



## An Insider's View of the Market's Most Beaten Up Sector

### Description

**Take Stock** is the Motley Fool Canada's **free** investing newsletter. To have future editions delivered directly to you, simply [click here now](#).

Dear Fellow Fools,

A few weeks ago, Fool.ca contributor Robert Baillieul had the chance to interview **Silver Wheaton's** (TSX:SLW, NYSE:SLW) CEO, Randy Smallwood. At this time of year, when so many are reflecting on what worked and what didn't in 2013, it's hard to argue that Silver Wheaton, and the rest of its mining related peers are at the top of most "didn't work" lists. In this week's Take Stock we provide four highlights of Robert and Randy's conversation that relate to the current state of the mining industry, as well as what the future may hold.

Enjoy the discussion.....

**Robert Baillieul:** After the recent battering the mining industry has taken, is there any sense of optimism?

**Randy Smallwood:** I would say right now most people are pretty confident that we're near a bottom. I don't think anyone wants to pick off a bottom in commodity prices. But there're a lot of factors that sort of support that.

The cost to actually produce the metal is the strongest one. Where you can actually point to hard data. There just isn't a lot of space further down without impacting mining capacity. So that supply side pressure will support the price itself.

So now the question is how long until we're going to stay in this trough. And so much of that depends on, and I'm going to say, emotional sentiment to the U.S. dollar remaining a reserve currency.

I'm going to quote someone on T.V., 'There's a lot of happy speak about how strong the economy is.' But we don't see any strong changes. Somewhere along the line it's going to catch up and we're going to see strength again in precious metals.

The general consensus out there, most people seem to think it's probably six months to a year and a half before reality really kicks in. And people realize that the U.S. dollar doesn't have any fiscal strength behind it.

**Baillieul: Let me play devil's advocate to that point. When I look out at the economy right now, inflation is pretty well flat. We haven't seen any uptick in the consumer price index. We're expecting maybe a Fed taper announcement this afternoon or possibly by the spring. Other than your supply side argument, why would I want to be in precious metals?**

**Smallwood:** Well because we're near a bottom in terms of the supply side means that it's a good time to invest into it. The question is, and this is what we've seen, how long is it going to be until it actually starts moving again.

And you have to go back and look at fiscal policies in the United States. And some of the drive that we have seen in the economy is due to the devaluation of these fiat currencies over the last five years.

People talk about this as the great commodity boom in terms of prices. I don't think that's the proper word. I think what we've seen is the massive devaluation of currencies around the world relative to hard assets.

When I look around the world, that's all I see. Countries continuing to devalue and it's just a matter of who's doing it the fastest. Who's doing it first. And right now the United States is losing that devaluation race. That will catch up to the United States.

For an economic perspective, when you have Japan massively devaluing their currency its going to shift away economic strength from the United States. The United States is of course important to us because that's what we're measuring the strength of precious metals in. So eventually that will catch up.

We see the Euro itself. Germany is setting records in terms of exports on a devalued Euro because they don't have to deal with the Mark. I don't think it's a system that's going to work.

So when I look around I see just enough band-aids being applied around the world. But bandaids don't fix the wounds. They only cover them. And it's eventually going to catch up.

**Baillieul: So given the bullish backdrop for precious metals, why are you more optimistic on the prospects of silver relative to gold?**

**Smallwood:** Well the first thing, and we've all seen this, is that silver is more volatile than gold. So when you make your investments in the bottom part of the price curve when precious metal prices move, and gold and silver have a very strong correlation with each other, silver will typically outperform gold. So that's one of the appeals of being in the silver space over the gold space.

The other core side of it is the fact that over half of silver is consumed. Silver conducts electricity better

than any other metal. It's the most efficient means of conducting electricity.

So in these times when we're looking for the most powerful smartphone, tablet, mobile electronics, silver is going to play a role. Solar panels, the efficiency in trying to get that it's a sustainable industry without subsidies, silver will play a role in that. Silver also has strong antibacterial qualities so you see continued new applications where silver is being used in water purification systems and burn treatment systems.

Half of it's consumed in a space where there is not a lot of recycling. So it's another strength that I see in silver that I don't see in gold.

Gold is a very emotional holding. There is some function strength behind the demand for silver. But the key reason for us is, of course, return. We're focused on profit. That higher volatility the silver has generally means that in an upwards market it will outperform.

**Robert Baillieul: ETFs have made it easy to add precious metals to a portfolio. In the U.S. we have the SPDR Gold Trust ([NYSEMKT:GLD](#)) and the iShares Silver Trust ([NYSEMKT:SLV](#)). Here in Canada we have the COMEX Silver ETF ([TSX:HUZ](#)). Why should I bother looking at a miner or a streamer like Silver Wheaton.**

**Randy Smallwood:** That's a great question. Where did ETFs come from? ETFs came from people who were concerned with the risk of investing into the mining space. And what we've seen in the traditional mining industry with the operators out there is that the problem they have is that as commodity prices climbed, so did their costs.

The market didn't expand nearly as much as anyone expected. So people were looking at the increases in commodity prices and felt safer in the ETF.

Well, I would challenge anyone that's invested in an ETF to take a good look at the streaming model and have a look at Silver Wheaton as an option. Because what we deliver is cost confidence. You know what our costs are going to be on a per-ounce basis. The capital cost, the upfront payment is all made and committed to and clear so there's no cost surprises.

So you get that same, in fact, *better* exposure to the commodity price because we have leverage. We do have that base cost around \$4 and some odd cents per ounce.

But on top of that you get exploration and expansion growth. And accretive acquisitions. So we continue to add value to exploration success at our operations. So that goes right back into our shares. And we give them the opportunity to expand in terms of making new acquisitions where we add in value.

So one of the facts that I think is really important is that an investor in Silver Wheaton had about one and a half ounces per share behind a share of Silver Wheaton. That same share, so that same share all of the way through and not adding any more shares, now has over six and a half ounces per share.

So we grow and you get the benefit of that growth that you don't get in an ETF. With an ETF, you get one ounce, and it stays an ounce. The only thing you get is the commodity price exposure. With Silver Wheaton you get that same commodity price exposure, you get leverage on that commodity price, and

you get gold within. And we pay a dividend.

And the final coup de grâce in this is that our company is very efficient. Our company has a total of 28 employees in the company right now. When you take our G&A [general and administrative expense] and compare it to the fees that you pay for an ETF, we deliver all of that for less than what the ETFs do. And when you consider that we pay a dividend, we actually pay you to own our stock.

And we deliver all of the above. We are a much more attractive investment than an ETF.

It's an area, and we have seen that. We have that the streaming companies, especially in the silver space, have taken market share compared to the ETFs. And it's an area that we put a lot of focus into trying to educate people the strengths that we provide. And we think we compare very favourably against an ETF.

### **The Foolish Bottom Line**

Randy's views on the future of his industry tend to fly in the face of how most are currently thinking about this sector. His bullish tone is predicated on some sizeable shifts that may or may not occur. Given this year's performance however, you can be sure that if Smallwood's views prevail, Silver Wheaton owners are going to be richly rewarded for their patience in 2013.

If you'd like to read the complete interview, just follow these 3 links:

Part 1: [Silver Wheaton CEO Randy Smallwood on Corporate Strategy, Debt Ratings, and Pascua Lama](#)

Part 2: ['The U.S. Dollar Doesn't Have Any Fiscal Strength Behind It.'](#)

Part 3: [Silver Wheaton CEO Randy Smallwood on Miners vs. ETFs](#)

Many thanks to Robert and Randy!

Foolishly yours,

Iain Butler

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