Is Teck Resources Ltd.'s Dividend Cut Too Little, Too Late?

Description

Coal, copper, and zinc miner **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) recently slashed its dividend by two-thirds in order to shore up its balance sheet as the impact of sharply lower commodities prices bites deeper.

Surprisingly, even after this piece of bad news, some analysts are convinced that Teck represents a long-term contrarian investment on a rebound in commodity prices. This couldn't be further from the truth, with Teck set to come under even greater pressure as commodity prices weaken further.

Now what?

While some analysts are claiming that the collapse in commodity prices is nothing more than a cyclical downturn, I believe they are moving back to their fair value after the end of the commodities super-cycle.

Over the last decade commodities prices were distorted by the insatiable demand of a rapidly modernizing China, which created a commodities boom of epic proportions. Demand for steel-making coal, iron ore, steel, and copper soared to record levels as China rapidly urbanized, expanded its industrial base, and grew its GDP by double digits almost every year.

However, the good times have come to an end with China's economy slowing sharply in recent years. The 2015 GDP is forecast to have growth of 7%, which is its lowest level in almost three decades. Such a significant decline in the rate of economic growth will drive lower demand for commodities across the board.

The terminal decline of China's construction activity is having a marked impact on demand for steel-making coal and copper, as China is the single largest user of steel and copper. It is also unlikely the industry will recover anytime soon because China has overbuilt, with existing housing inventories in major urban centres more than capable of meeting demand.

Supply pressures are also set to take their toll on prices for steel-making coal. There are already large inventories in China and major miners, including **BHP Billiton Ltd.,** that are focused on expanding production to boost efficiencies and replace revenue lost because of weak prices.

For all of these reasons, I expect prices for steel-making coal to weaken further, as it is set to drop below US$100 per tonne.

So what?

The impact of these headwinds can already be seen in Teck's first quarter 2015 results. Steel-making coal had an average price of US$106 per tonne, or 19% lower than a year ago and 34% lower than the same period in 2013. With steel-making coal making up 40% of Teck's revenue, I expect its financial position to deteriorate further, despite the recent dividend cut that created $340 million in annual savings.

In fact, it could even experience a liquidity crunch should commodity prices plummet further. This is despite having $1.4 billion in cash on its balance sheet and an available line of credit for US$3 billion. Teck is committed to spending a further $2 billion on the Fort Hills oil sands project and has $1.8 billion in debt maturing between now and the start of 2018.

For these reasons, I believe that Teck's outlook remains poor and another dividend cut could be on the table. This makes it a stock that offers little to no upside and should be avoided by investors.

CATEGORY

1. Dividend Stocks
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1. Editor's Choice

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1. NYSE:TECK (Teck Resources Limited)
2. TSX:TECK.B (Teck Resources Limited)

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