Dividend Watch: Teck Resources Ltd.

Description

Teck Resources Ltd. (TSX:TCK.B)(NYSE:TCK) offers investors a big dividend, but market watchers are concerned about the safety of the payout.

Let's take a look at Teck to see if the company should be in your portfolio.

Stock and dividend history

Teck's stock has been on a nasty multi-year slide, dropping from $60 all the way down to the current level of $16.50. The interesting thing in the story is that Teck has remained profitable all along and actually increased the dividend payout. In fact, the distribution increased by 50% in the past four years.

The company has done a fantastic job of managing costs and keeping all three divisions in the black, despite the weak environment. But margins are getting squeezed and analysts are concerned the payout is no longer sustainable.

Coal and base metal prices

Teck produces three commodities that have been under severe pressure for some time.

Metallurgical coal is the company's largest source of revenue, but prices for steel-making coal, as it is also known, have been in the dumps for several years. The current price is less than $120 per tonne, a level that puts nearly a third of all producers in the red.

North American suppliers have cut coal production to try to bring the market back into balance, but low demand from China and high output in Australia continue to depress prices.

A turnaround in the met-coal market had been expected for the second half of 2015, but that could get pushed into next year.

Copper and zinc are Teck's two other products. Both base metals took a nosedive through the end of 2014, but a solid rally off the lows has pundits trying to decide if copper and zinc have finally bottomed out. Zinc is up more than 11% in the past month and copper prices have picked up about 10% since the end of January.

Canadian dollar weakness and falling oil prices

The weakness in the Canadian dollar against its U.S. counterpart helps offset low commodity prices. Teck says every one-cent drop in the loonie against the U.S. dollar adds $52 million in annualized earnings. Every US$1 drop in the price of oil adds $5 million to the bottom line. The Canadian dollar has dropped four cents since the start of the year and analysts generally expect the trend to continue. Oil prices are enjoying a bit of a tailwind right now, but it's too early to tell if the market has bottomed.

Balance sheet

Teck finished 2014 with about $2 billion in cash and cash equivalents and an untapped credit line of $3 billion. The company paid $518 million in dividends last year.

Should you buy?

At this point, the company still has ample funds to cover the $0.90 per share dividend. The big concern for analysts is Teck's $2.9 billion commitment over the next couple of years to get the Fort Hills oil sands facility completed.

Management might decide to reduce the distribution as a precaution to provide a cushion until Fort Hills is finished, but expectations for a cut to the payout are likely already baked into the stock.

At this point, I think long-term investors should buy the stock as a contrarian play, not as an income generator. Commodity prices run in cycles and it's always best to pick up best-in-class producers when things are really bad. If met coal, copper, and zinc stabilize or move higher from here, the dividend should survive and investors can treat that as a bonus.

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