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HALLGARTEN + COMPANY

Corporate Actions Note

Christopher Ecclestone
cecclestone@hallgartenco.com

Teck Resources

(TSX: TECK.A and TECK.B, NYSE: TECK)

Strategy: NEUTRAL

Key Metrics

Price (CAD)	**Teck A Shares**	$57.14
	Teck B Shares	$56.71
12mth high -low	**Teck A Shares**	$32-$66
	Teck B Shares	$33-$106
Market Cap (CAD mn)		$29,158
Shares Outstanding	**Teck A Shares (mns)**	7.8
	Teck B Shares (mns)	506.3

Teck Resources

Fox in the Henhouse

- + **Teck's management finally saw the light and attempted to come up with a restructuring that allowed the controlling family to have their cake and eat it too**
- + **A bid from Glencore produced a further uplift in the perceived hidden value at Teck**
- + **The addition of Glencore's more diversified (geographically & product-wise) mining assets to Teck's base metal assets would have made a significant new global metals major**
- + **The strong price of metcoal (now rebranded as steelmaking coal) in recent times has immensely strengthened Teck's finances, enabling the transformation**
- ✘ **Despite the merits of derailing the family's original proposal the Glencore offer is bad for Canada, bad for Teck and bad for shareholders**
- ✘ **The restructuring offer from Teck's controlling family played out over too long a period to be attractive to anyone except the most long-term of shareholders**
- ✘ **The proposed disentanglement from steelmaking coal was torturously complicated with no end date in sight**
- ✘ **Glencore itself has been bitten as the proposed offer highlighted the trader's dependence upon thermal coal revenues**
- ✘ **The presence of CITIC, the Chinese SOE, on the register has confounded Teck's plans as they are clearly playing a game to their own specific advantage**
- ✘ **Teck has been unable to articulate well how its long-torpid metals mining activities might move into being a major player (i.e. bulking up via acquisitions)**

A Predator Comes Calling

It has long been somewhat inevitable that Teck Resources would find itself on the dissection table after 15 years of wandering in the wilderness after a disastrous acquisition in 2008, when it made an ill-timed and excessively large bid for Fording Canadian Coal Trust (a metcoal miner). Fifteen years is a long while to suffer indigestion.

After Teck broke out of years of torpor in February of 2023, announcing a restructuring of its rococo dual voting structure, it popped up on the radar screen of Glencore and attracted a predatory break-up bid which would have radically changed the nature of both companies after feeding them through the corporate blender.

Matters have not gone as either company hoped and in this review we shall try to look at the can of worms that has been prised open by these corporate actions.

Teck/Glencore – Careful What You Wish For

The acquisition offer for Teck from Glencore has turned into a series of complications for both companies that go beyond the normal in a takeover spat. Teck's grand plans to finally (yet gingerly) unwind the iniquitous discriminated voting structure looked generous compared to the situation before but in the harsh light of day, and with another alternative in the offing, ultimately failed the sniff test with large holders and thus went into limbo. Meanwhile, Glencore's machinations to have its cake and eat it too in coal (both thermal and steelmaking coal) via acquiring Teck, have so far only succeeded in focusing attention on how dependent its own recent earnings surge have been upon thermal coal.

Both companies have experienced a bumpy ride in May as the three-month comparative price chart below indicates.

Species in Extinction

Teck is truly the Last of the Mohicans, a tribe of major names that were first corralled and then eliminated by Darwinian forces, and Ottawa neglect, over the last 25 years. Whither (more like, wither) Inco, Falconbridge, InMet and Noranda and the humbling of Sherritt by lack of Canadian pushback to US stupidity? Is it any wonder that with the decapitation of base metals majors, that the TSX has devolved into a happy hunting ground for gold-nuts and lithium groupies?

So now Teck has a target on its back and no Foreign Investment Review Board to keep it *virgo intacta*. Many would say that Teck brought on its own demise (don't they all?) with its mindless stubbornness (a machismo swoon) in continuing to pursue the disastrous takeover of Fording Canadian Coal Trust, in the midst of the 2008 crisis. Ironically, it could be argued that this asset is now the attraction that has the lone shark of Glencore circling. After all, as we argued several years ago, the base metals business of Teck has become a ragbag of patchy positions for which even First Quantum would not get out of bed, and which RTZ would consider beneath its dignity.

Will the last Canadian mining major please turn out the lights when they leave the room?

Once Bitten, Still Shy

While Kinross has distanced itself from many of the mistakes made in the last bull market, Teck (then Teck Cominco) is still joined at the hip with the disastrous Fording Canadian Coal Trust purchase at the peak of the mining Supercycle period for which it paid $14.1bn for Fording Canadian Coal Trust. So disastrous was this deal that nine years later, in 2017, the amount paid for Fording was still higher than the whole market capitalisation of Teck.

With the perfect opportunity to walk away from this mistake in the chaos of the crash of 2008, Teck persisted and has been paying the price ever since. Not only did it cause well over a decade of undervaluation of Teck's stock, but it crimped its room to manoeuvre on new purchases, resulted in obsessive debt reduction and removed the credibility of its actions. Like Kinross, any potential transactions (such as its failed pursuit of the Santa Rita nickel asset in Brazil in the latter part of 2021) would have been put under extra-strong investor scrutiny.

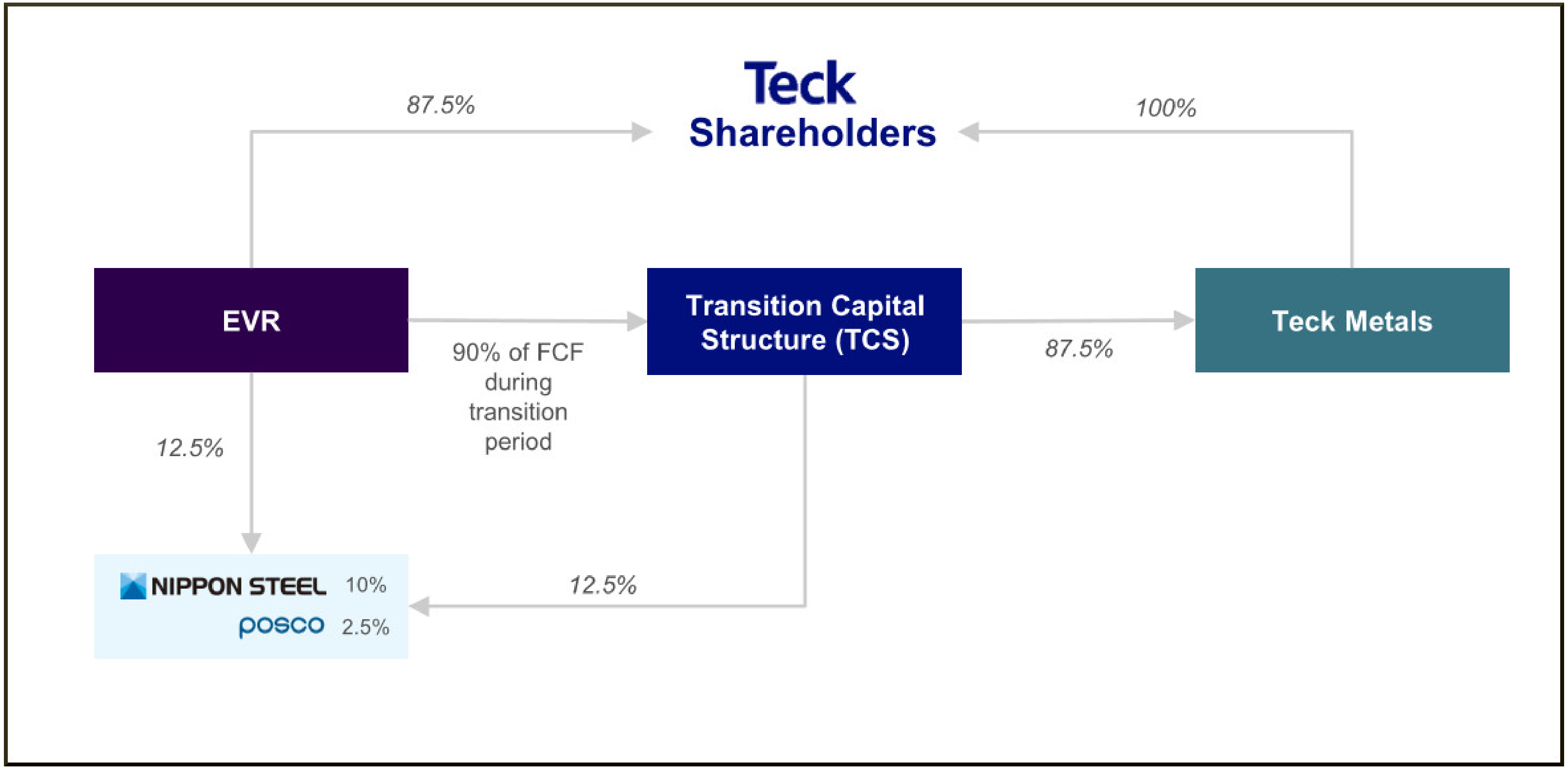
The Teck Break-Up

After years of inaction, in late February, Teck announced today the reorganization of its business to separate Teck into two independent, publicly-listed companies: Teck Metals Corp. (Teck Metals) and Elk Valley Resources (EVR). The market responded positively to this (surprise!) and, of course, we are very partial to demergers as a means to realise value. Usually, the sum of the divided parts is greater than the original market capitalisation of the original standalone entity.

The immediate response to this proposal was a near 50% surge in the share price of Teck (funny that…).

The company touted the separation as "creating two world-class resource companies to provide investors with a choice in allocating investment between two businesses with different commodity fundamentals and value propositions". Hey-ho, we have been saying this forever…. Nice of them to finally see the light in offering investors a "choice". Previously the only choice was between selling or holding.

Management claims that Teck Metals will be "growth-oriented, with premier, low-cost base metals production, a top-tier copper development portfolio and a disciplined capital returns policy". We presume that means dividends.


Teck
Shareholders
87.5%
100%
EVR
90% of FCF during transition period
Transition Capital Structure (TCS)
87.5%
Teck Metals
12.5%
NIPPON STEEL 10%
posco 2.5%
12.5%

Meanwhile, EVR will be a “high-margin Canadian steelmaking coal producer, focused on long-term cash generation and providing cash returns to shareholders, with significant equity value accretion potential”. Guaranteeing “high-margins” in the mining space is one of the alternative routes to hell, and even more iffy when steelmaking coal is involved considering the wild fluctuations in the steel industry.

Structure of the Deal

The break-up, though they stick to calling it a “Separation”, is structured as a spin-off of Teck’s steelmaking coal business by way of a distribution of EVR common shares to Teck shareholders.

In a confusing twist, Teck Metals will retain a substantial interest in steelmaking coal cash flows through a transition period in the form of an 87.5% interest in a gross revenue royalty and preferred shares of EVR. Under this transition capital structure, Teck Metals will receive quarterly payments consisting of Royalty payments and preferred share redemption amounts that will in aggregate equal 90% of EVR free cash flow.

Teck shareholders of record as of the applicable distribution record date will receive common shares of EVR in proportion to their Teck shareholdings at an exchange ratio of 0.1 common share of EVR for each Teck share (or approximately 51.9mn total EVR common shares) and approximately $0.39 cash per share for an aggregate of CAD$200mn in cash. Shareholders will be able to elect to maximize the amount of cash or common shares of EVR they receive, subject to proration, through a Dutch auction election process.

As part of the breakup, Teck would change its name to Teck Metals Corp. and will continue to be listed on the TSX and the NYSE. EVR has applied to have its common shares listed on the TSX.

EVR: the Royalty & Preference Share Arrangement

This divorce has a long separation period ahead of it…. This is largely due to Teck wanting to keep the steelmaking coal cash cow feeding the metals business.

In consideration for the transfer of the steelmaking coal assets to EVR, EVR will grant the Royalty and issue preferred shares and common shares to Teck Metals. The Royalty is a 60% gross revenue royalty that will be paid quarterly from EVR’s steelmaking coal revenue, subject to free cash flow and minimum cash balance limitations designed to support the financial resiliency of EVR and should generally generate payments equal to 90% of EVR free cash flow.

Therefore, the coal business could end up feeding the metals business over 11 years (or maybe as long as 20 years). To effect this complicated magic trick, Teck and its advisors have come up with a somewhat mind-boggling royalty and preference share structure designed to keep everyone happy, in theory.

The royalty will be payable until the later of:

- an aggregate amount of $7bn in royalty payments having been made, or

- the 31st of December 2028

The preferred shares will have an aggregate $4.4bn redemption amount and a 6.5% cumulative dividend. The preferred shares will be redeemed out of 90% of EVR free cash flow after the royalty is no longer payable. If not redeemed earlier, the preferred shares will mature 20 years from their date of issue. Assuming a US$185/tonne long-term benchmark steelmaking coal price and a CAD/US dollar exchange rate of 1.30, the Transition Capital Structure could be fully paid in approximately 11 years.

And the Debt….

Cash flow from the Transition Capital Structure is expected to provide Teck Metals with continued funding for prudent investment in its top-tier copper growth pipeline, while allowing for disciplined returns to its shareholders. Teck claims to have received preliminary indications that S&P, Moody's and Fitch are likely to affirm an investment grade credit rating on the existing senior notes of Teck Metals should the break-up proceed.

Teck claimed the new structure was "designed to provide EVR with flexibility to operate its business, provide cash returns to shareholders, and fund its environmental and social commitments in a variety of steelmaking coal price environments".

It is somewhat perplexing as to why EVR has been given the better balance sheet considering that it is supposed to be a cashcow. Management claims that EVR will come out of the gates with $1bn in cash and other working capital, no debt, and $88 million in leases relating to operations.

On the dividend front, Teck is signalling that EVR will have an initial base annual dividend of $0.20 per share, which we regard as rather measly. Then there will be supplemental distributions of 50% of free cash flow available after Transition Capital Structure payments.

Looking to the very long term, EVR will have credit facilities in place to meet its existing reclamation bonding requirements. Additionally, EVR will establish an Environmental Stewardship Trust and fund it through escalating fixed annual contributions, starting at $50mn, for long-term environmental obligations.

Bit Players - Nippon Steel and POSCO

The one fly in the ointment (not withstanding Glencore's later appearance) was Teck's existing coal joint venture partners (and major customers) Nippon Steel Corporation (NSC) and POSCO.

Teck came to an agreement with its joint venture partners to exchange their minority interests in the Elkview and Greenhills operations for interests in EVR. As a result, EVR will own 100% of its steelmaking coal operations. NSC's exchange of its 2.5% Elkview interest and its $1.025bn cash investment (payable to Teck Metals) will give it a 10% interest in EVR common shares and the Transition Capital Structure.

POSCO has agreed to exchange its current 2.5% interest in Elkview Operations, and its 20% interest in the Greenhills joint venture, for a 2.5% interest in each of the EVR common shares and the Transition Capital Structure.

According to the breakup documents, this implies an EVR enterprise value of approximately CAD$11.5bn.

EVR and NSC will enter into a long-term steelmaking coal offtake rights arrangement, continuing NSC's long-standing commercial arrangements for the purchase of steelmaking coal from the Elk Valley.

EVR and NSC will enter into an investor rights agreement, pursuant to which NSC will be entitled to certain customary rights including a right to nominate one director to the board of directors of EVR, pre-emptive rights on future securities issuances, and registration rights. NSC will agree to certain customary transfer and standstill restrictions.

The exchanges of the existing interests of NSC and POSCO, for interests in EVR, were conditional on the completion of the break-up and other customary conditions. The additional investment by NSC is conditional on completion of the break-up, however the break-up was not conditional on completion of the additional investment by NSC.

The Operations of the Mooted Teck Metals

As can be noted by the map below, most of the metals activities will be in the Americas. One does not need to go back far to the days of Teck Cominco when the company was truly a global player.

The activities now mainly consist of:

Copper:

Antamina

Quebrada Blanca

Carmen de Andacolla

Highland Valley

Zinc & Lead:

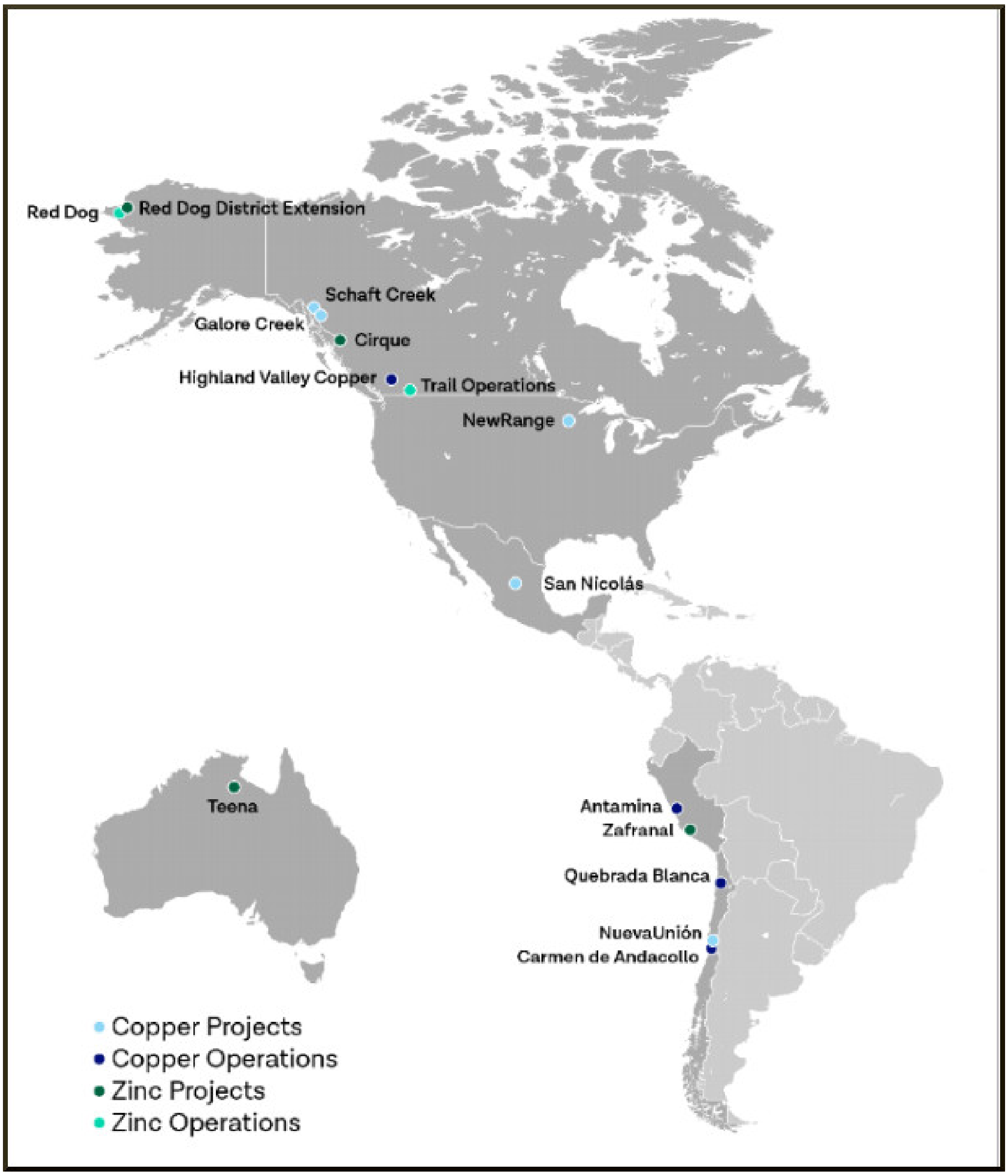
Red Dog

Trail Smelter

Projects

San Nicolas

NewRange



The Split Structure

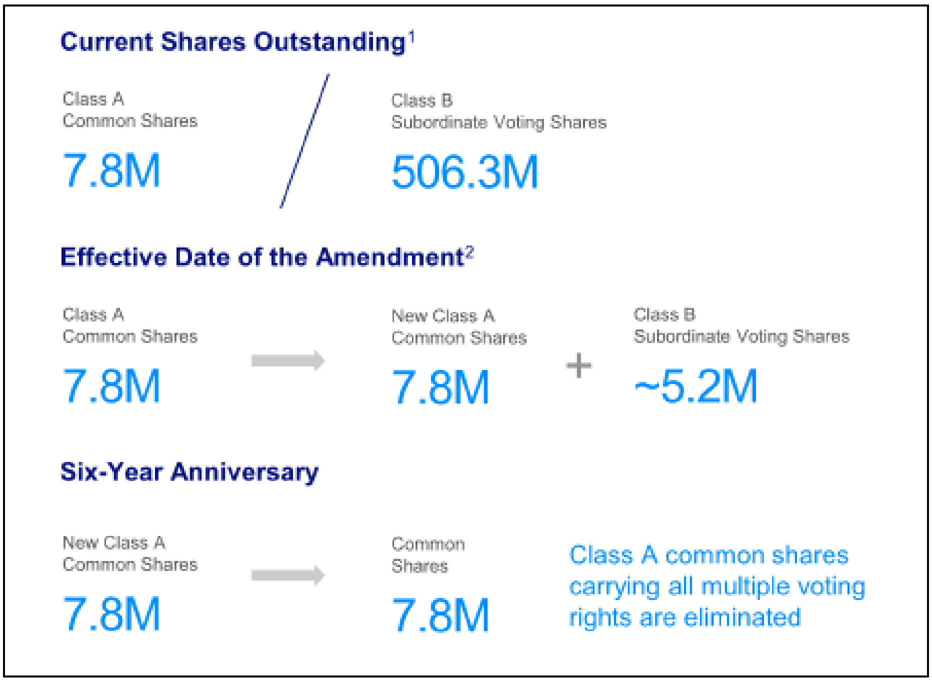
One oddity of Teck is the split share structure which remains a relative oddity amongst major miners.

Although Teck has a high free float (~98%), it is important to note that the Keevil Family hold control (with a stake of ~1%, but a majority of the voting rights) and this could be a key stumbling block.

Teck is one of the last major companies in the Western world stock exchanges to retain this old-style form of structure, which was once commonly used to protect founding (or controlling) family's interests and sinecures.

In late February, the company announced a proposed six-year sunset for the multiple voting rights attached to the Class A common shares of Teck. This was announced on the same day as the Teck break-up. Interestingly, the company noted that the implementation of the Dual Class Amendment was "not conditional on the implementation of the Separation, and the Separation is not conditional on implementation of the Dual Class Amendment. If both transactions are approved, the Dual Class Amendment will be implemented before the implementation of the Separation".

Currently, the Class A common shares carry 100 votes per share and Class B subordinate voting shares carry one vote per share. As of February 17, 2023, there are 7,765,503 Class A common shares and 506,276,448 Class B subordinate voting shares issued and outstanding.



The principal terms were, as always with Teck, complicated. On the effective date of the Dual Class Amendment, each Teck Class A common share will be acquired by Teck in exchange for one new Class A common share and 0.67 of a Class B subordinate voting share. The terms of the new Class A common shares will be identical to the current terms of Class A common shares, but will provide that, on the sixth anniversary of the effective date of the Dual Class Amendment, all new Class A common shares will automatically be exchanged for Class B subordinate voting shares, which will be renamed "common shares".

If the Dual Class Amendment was completed as of that date, approximately 5,202,887 Class B subordinate voting shares would be issued in connection with the exchange of Class A common shares (representing ~1% of issued and outstanding Teck shares). Both the exchange of Class A shares for new Class A shares and Class B shares on the effective date of the Dual Class Amendment and the exchange of the new Class A shares for Class B subordinate voting shares at the end of the sunset period will be tax-deferred for Canadian resident Class A shareholders. However, things panned out elsewise when (nearly) put to the vote…

The Glencore Offer

The bliss in the C-Suite at Teck was short-lived as, on March 26, Glencore (LSE: GLEN) announced, as its first gambit, an unsoliticed merger proposal with Teck Resources. This was a $23bn offer financed through shares, with an exchange ratio of 7.78 Glencore shares per Teck B share, translating into a 22% premium based on both firms' undisturbed closing price as of March 31, 2023. For Teck A shares, Glencore would offer 12.73 of its own shares, also translating into a 22% premium. Glencore and Teck shareholders would own 76% and 24% of the combined entity, respectively. The post-tax value of the synergies was estimated at $4.25-5.25bn.

The broad mechanics of the deal were:

- MetalsCo: comprising Glencore's and Teck's metals and minerals assets, Glencore's metals and energy (ex-coal), recycling, marketing and distribution businesses and its investment in Viterra
- CoalCo: comprising Glencore's and Teck's coal assets, Glencore's ferroalloys assets and Glencore's coal and ferroalloys marketing businesses

So, for us, the CoalCo was somewhat of a misnomer as it seemed to be more like a "Everything-related to-the-steel-industryCo" instead. The ferroalloys businesses of Glencore includes a mass of activities that have nothing to do with steelmaking coal.

As a sop to Teck it was going to be allowed to appoint the chairperson of MetalsCo, while Glencore was to appoint the chairperson of CoalCo, with the rest of the boards split 50/50.

In a truly Solomonic twist, Glencore then gets to appoint the CEO of MetalsCo, while Teck appoints CEO of CoalCo, and rest of management basis of "best of both". We had a vision of the first board meetings of both entities as akin to the chickens sitting down with the foxes. Who gets to make a meal of the other is not exactly a mystery. However, with Teck the chickens may be wilier than the foxes!

The naming of these two entities would be designed to reflect the merging of the two companies and these new names would be mutually agreed. Going on the basis of what had so far been posited, one might be called Glencore-Teck and the other called Teck-Glencore.

Forelock-Tugging to Canadian Sensibilities

While Ottawa seems to scarcely care about corporate machinations that diminish the country's status as a major mineral player, Glencore have clearly picked up a vibe that for major investors and opinion-makers it needs to mollify the pain if their transaction actually does gain traction.

Therefore, Glencore proffered the possibility that it would designate either Teck's Vancouver office or Glencore's Toronto office as MetalsCo's global Industrial Head Office. Industrial Head Office doesn't sound to us like a head-office and we wonder whether the denizens of Zug would take kindly to moving their biggest playing pieces from a tax-haven locale to one in the unkindly searchlight of CRA. The Industrial Head Office would “manage” ~3 times Teck’s current metals production. So what?!

It committed to maintain a “significant” Canadian representation on each of MetalsCo’s and CoalCo’s Boards of Directors and they would ensure that Canadians continue to serve in the management of MetalCo’s and CoalCo's Canadian assets. Still, that doesn’t sound like Canadians actually running the two companies at the highest level.

It would provide ongoing and long-term employment in Canada for Canadians and the proposed transaction would not materially change the day-to-day operations at Teck’s assets in Canada. Clearly, Swiss dairy farmers are not going to be bussed to the smelter at Trail or the Elk Valley coalmines.

It would maintain a listing of MetalsCo and CoalCo on the TSX.

It would continue to invest in Canadian capital expenditure programs in each of MetalsCo and CoalCo and make new investments in a reinvigorated exploration program in Canada. Hmmm, because Glencore/Xstrata has such a great record on exploration…. Not.

It promises to honour all of Teck’s commitments to local Canadian communities as well as to Indigenous communities to ensure their interests are acknowledged and protected, and honour all of Teck’s social, labour and environmental programs in Canada.

The Merged Entity (in Glencore’s vision)

The MetalCo would be present in the following metals:

- Copper: Collahuasi, Antamina, QB2, Antapaccay, KCC and Mutanda Cu/Co
- Nickel: INO, Murrin
- Zinc: Kazzinc, Red Dog, MRM, Mount Isa
- Materials processing, Recycling, Metals and Energy Marketing

The upside is envisioned as:

- Collahuasi Expansion
- Mutanda sulfides
- Antapaccay
- Coroccohuayco
- MARA

- El Pachon
- NewRange
- QB3
- San Nicolas
- Zafranal
- Galore Creek
- Nueva Union
- Shaft Creek

The Words Unspoken

We cannot help but think that this projected structure is somewhat disingenuous. In its own words the company stated, in May 2021, that it was "a major producer and marketer of more than 60 responsibly-sourced commodities that advance everyday life". Glenore's operations "comprise around 150 mining and metallurgical sites and oil production assets". In 2021, Glencore was in the midst of an asset sale spree, but it was projected that even after those sales it was estimated that it would still employ around 135,000 people, including contractors.

Where is the aluminium business? The US-listed Century Aluminum (NASDAQ:CENX) is 46% owned by Glencore, with Glencore is also buying 65% of the production. CENX has three U.S. aluminum smelters, in Hawesville, Kentucky, Robards, Kentucky (known as the Sebree smelter) and Mt. Holly, South Carolina (Mt. Holly), and one smelter in Grundartangi, Iceland). This forgotten holding only has a market cap currently of US$765mn.

Dare we mention Chromite? We have long kept an eye on the South African company, Merafe (JSE:MRF), listed on the Johannesburg Securities Exchange. It has a 20.5% participation through its wholly-owned subsidiary, Merafe Ferrochrome, in the earnings before EBITDA of a venture in which Glencore Operations South Africa Proprietary Limited has a 79.5% participation.

The JV only runs seven chrome mines and five ferrochrome plants in South Africa, which have a total capacity of 2.36 million tonnes per annum of ferrochrome.

Maybe they forgot about them….

Similarly, the Mokala manganese ore mine in South Africa, controlled by Glencore, was projected by a source of FastMarkets (in 2020) to produce semi-carbonate 37% manganese ore, and was expected to ramp-up production to its full capacity of 1.5 million tonnes per year around the start of 2021. Maybe they forgot they play in the Manganese space.

Maybe, we are just being cheeky in mentioning that Glencore has been also one of the biggest movers & shakers in the Vanadium space, much of that status emanating from its clinch-hold on the output of Largo Resources' Maracás Menchen Mine in Brazil, which theoretically ended in 2020. Then again it controls the Rhovan mine at Brits in South Africa.

Glencore's own site states that the company produced, in 2022, from its "own assets" some 1,488,000 tonnes of ferrochrome produced at our own assets and 19.8mn lbs of Vanadium pentoxide produced.

Frankly, the failure to mention all these activities shows that Glencore even when trying to inveigle investors to go with its offer, is still contemptuous of the intelligence of the Teck investor base.

Germanium – Even More Disingenuous

Glencore's economy of details, when it comes to the metals the merged entity will produce, becomes even more poignant when one delves deeper and looks at the critical metals/minerals that emanate from Teck's facilities. When these are brought into the harsh light of day one can see reasons why the Pentagon might fire up the Bat Phone to the White House and then the White House put though a hurried call to Ottawa advising "No way, Jose".

The chief metal in question is Germanium. Teck controls the Western world's supply of Germanium metal. Germanium metal is used as a semiconductor in transistors and other electronic devices, in optic fibre networks and in infrared night vision systems for military use. In recent years, consumption of Germanium military grade infra-red lenses has surged and the metal also has applications in highly efficient solar panels used in space. With applications for Germanium metal in defence and Germanium tetrachloride in fibre optics cable the assault on Teck should be raising some eyebrows in defence circles, that is if they even notice.

The DoD of the US, on its own website cited Nancy Albertson, a chemist and program manager for DLA Strategic Materials as saying ""Mainland China pretty much has a chokehold on the market right now, so if it decided to either ramp up the cost or cut us off completely — and that's not unheard of — that would be a very big issue for us" as she announced an increased effort by the US to recycle Germanium.

The U.S. relies on imports for over 50% of its germanium needs, and nationwide consumption was about 30,000 kilograms in 2020, according to the U.S. Geological Survey. The Defence Logistics Agency program is expected to yield 2,200 to 3,000 kilograms of recycled germanium a year — nearly 10% of the nation's annual need — for use in night-vision and thermal-sensing devices in platforms like Abrams main battle tanks, Bradley Fighting Vehicles, Apache helicopters and naval systems.

The criticality of Teck’s output was further evidenced when *force majeure* was declared some five years ago when one of their furnaces blew up, sending Germanium prices sky rocketing.

While a somewhat old statistic, Reuter cited U.S. Geological Survey data showing that China produced more than 70% of the 155,000 tonnes of total refined germanium production in 2016. We doubt this dominance would have changed at all in recent times. As is well-known when it comes to the morality of supplying China with critical metals, Glencore, in the view of many, has all the morals of an alley cat. Can the US allow Glencore to achieve a stranglehold on Teck’s Germanium output? Is this a repeat of the massive own-goal that was the sale of Cabot’s specialty fluids division to Sinomine which gave China dominance of the Cesium market.?

Rarely on the High Ground

After all it was only November of last year when Glencore Energy (UK) Ltd was ordered to pay GB£281mn, the largest ever penalty handed down to a company in a UK court, after pleading guilty in June 2022 to all seven charges of bribery brought against the company.

The charges brought by the UK’s Serious Fraud Office (SFO) relate to Glencore’s oil operations in Cameroon, Côte d’Ivoire, Equatorial Guinea, Nigeria and South Sudan from 2011 to 2016, with over US$28mn paid via employees and agents to secure preferential access to oil, including increased cargoes, valuable grades of oil, and preferable dates of delivery.

Investigations into these bribes had a global scope with the SFO working with the U.S., and collaboratively with Dutch and Swiss prosecutors on this case. The European cases are still ongoing and the broader U.S. case, extended to claims of bribery in Brazil, the Democratic Republic of the Congo and Venezuela. Glencore has already stated that it expects to pay up to US$1.5bn to settle bribery and market manipulations cases. These include a case in Brazil in connection with the *Lava Jato* (Car Wash) probe which has long roiled political waters there and was one of the reasons for the demise of Dilma Roussef, Brazil’s president from 2011-2016.

The issues are not all behind Glencore though, as an investor group launched a lawsuit against the company, apparently related to losses linked to its recent bribery cases. The company is also facing another investigation, with Zambia’s Anti-Corruption Commission launching a probe into an alleged payment to a political party.

The Natural Resource Governance Institute commented on this and other matters stating that Glencore should “review engagements with Russian SOEs, adopt and publish measures to reduce corruption risks in business with SOEs, and make transparent its transactions with SOEs in all countries. Glencore should also cease all relations with Dan Gertler, who the U.S. sanctioned in 2017 for high-level corruption yet still receives substantial royalties from deals in the DRC. Although Gertler denies any wrongdoing, the DRC is estimated to have lost a staggering US$3.71bn (at least) from the deals he was involved in, alongside Glencore and ENRC".

And China….

Glencore's rise has paralleled that of China's in recent decades. In August of last year, the Financial Times reported that Glencore (and other global trading groups) had stopped supplying Chinese metals merchant Huludao Ruisheng after US$500mn worth of copper went missing in yet another of the oft-repeated scandal that bedevil the metals trading space in China.

The FT reported that "Glencore and Geneva-based IXM have stopped supplying the Liaoning-based group, according to people familiar with the matter. Glencore had also transferred some of its existing metal stocks from the port city of Qinhuangdao to alternatives such as Qingdao in an effort to avoid similar problems, added a trader".

Being caught in Chinese trading scams though is somewhat of a Red Badge of Courage in the trading space these days with Trafigura having more egg on face than either Glencore or IXM.

The Response

Teck quickly rejected Glencore's offer, citing concerns about exposure to thermal coal and oil trading. Teck's management maintained that its own planned separation of its metals and coal businesses would maximize value for shareholders.

We had to laugh because the response was almost as if Teck was saying "how dare they suggest breaking us up!".

Glencore Sweetener

Then, on the 11th of April 2023, Glencore responded to the understandably unwelcoming response of Teck and proposed modifications to the terms of the "Proposed Merger Demerger". It stated that "Glencore acknowledges that certain Teck investors may prefer a full coal exit and others may not desire thermal coal exposure". The first is not true or they wouldn't be Teck shareholders (with its exposure to steelmaking coal), while the latter is most definitely the case.

Accordingly, Glencore proposed a cash element to the "Proposed Merger Demerger" to effectively buy Teck shareholders out of their coal exposure such that Teck shareholders would receive 24% of MetalsCo and US$8.2bn in cash. This valuation was in line with both:

- the implied enterprise value of Elk Valley Resources ("EVR") and the Transitional Capital Structure owned by Teck shareholders based on the Nippon Steel investment under the proposed standalone separation into Teck Metals and EVR

- the upper end of the valuation ranges of EVR provided by Origin Merchant Partners, in its fairness opinion to the Special Committee of the Teck Board

Thus, more of the merged assets remain under the control of Glencore's nomenklatura. Presumably also the cash going to Teck shareholders comes out of the hide of someone, *ergo*, leaving one, or both, of the post-merger/demerger entities with more debt, or less cash, or both.

If a transaction were to materialise, Glencore states that it would manage its balance sheet through to closing, consistent with its current shareholder returns framework, such that MetalsCo would continually consider the above cash element (from zero up to US$8.2bn) as part of its previously highlighted ~US$8 billion pro-forma net debt cap, down from Glencore's currently applied optimum net debt maximum level of ~US$10bn. As we all know, heavily debt-laden miners do not have happy historical precedents.

Glencore claimed to remain enthusiastic about the merits and prospects of CoalCo and "expects a significant proportion of Teck shareholders to share our view".

The Spotlight of Glencore

As mentioned earlier, an unforeseen side effect of the Teck bid for Glencore was that it provoked spotlighted how dependent Glencore's recent earnings surge has been upon thermal coal.

Then Glencore's annual meeting in late May saw just over 30% of Glencore's investors rejecting the company's climate progress report, demanding more clarity on how the global miner will meet its commitments to cut emissions.

Around 29% of shareholders also backed a shareholder resolution seeking more disclosure on progress in scaling back thermal coal production.

Reuters reported that Glencore said in a statement, dated May 3rd, that it opposed the shareholder motion "because it risked undermining the board's responsibility for its climate strategy, given existing disclosures".

Opposition to its climate progress passing the 20% threshold constitutes material dissent among shareholders.

Freeport to the Rescue?

It was briefly mentioned that Freeport might enter the fray, but then they melted away into the mist. This was a bizarre idea and equally poor for Canada and shareholders as Freeport have never struck as an dynamic.

Enter (and Exit) the Dragon

When the battle royal began China Investment Corporation, an SOE (and essentially China's sovereign wealth fund), had a 10.3% stake in Teck via its wholly-owned subsidiary, Fullbloom Investment Corporation. This holding dated back to July of 2009 when CIC agreed to purchase on a private placement basis, through Fullbloom Investment Corporation, some 101,304,474 Class B subordinate voting shares for CAD$17.21 per share. The aggregate purchase price, at the time, was around US$1.5bn (or approximately CAD$ 1.74bn) in cash.

Aa a result, CIC held Class B Shares representing approximately 17.5% of Teck’s then issued and outstanding Class B Shares, approximately 17.2% of Teck’s issued and outstanding shares and approximately 6.7% of the aggregate voting rights attaching to Teck’s Class A common shares and Class B Shares.

In mid-April, Bloomberg reported that China Investment Corp reportedly favors Glencore's proposal for a Teck breakup. Apparently, the Chinese particularly liked the proposal for the coal assets because it would allow for a cleaner exit for investors, and according to Bloomberg “the fund is said to be considering a vote against Teck's own split plan, although it has not made a final decision”. CIC may still seek a higher price from Glencore before supporting its offer, according to the report.

As Teck needed to secure two-thirds approval from both classes of shares, voting separately, to get its plan across the finish line the votes of the Chinese became critical.

However, in our humble view, CIC even caring about Teck’s steelmaking coal exposure is a total red herring, we can see many, many reasons why the Chinese favour Glencore control of Teck’s assets (see Germanium comments above).

In the final wash the Chinese thumbs down on the Teck deal helped ensure that the proposal failed at the shareholders’ vote. It did, however, also refocus attention on the stakes that Chinese SOEs (et al.) held in major Canadian companies. At the time that Ottawa cracked down on Chinese stakebuying, it was also indicated they would not go after legacy stakes. The Chinese “playing God” at Teck’s hour of need could very well reopen that debate.

On the 23rd of May the company announced that it had sold 110,700 Class B subordinate voting shares thru trades on the Toronto Stock Exchange and other alternative trading systems in Canada at an average price of approximately C$54.40 per Class B Share, for aggregate gross proceeds of approximately CAD$6,022,080.

This brought the holding of Fullbloom down to 53,128,474 Class B Shares of Teck, representing approximately 9.99% of the issued and outstanding Class B Shares and approximately 4.05% of the aggregate voting rights attaching to Teck's Class A common shares and the Class B Shares of Teck. This of course, removes CIC’s status as a reporting insider in Canada. Hmmmm.

Then Teck Chokes

Just hours ahead of the long-awaited vote on the restructuring plan, Teck announced that it had "determined not to proceed with the consideration by its shareholders at its upcoming annual and special meeting of shareholders on April 26, 2023 of the current proposal to reorganize Teck's business into two companies". It also canned the related items of business in respect of the consideration of the stock option plan for EVR and the shareholder rights plan for EVR.

Quite clearly the vibes from the Chinese (and others) had spooked Teck's controlling shareholders into thinking that the shareholders might vote down the proposal and thus weaken Teck's hand. Which it has ended up doing anyway. The philosophy might be to live to fight another day.

Loaded with Irony

The poignancy of all this is that the transaction that should never have occurred in 2008, and that we (and others) had urged to take place in the intervening 15 years, should finally be adopted by management and then proving to be a catalyst for them being put in the target zone for a takeover (of sorts).

Conclusion

Well, might they say: "Oh, what a tangled web we weave when we seek to sustain an unviable discriminatory share structure past its use-by date". Teck has spent much time and missed opportunity over the years trying to sustain the unsustainable and now the chickens are coming home to roost.

Way back in June of 2017, we wrote in our Monthly Review: "Frankly, the company would be rewarded by the market if it split off the coal assets and set them free". And we noted that Teck should take its cue from RTZ, which was doing just that (though as a trade sale) at that time in Australia.

In our opinion, the Teck proposal to resolve its complicated voting structure was too little too late. The steelmaking coal assets should be simply demerged and the metals division should hit the (smart) acquisition trail to bulk up. As for Glencore, it should demerge its coal, and maybe even its other mining assets, and return to its roots as a trader.

Teck, in recent days, has claimed that it has received a number of inbound indications of interest regarding various forms of potential transactions involving Teck's steelmaking coal business. However, with the Chinese knocked out of the picture and Western markets wary of the "C" word, that leaves only the Indians.

We came, and went, through a **LONG** position in Teck in recent years. Adding it to the Model Resources Portfolio at $22.46 in June 2017 and cutting the position loose in late 2021, at a price where we were up over 100%.

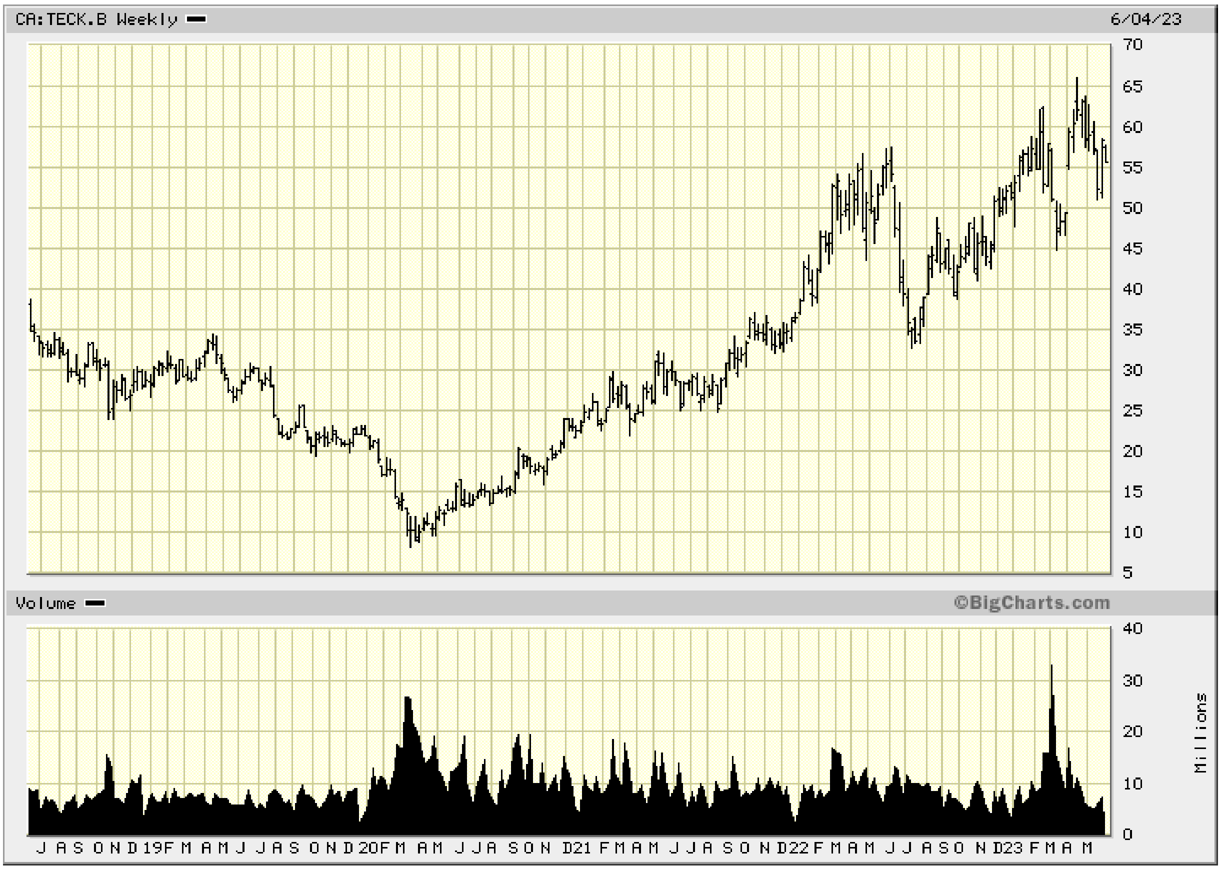
As we noted in one of our recent Twitter posts "Would the last Canadian major to leave the room, please turn out the lights!". The Teck proposal creates two Canadian majors, most particularly a real major in Coal, which it has hitherto lacked (at least since Teck acquired Fording in 2008).

The Glencore transaction moots recombining some of the assets (or at least the memory thereof) that were moved to foreign control by the Noranda and Falconbridge takeovers of unfond memory. But those entities, while Canadian-listed, wont seemingly be domiciled in Canada.

Teck appears well overvalued at current levels, but the prospect of being on board the Glencore "mash-up" strategy does not look attractive either. We suspect Teck can come up with a better idea than it has done so far. In our more fanciful moments we wonder what merging Vale's base metal division (mooted for demerger) with Teck Metals might look like. That would truly create a Canadian champion that could stand on the exalted heights where only BHP and RTZ currently dwell. Only an epic deal of such dimensions might justify Teck's current $29bn valuation.

For now, the deal from Glencore is frankly bad for Teck, bad for shareholders and bad for Canada.

Pass…..



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