Will Teck Resources Ltd. Cut Its Dividend?

Description

The market for metallurgical coal, also known as steelmaking coal, is in the dumps and copper prices aren't faring much better. Unfortunately for **Teck Resources Ltd.** (TSX: TCK.B)(NYSE: TCK), the company is a major producer of both commodities.

As a result, Teck's earnings are getting pinched and the stock price is trading near a five-year low. In fact, the company's shares have been on a downward trend since topping the $60 mark in early 2011, currently trading closer to $20.

Investors that believe in the long-term value of Teck have been somewhat consoled by the fact that the dividend is still intact. The current distribution of $0.90 per share yields about 4.25%.

Are new investors in Teck kidding themselves by thinking they will get paid to wait for the turnaround?

Let's take a look at Teck's situation and see if the dividend is at risk.

Metallurigcal coal earnings

In the second quarter of 2014, Teck's average realized price for steelmaking coal came in at an abysmal US$111 per tonne. Coal represented about 42% of Teck's Q2 revenue.

North American producers have scaled back production of met coal but the slowdown in China's steelmaking industry combined with increased met coal exports from Australian sources continues to throw a black cloud over the market.

For most producers in the industry, the current price is way below their operational breakeven level and analysts believe the rock-bottom price in unsustainable for the long term. Teck still managed to squeeze some earnings out of the division with a 3% gross profit.

Copper earnings

Teck only received US$3.08 per pound in the second quarter for its copper production. However, the company is a low-cost producer of the base metal and still realized gross profit margins of 25% in its copper operations. Copper accounted for roughly 32% of second-quarter revenue.

Zinc earnings

The zinc market is actually in very good shape. Teck's Q2 2014 average realized price came in at US$0.94 per pound, a 13% gain over the same period in 2013. Gross profit margins in the zinc operation were 21%. Zinc sales contributed the other 26% of revenue in the second quarter.

The company is restarting its Pend Oreille zinc mine in December, and recently raised its 2014 zinc production guidance. The company now expects to produce 600,000 to 615,000 tonnes, up from the original forecast of 555,000 to 585,000 tonnes. The increase is primarily attributable to better-than-expected production at its Red Dog mine.

Teck has done an excellent job of reducing costs in order to maintain profitability during the downtrend in the met coal and copper markets. The company's cash balance was a healthy $2.1 billion as of June 30 2014.

Teck has a 20% interest in the Fort Hills oil sands project. The company is committed to spending nearly $3 billion over the next four years on the project. By 2018, the facility is expected to be operational, producing more than 160,000 barrels of oil per day.

In its Q2 2014 report, Teck announced a plan to repurchase up to 20 million shares in the next 12 months.

What does it all mean for Teck's dividend?

Teck is still profitable. The company is maintaining its commitment to Fort Hills, and even plans to buy back more than 3.5% of its common stock.

Given its financial stability, it is extremely unlikely that Teck will cut its dividend anytime soon. In fact, once the Fort Hills project moves from development to production, it is possible that Teck will increase the dividend payout.

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aswalker