



Is Silver Wheaton Corp. the Best Way to Play the Gold and Silver Rally?

Description

Silver Wheaton Corp. (TSX:SLW)(NYSE:SLW) is up nearly 50% since early November and investors are wondering if the rally in the stock is going to continue as it approaches a major resistance point of \$30 per share.

In the past two years, Silver Wheaton has taken a run at the \$30 mark three times, but each of the previous rallies fizzled out, and the stock fell back sharply.

Let's take a look at the situation right now to see if the stock could be setting up for an extended move higher, or is destined to run out of steam and take the elevator back to \$20.

Gold and silver costs per ounce

Silver Wheaton has a very simple business model. The company pays miners upfront for a guaranteed supply of gold and silver extracted from mines that are primarily built to obtain other metals.

The agreements are made at very low prices. Silver Wheaton then sells the silver and gold at market prices when it receives the product.

Why would the miners do this?

Mining companies require huge amounts of capital to get a mine built and put into production. With gold, silver, and copper prices being very weak in recent times, the miners have had a tough time getting cheap capital.

Stock prices have been beaten up so badly that issuing equity is very dilutive. The bond market isn't a great option either, as lenders are demanding hefty premiums. Right now, Silver Wheaton is able to negotiate favourable deals because miners have very few options for securing cheap upfront capital.

In its Q3 2014 earnings statement, Silver Wheaton had an average silver cost of \$4.16 per ounce. Its average cost per ounce of gold was \$378. Cash operating margins for the third quarter were above 70% and the Q4 numbers should be even better.

As gold and silver prices continue to rally, Silver Wheaton's margins and free cash flow should expand significantly.

Balance sheet

Silver Wheaton finished the third quarter of 2014 with \$233 million in cash and a \$1 billion credit facility. This allows the company to take advantage of opportunities to secure long-term supply at attractive prices.

Production growth

Silver Wheaton is predicting strong production growth in 2015.

The Constancia project is expected to go into commercial production in the first half of this year. An expansion at the Salobo copper mine in Brazil is pumping out record gold production, and the Peñasquito mine in Mexico recently received a huge increase to its resource estimates.

Metals prices

Gold and silver prices are moving higher and the tailwinds behind the surge look like they could be strong enough this time to push the rally into the middle of the year.

If you believe that gold and silver have bottomed out, Silver Wheaton is a great way to play the rally without taking on the operating risks faced by the individual mining companies.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

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

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