3 Reasons a Dividend Cut Is Coming at Teck Resources Inc.

Description

Recent years have not been fun for **Teck Resources Inc.** (TSX:TCK.B)(NYSE:TCK) nor its shareholders. Most crucially, prices for steelmaking coal have more than halved since 2011, putting a big dent in Teck's bottom line.

Yet over this time, the company's dividend has actually increased by 50%. Teck now yields 5.3%, good enough for fourth place on the **S&P/TSX 60**, and many investors are wondering if this payout is safe.

If I were you, I wouldn't count on it. Below are three reasons why.

1. The balance sheet

In years past, Teck has been a very aggressive company, one that has made big acquisitions in an attempt to grow. So, in today's environment of depressed commodity prices, you would expect Teck to have a shaky balance sheet. Unfortunately, you would be right.

Based on year-end 2014 numbers Teck has 2 billion of cash, but $8.4 billion in debt. That results in net debt of $6.4 billion, or over $11 per share. Keep in mind that Teck has a stock price under $20.

CEO Don Lindsay wants Teck to have an investment-grade credit rating, and has made that a top priority. Here's the problem: in January S&P cut Teck's credit rating to BBB-. This is the lowest investment-grade credit rating any company could have, so if Teck's rating is cut again, Mr. Lindsay's goal will be unfulfilled. Cutting the dividend (which currently costs the company around $500 million) would help Teck avoid this scenario.

2. Cash needs

If Teck wasn't under enough pressure already, it has committed US$2.9 billion in capital to the Fort Hills oil sands project. First production will begin in 2017 assuming there are no delays.

Making matters worse, Teck only owns 20% of Fort Hills, meaning the company does not control the project's fate. **Suncor Energy Inc.** is the project operator and largest stakeholder. So, as long as

Suncor wants to build Fort Hills, Teck must follow along.

At this point, Teck’s management seems happy with Fort Hills, even if shareholders are less than thrilled. That said, even Mr. Lindsay must acknowledge that the project will put more pressure on the company’s balance sheet. The dividend may just have to take a back seat.

3. Another acquisition?

Given Teck’s situation, you would think the company is not looking to make any acquisitions. This time, you’d be wrong.

At Teck’s annual meeting this week, Mr. Lindsay said the company is looking to acquire a copper-producing asset. The reason is simple: as it stands, copper production is set to decline, and the company’s major copper projects have been stalled. An acquisition could reverse this decline.

Given all these priorities, I can’t imagine Teck paying shareholders $500 million per year. So, if you’re counting on that dividend for some regular income, I would switch your investment into a more reliable company.

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