1 Thing You Must Know Before Investing in Silver Wheaton Corp.

Description

Silver Wheaton Corp.'s (TSX: SLW)(NYSE: SLW) stock has been under considerable downside pressure recently thanks to the slump in silver prices, with the downside gaining extra impetus following the latest disappointing earnings.

Many investors love Silver Wheaton because it is a metals streaming company. What this means is that the company has agreements with miners to purchase a certain amount of metal from their mines, generally for a previously agreed-upon price. The benefit of this is that it is not exposed to the risks inherent in mineral exploration and production. However, there are also downside risks with this arrangement, particularly in the current environment. As a result, metals streaming companies tend to outperform miners during a bull run but they are exposed to more downside risks in a low price environment.

Production

During a bull market, the fact that a metals streaming company's prices are fixed can be a good thing. When times are good, many miners choose to produce the maximum amount of metal possible, with little regard to production costs. Metals streaming companies do not engage in production, so this is of little consequence. The stock can rally on the sentiment of higher prices alone; investors don't even need to consider the business' operational (mining) costs. During the last bull run in silver prices, from 2005-2011, Silver Wheaton's stock soared an impressive 1,228%. Silver miners also soared, but their climb was much lower, with most silver miners rising between 150%-200%.

This fact changes when we are in a declining price environment. When metals prices decline, a great deal of the sentiment surround the stock value of miners relates to their ability to control production costs. For Silver Wheaton, production costs are completely out of its control; therefore, the sentiment surrounding its stock is mostly controlled by prices.

Price pinching

Streaming company's in essence pay up front for their share of metals. There are many different contract stipulations that streaming companies may request to help shelter themselves from fluctuations in prices, but, simply put, whenever a company agrees to purchase something in the future for a previously agreed-upon price, there is some risk. When we are in a rising price and demand environment, metals streaming companies can see benefits. However, when we are in a declining price and demand environment, this can be a negative.

If Silver Wheaton were to agree upon taking a large delivery of silver at a higher price and if the selling price collapses, as well as the demand for that silver, then the company risks getting pinched.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

1. TSX:WPM (Wheaton Precious Metals Corp.)

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