These Are 2 of Canada's Most At-Risk Dividends

Description

It's a tough time to be a commodity company shareholder. The RBC commodity price index, which tracks 24 of the top exported Canadian commodities, is currently sitting at lows not seen since 2008, and before that, 2005. Perhaps the most concerning aspect of owning commodity stocks has been the slew of dividend cuts to hit the space recently.

Shareholders of **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) and **Canadian Oil Sands Ltd.** (TSX:COS) know this better than anyone. In April Teck cut its dividend by a staggering 66%—on the back of metallurgical coal prices hitting a decade low—from $0.45 to $0.15 semi-annually. Canadian Oil Sands made a similar move in January of this year, slashing its top-tier dividend by 85% from $0.35 to $0.05 due to tumbling oil prices

While investors may be comfortable with the sustainability of the current dividends for both these companies, the numbers reveal cause for concern. Ultimately, the dividends of both these companies depend on the prices of their underlying commodities. The previous dividend cuts for both companies made the new dividends sustainable temporarily at previous price levels, but unfortunately, prices for both oil, coal, and copper have slid further since then.

A closer look at Canadian Oil Sands's dividend

A quick look at the guidance document released by Canadian Oil Sands on July 30th certainly bodes well for the dividend. The company is forecasting cash flow from operations of $474 million (which was revised upwards from the previous April 2015 guidance largely due to the strong American dollar). At the same time the company is forecasting capital expenditures of $422 million. This means the company has $52 million of free cash to use to fund its dividend.

With the dividend estimated to cost about $97 million for the year, the company is only short about $45 million. This is a deficit that is sustainable for quite a while. Currently, Canadian Oil Sands has $1.54 billion in available credit facilities, with $555 million currently drawn. Borrowing an additional $45 million annually for several years would not add significantly to the net debt of the company.

The problem for Canadian Oil Sands is the assumptions it used to calculate its cash flow. Most importantly, Canadian Oil Sands used an average WTI oil price of US$55 for 2015 to make its calculations. As of this writing, WTI prices are sitting at US$45.30 per barrel. For the first half of the year Canadian Oil Sands realized an average WTI price of $53.34 per barrel, meaning that WTI prices are already below the forecasted amount for half the year.

A return to the mid-50s for the second half of the year looks unlikely because of a weak Chinese economy, a American strong dollar, and strong supply weighing down the market. If oil prices average US$50 for 2015, Canadian Oil Sands would see an overall shortfall of nearly $200 million, according to their estimates. This could be even greater if production comes in lower, and this would almost certainly result in another dividend reduction.

Teck Resources is in a similar boat

Teck Resources also requires prices for its key commodities to recover in order for its dividend to be sustainable. Teck's products include metallurgical coal, copper, and zinc. Coal and copper are Teck's primary products; coal prices are currently hovering near decade lows, and copper prices are near six-year lows.

Currently, Teck Resources has average coal prices of US$101 per tonne for the year, copper prices of US$2.69 per pound, and zinc prices of US$0.97 per pound. According to estimates by analysts at TD Bank, if coal prices were to average US$99.8 per tonne for 2015, and copper prices were to average US$2.55 and US$0.95 per pound, respectively (which is a reasonable estimate), then Teck would bring in about $1.7 billion in cash flow for the year.

However, due to Teck's large amount of capital expenditures (including their Fort Hills oil sands project), the company is expecting $2.1 billion in capital expenses for the year. With dividends of about $350 million, the company will be about $750 million short for 2015.

While the company started the year with $2.1 billion in cash and has about $4.2 billion in undrawn credit facilities, the dividend is unsustainable if prices do not improve substantially. Few analysts are betting on a steep recovery.

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Date
2025/08/01
Date Created
2015/08/05
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