'll be up and running here by the end of the year.

Orest Wowkodaw
Analyst, Scotia Capital, Inc. Q

Just finally, Red, what's your confidence level in this updated number, the CAD 7.4 billion to CAD 7.75 billion? Do you think this is it?

Harry M. Conger
President, Chief Operating Officer & Director, Teck Resources Limited A

Well, the qualifiers knowing what we know today, all trends, everything that we know of today are included in that. And we've assumed that we continue to have this high absentee rate that we're incurring right now, and the inefficiencies associated with that are all calculated. And so those are – everything we know of is in there and trended according to current what's happening on the ground today. So we're confident that it's a good number and a good estimate.

Orest Wowkodaw
Analyst, Scotia Capital, Inc. Q

Thanks, Red.

Operator: Our next question comes from Lawson Winder of Bank of America Securities. Please go ahead.

Lawson Winder
Analyst, Bank of America Securities Q

Hello. Good morning and thank you for the update. If I may, I would like to ask about the alternate concentrate shipping options for QB2. If you could maybe discuss to the extent possible what those arrangements are, what they look like in terms of costs? And also what they look like in terms of capacity? So, for example, if the processing facility were fully ramped up, would that alternate concentrate shipping arrangement be sufficient [indiscernible] (00:49:20)? Thank you very much.

Jonathan Price
Chief Executive Officer & Director, Teck Resources Limited A

Lawson, thanks for the question. I'll pass that to Réal Foley, our SVP of Marketing and Logistics.

Réal Foley
Senior Vice President-Marketing & Logistics, Teck Resources Limited
A

All right. Thanks, Lawson, for the question. Yeah. We're working hard on those alternate shipping arrangements, and we actually have [indiscernible] (00:49:43) in place. They're actually containers with a [indiscernible] (00:49:48) for shipping via trucks to alternate ports. And there are arrangements in place with alternate ports working also with trucking companies in order to enable that. So we're confident that we have the capacity to ship the concentrate that will be produced by QB during the year.

We're also looking at domestic sales within Chile to the copper smelters that are in Chile. And transportation arrangements are also being worked on to get the concentrate to those concentrators.

Jonathan Price
Chief Executive Officer & Director, Teck Resources Limited
A

Yeah. Thanks, Réal. The other thing I'll just add to that, Lawson, is some of these arrangements are very common in Chile, and they're used to handle supply chain disruptions and interruptions at ports due to weather events. So, establishing some of this now will likely be advantageous for us anyway in the medium-term.

Lawson Winder
Analyst, Bank of America Securities
Q

It makes a lot of sense. Thanks, Jonathan. Thanks, Réal. And then, just any indication as to the cost of this alternative versus the port?

Réal Foley
Senior Vice President-Marketing & Logistics, Teck Resources Limited
A

Yeah. Lawson, I think it's early days for that. We'll provide guidance as we go into next year if this is something that we do give guidance on.

Lawson Winder
Analyst, Bank of America Securities
Q

Okay. Fair. And then I also wanted to follow up on the oil sands sale. Congratulations on completing that now. So you're now effectively head of the business of operating oil sands or sharing an operating oil sands asset, but you still have a substantial oil sands project in the portfolio. Has there been any thought to the potential sale of Frontier, has there been any interest in from potential buyers in maybe purchasing that?

Jonathan Price
Chief Executive Officer & Director, Teck Resources Limited
A

Yeah. Lawson, I'll just make a couple of comments first on the divestment of Fort Hills. We have run a competitive process on that, on our non-operated interest in that for some time. We did have multiple parties actively bidding on the asset. The valuation we've achieved here, the CAD 1 billion of cash from Suncor, reflects the assumptions that underpin the long range plan that were provided by the operator. And if you look at Suncor's press release, they will talk to some of the medium term challenges associated with that asset as they're now understood, and they will get more detailed guidance at the end of November. So I think that will be helpful in getting a better understanding of the potential value of this asset now, on a forward looking basis, perhaps relative to prior expectations.

The final thing I would say about that is, is the multiple that we've transacted at is actually competitive relative to recent precedent transactions for similar assets, for oil sands assets. So we're very satisfied with the valuation achieved here and we think it's a good deal for our shareholders. We think it improves our investability because we know oil sands has been an overhang for us and it's consistent with our strategy of moving away from carbon towards green metals in the portfolio.

Now to your specific question on Frontier [ph] and lease (00:53:25), we do believe that they are valuable options. They are not options for us to execute and develop. As you highlight, we won't be operators in the energy sector nor in oil sands specifically. And therefore, we will evaluate options to transact on those over time. Fort Hills though being an asset in operation was the priority for us and hence we chose to deal with that upfront.

Lawson Winder
Analyst, Bank of America Securities

Q

Fantastic. Thank you very much.

Operator: Our next question comes from Jackie Przybylowski of BMO Capital Markets. Please go ahead.

Jackie Przybylowski
Analyst, BMO Capital Markets Corp. (Canada)

Q

Thank you very much, and thanks for taking my questions. My first question I think will be on the follow-up on the question about Fort Hills. And, Jonathan, I know you sort of alluded to this at the beginning of the call, but I would love to hear just some thoughts about what you're planning to do with the CAD 1 billion that you'll be bringing in from the asset sale? And even just this really broadly is that thought of as a potential for a fairly large onetime capital return to shareholders, or do you require that for QB2 or other parts of the business or is the business some combination of both things? Thank you.

Jonathan Price
Chief Executive Officer & Director, Teck Resources Limited

A

Yeah. Great question, Jackie. The proceeds when we receive them upon the completion of the transaction will be put towards the capital allocation framework, that's how we've talked about this previously. As you know, through the capital allocation framework the first 30% of available cash flow is automatically returned to shareholders. And then we retain, of course based on consultation with our board, the discretion to return additional amounts if we believe that's warranted, based on other uses of cash at that point in time. So key message, there will be a return to shareholders as a result of this due to the operation of the capital allocation framework, minimum 30%, but potential for upside on that.

Jackie Przybylowski
Analyst, BMO Capital Markets Corp. (Canada)

Q

And that would be – to be clear that would be a special dividend or could it be a buyback? Or do you have thoughts about sort of the format on that?

Jonathan Price
Chief Executive Officer & Director, Teck Resources Limited

A

It could be – Jackie, we make that determination at the time based on the share price for example based on discussions with our shareholders and any particular view on preferences at a point in time, but it could go either way.

Jackie Przybylowski
Analyst, BMO Capital Markets Corp. (Canada)

Q

Understood. Thank you. And maybe another question. Just, I noticed in the last couple of quarters your MD&A, you talked about income tax is going to be starting to be charged on Canadian assets starting in 2022 with maybe cash tax payments in 2023 and 2024. Can you give us a little bit of modeling help? How should we expect to see your income statement change maybe in the beginning of 2023 as a result of that?

Jonathan Price
Chief Executive Officer & Director, Teck Resources Limited

A

Yeah. Thanks. Good question. I'll hand that directly over to Crystal.

Crystal Prystai
Interim Chief Financial Officer, Teck Resources Limited

A

Thanks, Jackie. That's a good question. You're correct. We are cash taxable on our 2022 earnings. However, we have with the tax installment rules and there are some income inclusion timing rules relating to our partnerships, that's where most of our Canadian coal and copper operations are held. That allows for us to defer the cash tax payments associated with the 2022 earnings into 2023, and the majority of which actually would be deferred into 2024. So the determination of the amount of those cash taxes will depend on our full year earnings for 2022 and we would – we can take offline the proportion to allocate. But I think you can assume the majority of it goes into 2024 in terms of the payment timing.

Jackie Przybylowski
Analyst, BMO Capital Markets Corp. (Canada)

Q

Okay. That's great. I might follow up with you offline. Thank you. And if I could just – let me just make one last question and hopefully it's a quick one. I'm guessing it will be. The revised budget that you've given us for QB2, can you give us any indication on how much there is contingency remaining in the budget for QB2 now that you've changed the bookings?

Jonathan Price
Chief Executive Officer & Director, Teck Resources Limited

A

Crystal or Red, do you want to take that one up?

Harry M. Conger
President, Chief Operating Officer & Director, Teck Resources Limited

A

Yeah. Jackie, the way I would characterize it is all known variances that we've faced and face going forward are all included in that estimate. We've also made an estimate on foreign exchange rate, et cetera. So I would tell you that all things that we know of, all contingencies are covered at this point.

Jackie Przybylowski
Analyst, BMO Capital Markets Corp. (Canada)

Q

All right. Okay. That's about what I expected. Thank you very much. That's all my questions. Thank you, everybody.

Operator: Our next question comes from Brian MacArthur of Raymond James. Please go ahead.

Brian MacArthur
Analyst, Raymond James Ltd.

Q

Good morning. Just two follow-ups. First, Red or Jonathan, for the QB numbers when you say everything is in, does that include working capital build as well or is there another cash call for that as we go through 2023 given all the timing changes on this now?

Jonathan Price
Chief Executive Officer & Director, Teck Resources Limited

A

Red, have you got that?

Harry M. Conger
President, Chief Operating Officer & Director, Teck Resources Limited

A

Yeah. Brian, when we talk about construction capital, there's no working capital built into that. We're budgeting on the operations side for the startup with the mining operations and all that goes on there, that's where any working capital cuts are going to be accounted for.

Brian MacArthur
Analyst, Raymond James Ltd.

Q

Great. Thanks. That's how I thought you were doing it. Second question, you talked about on Fort Hills gross proceeds and back to the tax discussion that was out there. Is there a significant tax on that sale? What I'm trying to get at is obviously the potential proceeds available for capital return.

Jonathan Price
Chief Executive Officer & Director, Teck Resources Limited

A

Crystal?

Crystal Prystai
Interim Chief Financial Officer, Teck Resources Limited

A

Thanks, Brian. Great question. In short, the answer to that is there is no material tax impact. There is a small capital loss that we expect on the transaction. But it isn't material in nature in relation to the CAD 1 billion.

Brian MacArthur
Analyst, Raymond James Ltd.

Q

Thank you. And...

Jonathan Price
Chief Executive Officer & Director, Teck Resources Limited

A

I was just going to say no capital gain Brian as Crystal highlighted.

Brian MacArthur
Analyst, Raymond James Ltd.

Q

Perfect. Thank you. And my third question just relates and Jonathan I think the long-term copper slides, great to show all your options. But you sort of have Zafranal in there now. Are you still now maybe changing your view that you're maybe going to develop this as opposed to have a partner, which was maybe the way it was discussed before financing? Has anything changed there just given the divestiture of Fort Hills and anything? Is there any change in the strategy with Zafranal going forward?

Jonathan Price
Chief Executive Officer & Director, Teck Resources Limited

A

We're still looking at the optimization of that. Brian, we have a number of options there. Of course, you know in the past we were looking to divest that. We've continued to ensure that that is fully permitted with the feasibility study behind us. So it will be completely de-risked. We could look at the introduction of another partner, given we have Mitsubishi in there for 20% at the moment and we have the balance of 80%. And we could just move ahead with the development on a 100% basis. All options are still on the table for us on that one. We have a lot else in the pipeline in that same timeframe to be grappling with. So I would say we are certainly long options in that period and part of the determination we need to make, what is the right sequence of development here for these assets based on their risk and return profile. So, all part of the optimization also in the mix and all options on the table.

Brian MacArthur
Analyst, Raymond James Ltd.

Q

Great. Thank you very much for answering my questions.

Jonathan Price
Chief Executive Officer & Director, Teck Resources Limited

A

Most welcome.

Operator: This concludes the question-and-answer session. I will now hand back the call over to Mr. Price for closing remarks.

Jonathan Price
Chief Executive Officer & Director, Teck Resources Limited

I think we'll probably hand it to Mr. Phillips for closing remarks. Are we?

H. Fraser Phillips
Senior Vice President, Investor Relations & Strategic Analysis, Teck Resources Limited

Yeah, absolutely. So thanks, everybody, for joining us. If you didn't get your questions addressed and I know there are some that did not, please let us know and we'll follow up and set something up so we can chat or do it over e-mail. Thanks again for joining us and look forward to speaking to everybody again a quarter from now.

Operator: This concludes today's conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.