Will Teck Resources Ltd. Finally Eliminate its Dividend?

Description

As prices of copper and coal—**Teck Resources Ltd.'s** (TSX:TCK.B)(NYSE:TCK) main products—continue their plunge, so does Teck's dividend. As of about two weeks ago, Teck paid a dividend of about $0.30 annually, which worked out to a healthy yield of about 5%. This recently changed, with Teck slashing that dividend by 67% to 0.10% annually—a yield of only 1.8%.

This is on the back of another dividend cut in April, when Teck cut its dividend once again by 67%. The reasons why are clear: Teck ended 2014 with metallurgical coal prices of about $126 per tonne, and today they are sitting at about $73 per tonne.

The same goes for Teck's second-biggest product—copper—which is at a six-year low. For investors looking at Teck's dividend, the question is whether or not the dividend is sustainable at current price levels or even at lower levels if prices continue to fall.

Teck's previous dividends were unsustainable

The amount of cash flow Teck receives (which it uses to pay its dividend) is dependent on both Teck's production levels and the prices it receives. For 2015, Teck should have operating cash flow of about $1.5 billion (although it could be lower depending on how weak prices remain during Q4). This is down from $1.9 billion in operating cash flow for 2014.

While this may not seem like a huge drop, it is important to remember that Teck has plenty to spend on capital expenditures due to the fact that it is funding its Fort Hills oil sands project, which is due to be in service in 2017. Teck still has about $1.5 billion to put into Fort Hills on top of its regular sustaining capital expenditures.

The end result is that Teck will be spending $2.2 billion on capital expenditures this year, which is far more than the $1.5 billion it will be taking in. This $700 million shortfall was only made worse by Teck's dividend. Teck's previous dividend of $0.30 annually would have cost them $173 million annually, an amount Teck simply couldn't afford given its already large shortfall.

This shortfall is made even worse by the fact that Teck had about $400 million of debt due in October, and although the company began the year with $2 billion in cash, at the current rate of cash outflow, Teck would've ran out of cash by the end of 2016 and would be forced to draw on its credit lines.

Fortunately, the dividend now seems sustainable

The good news for Teck shareholders is that a slew of recent events at Teck—on top of the dividend cut—now makes Teck's dividend seem sustainable, even if Teck sees a further decline in commodity prices.

Teck's recent dividend cut will reduce the dividend from $173 million to about $57 million. Although this may not sound like much in the context of Teck's huge shortfall, Teck has also recently announced that it will also be cutting its capital expenditures by $350 million as well as its operating expenses by about $300 million.

In addition to this, Teck has recently engaged in a series of streaming agreements. These agreements involve selling future production for upfront payments, and the recent agreement with **Franco-Nevada Corp.** involved Teck selling future silver output for US$610 million. This is in addition to a similar agreement made earlier in the year, in which Teck received US$162 million for a total of about CAD$1 billion.

The end result of all these actions means Teck's new dividend is almost certainly secure. After raising $1 billion in cash from the streaming agreements, Teck will end the year with $1.8 billion in the bank.

Most analysts are expecting a slight recovery in prices next year (**RBC** is predicting prices of $105 per tonne for coal, and **TD** is expecting about $85 per tonne), but even in a scenario where prices average lower than this year, the recent cuts combined with Teck's strong cash position should enable it to maintain its fairly small dividend for the next year or two.

After 2017, Teck should see its capital expenses drop because Fort Hills will be completed, which should further solidify the dividend.

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