



Is Silver Wheaton Corp. Really the Best Way to Bet on Silver's Recovery?

Description

There's a very simple reason why **Silver Wheaton Corp.** (TSX:SLW)(NYSE:SLW) is the most popular silver stock in Canada.

Instead of actually mining silver, the company takes another approach. It agrees to lend silver producers a certain amount of money in exchange for being able to buy its production at a discounted level. Thus, Silver Wheaton isn't exposed to operational risk, and it minimizes its exposure to just one mine by funding more than a dozen different projects.

Investors love the concept. Since the company became publicly traded in 2004, the share price is almost up 300%. That beats the pants off both gold and silver, and also makes it a better performer than most precious metal producers.

That outperformance has led to a somewhat high valuation. Silver Wheaton earned \$0.56 per share over the last 12 months, and analysts only expect that to increase to \$0.75 per share next year. A forward P/E ratio of 22 is a little expensive.

It's easy to argue that Silver Wheaton deserves a high valuation. The company has a great balance sheet, and investors like the lower risk profile of its streaming business model. It also has grand expansion plans; management has stated they plan to do an additional US\$5 billion worth of deals by the end of the decade.

But what about a silver producer? Would **Pan American Silver Corp.** (TSX:PAA)(NASDAQ:PAAS) be a better choice, especially if silver recovers?

The case for Pan American

Pan American is one of the world's largest silver producers, with a total production of 25 million ounces of the commodity. It also produces gold. About 60% of revenues are from silver.

Results have been lackluster lately. The company reported a loss of \$0.18 per share in the first half of 2015 compared to a slight profit last year. Operating cash flows declined from \$0.56 per share to \$0.21

per share. Revenue was down primarily because of the price of the two commodities. Silver was down 17%, while gold was down 6%.

The good news is that costs were down. The company's all-in sustaining costs per ounce of silver sold dropped to \$14.35, a decrease of more than 10% compared with the same time in 2014, when the same costs were \$16.45 per ounce.

Pan American's leverage to higher silver prices makes it really interesting. Say the price of silver increases to \$20 per ounce. Pan American's revenue would jump some 25% overnight, while costs would stay largely the same. Just about all of that revenue would flow to the bottom line, and the earnings loss would immediately turn into a gain. Earnings could easily hit \$1 per share in such a scenario.

The company also has a good balance sheet. Debt is just US\$61.8 million, while it has US\$275 million in cash and short-term investments. It also has the ability to finance future expansions with a US\$300 million credit facility already in place.

Pan American also has many potential growth projects on the horizon. It plans to spend US\$160 million between now and 2017 expanding its La Colorada project, which will generate an internal rate of return of 22% if silver can average US\$19 per ounce during the next 10 years. That's a payback period of just 2.5 years.

An expansion with similar economics is also planned for Pan American's Dolores project. Silver production from that mine is expected to grow by 40% annually when it's finished. Additionally, the company plans to bring its costs down by closing Alamo Dorado, a mine with costs higher than the current value of silver.

It comes down to this. Pan American is more exposed to the price of silver, which means it likely has more upside than Silver Wheaton if the price of the commodity recovers. Silver Wheaton is profitable at today's levels, but also has less exposure to the price of silver.

There are pros and cons to each investment. But if you're bullish on silver, I'd say Pan American is the better choice.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

1. NYSE:PAAS (Pan American Silver)
2. TSX:WPM (Wheaton Precious Metals Corp.)

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Author

nelsonpsmith

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