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Research Update:

Taseko Mines Ltd. Upgraded To 'B' From 'B-' On Revised Copper Price Assumptions; Outlook Stable

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Overview

- We expect Canada-based copper producer Taseko Mines Limited to generate credit measures stronger than our previous expectations over the next two years, led primarily by the increase in our copper price assumptions.
- Based on the corresponding improvement in our earnings and cash flows estimates, we expect Taseko's adjusted debt-to-EBITDA to remain below 4x in 2018 and 2019, in line with our previous upgrade trigger.
- In our view, the lack of near-term debt maturities and ample cash position provides Taseko with greater flexibility to manage future periods of copper price volatility.
- As a result, we are raising our ratings on Taseko, including our long-term corporate credit rating to 'B' from 'B-'.
- The stable outlook on Taseko primarily reflects our expectation that the company will generate and sustain adjusted debt-to-EBITDA below 4x over the next two years, led by the gradual increase in our copper price assumption that should facilitate modest improvement in the company's liquidity position.

Rating Action

On March 20, 2018, S&P Global Ratings raised its long-term corporate credit rating to 'B' from 'B-'. The outlook is stable.

At the same time, S&P Global Ratings raised its issue-level rating on the company's US$250 million senior secured notes due 2022 to 'B' from 'B-'. The '3' recovery rating on the debt is unchanged and reflects our expectation for meaningful (50%-70%; rounded estimate of 65%) recovery in the event of default.

Rationale

The upgrade primarily reflects the improvement in our estimates for Taseko's prospective cash flows and credit measures, which mainly reflect improved copper prices. Prices have remained strong and above our previous expectations for several months, and we recently revised our assumptions for 2018-2020 (see " Metals Stay Strong: S&P Global Ratings Raises Its Price Assumptions For

Metals Again," published March 8, 2018, on RatingsDirect). We now expect Taseko to generate an average adjusted debt-to-EBITDA ratio below 4x over the next two years, in line with our previous upgrade trigger. We also expect the company to generate positive free cash flow over this period, which should strengthen its liquidity position from improved levels in 2017. In our view, Taseko's stronger cash position and lack of near-term debt maturities following its refinancing last year, improve the company's ability to manage copper price volatility.

Our assessment of Taseko's financial risk assessment has improved following the increase in our estimates of the company's cash flows and credit measures. We now estimate Taseko will generate an adjusted debt-to-EBITDA ratio of just below 4x in 2018 and the mid-3x area in 2019. Our assessment also incorporates the stronger-than-expected operating results the company generated in 2017. Leverage significantly declined to about 2.5x, following sharply higher earnings and cash flow that facilitated material (about C$70 million) net debt reduction.

We do not consider strong credit measures in 2017 to be sustainable, given above-average grades that are expected to revert to life of mine average levels over the next two years. However, we view Taseko's prospective leverage, which includes the company's silver stream agreement (about 0.5x impact) and is not net of cash on hand, to be commensurate with the ratings. Our expectation for modestly lower earnings and cash flow reflect lower, albeit relatively stable annual copper output, and a corresponding increase in Taseko's cash cost of production. We estimate gradually higher copper prices will likely mitigate the impact on the company's margins. We also expect Taseko to generate positive free cash flow, particularly in 2019, with relatively stable debt levels following the company's refinancing transactions in 2017.

Our financial risk assessment also incorporates our expectation for copper price volatility, the potential for increases in capital expenditures, and debt related to Taseko's Florence copper project in Arizona. We estimate that a relatively modest decline in average prices could lead to a material increase in the company's leverage measures. For example, a 20 U.S. cent per pound decline in copper prices in 2018 and 2019 (relative to our pricing assumption) increases Taseko's estimated adjusted debt-to-EBITDA by about 1x. While we expect copper prices to gradually improve through 2020, we cannot rule this out.

We assume investments in the Florence project to remain relatively high this year, related to Taseko's production test facility (about US$20 million), but decline in 2019 and support free cash flow generation. Barring a material downturn in copper prices, we believe the company will proceed with the project (Phase 2) once permitted. However, we do not envision major construction starting before 2020. In addition, we have not included the project in our estimates, particularly given the uncertainty regarding the amount of debt that could be required to fund the significant (about US$200 million) capital expenditures, and the related timing.

Our base-case assumptions are as follows:

- Copper price of US$2.90 and US$3.00 per pound in 2018 and 2019, respectively
- Average production cash costs, net of modest molybdenum byproduct revenues, of close to US$2.00 per pound in 2018 and modestly declining in 2019
- Annual attributable copper production of about 100 million pounds
- Capital expenditures of about C$60 million in 2018, which include capitalized stripping costs and spending on the production test facility at Florence
- Our adjusted debt calculation primarily consists of the secured notes, asset retirement obligations, and silver stream agreement

Our view of Taseko's business risk profile primarily reflects a single mine operation with a high cost structure. The company derives all production from its 75%-owned Gibraltar mine, which exposes it to copper market fluctuations and unexpected production disruptions that can impair operating results. In addition, the company's profitability remains highly sensitive to weaker-than-expected copper prices or higher-than-expected costs given the small scale of operations and high cost structure. In our view, these factors limit upside to our assessment. However, the Gibraltar mine's multi-decade mine life provides a high degree of production visibility and the company also has several potential development properties. The Florence project provides the greatest opportunity for Taseko to enhance its operating breadth, but commercial production is unlikely before 2021 and, at this point, not incorporated into our assessment.

Liquidity

We continue to view Taseko's liquidity position as adequate. We expect the company's sources of liquidity will exceed uses by over 1.2x in the next 12 months. We also expect that the company will achieve positive sources less uses in the short term, even if EBITDA declines by 15%. In addition, we now believe that the company has a generally satisfactory standing in credit markets, has demonstrated prudence in managing its liquidity, and does not face covenant issues.

Principal liquidity sources include:

- Estimated cash and equivalents of about C$80 million at Dec. 31, 2017
- Funds from operations of about C$75 million over the next 12 months

Principal liquidity uses include:

- Debt repayment requirements of about C$10 million related to capital leases and equipment loans in 2018
- Capital expenditures of about C$60 million in 2018 and meaningfully lower in 2019

Outlook

The stable outlook reflects our expectation that the company will generate an adjusted debt-to-EBITDA ratio of below 4x over the next two years, and improve its liquidity position from positive free cash flow generation. Our estimates are driven primarily on our expectations for relatively strong average copper metal prices to persist in 2018 and 2019.

Downside scenario

We could take a negative rating action if Taseko were to generate earnings and cash flow below our expectations leading to adjusted debt-to-EBITDA ratio of about 5x or if the company generates negative free operating cash flows to an extent that materially weakens its liquidity. In this scenario, we would expect Taseko to realize weaker copper margins from lower prices or higher-than-expected cash costs, or capital expenditures materially above our estimates.

Upside scenario

We believe an upgrade is highly unlikely in the next 12 months given the limited diversification of Taseko's operations and high sensitivity to copper price fluctuations related to its relatively high cost structure. However, we could upgrade Taseko if it materially improves its scale and operational diversity, most likely from acquisitions, and we believe the company will maintain an adjusted debt-to-EBITDA ratio below 3x.

Ratings Score Snapshot

Corporate Credit Rating: B/Stable/--

Business risk: Vulnerable
- Country risk: Very low
- Industry risk: Moderately high
- Competitive position: Vulnerable

Financial risk: Aggressive
- Cash flow/leverage: Aggressive

Anchor: b

Modifiers
- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)

- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Issue Ratings--Recovery Analysis

Key analytical factors

- Our '3' recovery rating on Taseko's senior secured notes is unchanged. The issue-level rating on the notes is 'B', in line with our 'B' long-term corporate credit rating and our notching guidelines for a '3' recovery rating.
- We value the company as a going-concern using a 5x multiple (which is consistent with mining peers) of our projected emergence EBITDA, which approximates Taseko's fixed charges in the simulated default year and represents persistent weakness in copper prices and a significant decline from our estimate of the company's EBITDA in 2018.
- The '3' recovery rating on the company's senior secured notes corresponds with meaningful (50%-70%,rounded estimate 65%) recovery and an issue-level rating that is the same as the corporate credit rating.
- The notes have a first-lien claim on Taseko's 75% interest in the company's Gibraltar mine in British Columbia.

Simulated default assumptions

- Simulated year of default: 2021
- EBITDA at emergence: About C$50 million
- EBITDA multiple: 5x
- Canada-U.S. exchange rate: $1.29

Simplified waterfall

- Net enterprise value (after 5% administrative costs): C$240 million
- Valuation split in % (obligors/non-obligors): 100/0
- Priority claims: C$13 million

- Total value available to secured claims: About C$230 million
- Senior secured debt claims: About C$335 million
- --Recovery expectations: 50%-70%; rounded estimate 65%

All debt amounts include six months of prepetition interest

Related Criteria

- Criteria - Corporates - General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Metals And Mining Upstream Industry, Dec. 20, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - Industrials: Methodology For Standard & Poor's Metals And Mining Price Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Metals Stay Strong: S&P Global Ratings Raises Its Price Assumptions For Metals Again, March 8, 2018

Ratings List

Upgraded; Recovery Rating Unchanged

	To	From
Taseko Mines Limited		
Corporate Credit Rating	B/Stable/--	B-/Stable/--
Senior Secured	B	B-
Recovery Rating	3(65%)	3(65%)

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.