3 Reasons to Place a Contrarian Bet on Silver Wheaton Corp.

Description

Silver Wheaton Corp. (TSX: SLW) (NYSE: SLW) has lost a bit of its shine in the past three months. Traders drove the stock sharply lower in August when the company reported weaker-than-expected Q2 2014 earnings, and falling gold and silver prices have exacerbated the slide.

In the past two weeks, things have started to change. Silver Wheaton's shares bottomed near $21 on October 8 and the market is starting to realize the long-term prospects of this stock justify a much higher share price.

Here are three reasons why I think contrarian investors should consider buying Silver Wheaton right now.

1. Fed still on hold

Gold and silver prices have been on the slide for the past couple of months because investors started buying into the idea that the Fed was finally going to start increasing interest rates. We've seen this a number of times over the past three years, and each time, it has been a false start. This time it looks to be that way again.

Oil prices are in a bear market, global growth projections are being reduced, and disasters ranging from deadly diseases to civil wars are controlling the headlines. Suddenly, the Fed doesn't seem so keen to begin raising rates.

This is important for investors looking at Silver Wheaton because most people think the market will unload precious metals when interest rates begin to rise. In fact, the previous expectation of a rate hike in early 2015 is pretty much out the door and analysts are now looking at the end of next year or the beginning of 2016.

At some point, rates will rise, but the current weakness in the global economy is going to take a toll on the U.S. recovery and that means the Fed will continue to sit on the sidelines.

The long-term outlook for precious metals should be positive, given the fact that central banks are unlikely to slow down their printing presses. Eventually, you have to pay the piper.

2. Low-cost supply

Silver Wheaton continues to grow production through its streaming arrangements with the world's top miners. Periods of weak prices in the metals markets actually offer Silver Wheaton a great opportunity to secure added supply at favourable rates.

The company pays miners up front for long-term supply of the silver and gold by-products that come out of mines. In exchange for the lump-sum payment, Silver Wheaton only has to pay about $4 per ounce of silver and $400 per ounce of gold. Miners are having a tough time raising capital in the current market. With share prices being so weak, issuing equity is very dilutive and deals have to be done at heavily discounted prices. One way to get cash for exploration and expansion is to sign a streaming deal. Right now, Silver Wheaton can negotiate long-term contracts at excellent prices because the miners have no other place to go.

3. Production growth

In its Q2 2014 earnings statement, Silver Wheaton maintained its production guidance of 36 million silver equivalent ounces. By 2018, that number is expected to rise to 48 million ounces as the Constancia mine owned by **Hudbay Minerals Inc.** and the Rosemont mine owned by **Augusta Resource Corporation** begin production. Expansions at other mines already in operation will also add supply.

This is where contrarian investors should be getting excited. The market isn't pricing in the production growth. With such low input costs, Silver Wheaton is profitable at current prices and earnings should skyrocket as production ramps up and precious metals recover.

The bottom line

Being a contrarian investor takes some guts. Silver Wheaton is probably trading near its bottom, but there could be short-term volatility if Q3 earnings miss estimates. From a long-term perspective, the upside potential is huge and probably outweighs the downside risk at this point.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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1. NYSE:HBM (Hudbay Minerals Inc.)
2. TSX:WPM (Wheaton Precious Metals Corp.)

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Date
2025/07/28

Date Created
2014/10/22
Author
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