Is Teck Resources Ltd's Generous 5.3% Dividend Yield Safe?

Description

With the exception of some of the most popular technology names, I'm not sure there's a more exciting stock to own than **Teck Resources Ltd.** (TSX: TCK.B)(NYSE: TCK).

After being one of the best performing stocks on the TSX between 2002 and 2008, the stock absolutely cratered during the Great Recession. Shares dipped all the way from more than $50 each to $5. The company's seemingly imminent bankruptcy was one of the major stories in early 2009.

But to its credit, the company managed to avoid a restructuring, giving investors who were brave enough to buy during the low period some huge returns. By the end of 2010 shares traded at more than $60 again, but the gain was short-lived, as shares began a slow and steady decline. As of today, shares have cratered to just $17.10 each.

Because of the huge decline in the share price, Teck has a pretty attractive dividend yield, coming in at 5.3%. Can investors count on it going forward? Let's take a closer look.

Free cash flow

Based on net earnings, the verdict is pretty simple. Teck's dividend is $0.90 per share annually, and results for the last 12 months show net earnings of just $0.81 per share. Considering the strength of the metallurgical coal market — which accounts for more than 50% of Teck's revenue — results are likely to get worse going forward, not better. That's because the price of coal is at close to a five-year low, mostly due to a lack of demand from its biggest customer, China.

A look at free cash flow isn't much better. Through the first nine months of 2014, the company generated approximately $1.5 billion in cash from operating activities. Once you subtract nearly $1.1 billion in capital expenditures, there isn't quite enough to pay the dividend, which came in at $518 million. On the surface, that's not good.

But in reality, it isn't that bad. Unlike most companies, Teck doesn't pay a quarterly dividend, it pays semi-annually in January and July. All free cash flow has to do in the fourth quarter is come in marginally positive and it will be enough to cover the dividend.

Although it's dwarfed by its long-term debt, Teck still has cash in the bank, to the tune of $1.8 billion. This cash pile is slowly being depleted, but not to cover operational issues. This serves as a bit of a cushion.

There's one main reason for investors to get excited about Teck Resources going forward.

A potential free cash flow machine

The future is mostly in the oil sands, after the company decided not to go ahead with two coal projects in B.C. and Chile.

Along with other owners **Suncor Energy** and **Total SA**, Teck controls 20% of the Fort Hills project, which is projected to start producing oil by 2018. Estimates are that it will grow to produce 180,000 barrels of oil per day within a year, and has reserves of more than 3 billion barrels. It might be the finest piece of land in the region not already developed.

Teck’s portion of that will be 36,000 barrels per day, or 13 million barrels per year. At a recent conference, management indicated that the company was looking at a projected free cash flow of more than $450 million annually from Fort Hills, which nearly doubles its current free cash flow. That’s great news for the company in the long-term.

That’s the crux of Teck’s dividend right there. If the metallurgical coal market rebounds, and both zinc and copper remain relatively strong, it’ll have no problem maintaining its payout. If raw materials continue to sell off, cutting it to save cash would be prudent. At this point I’d call the dividend safe, but investors will need to keep an eye on it.

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