



Silver Wheaton Corp.: Is This Stock Headed to \$40?

Description

Silver Wheaton Corp. (TSX:SLW)(NYSE:SLW) is up 50% in 2016, and investors who missed the first leg of the rally are wondering if the stock is headed much higher.

Let's take a look at the streaming company to see if it deserves to be in your portfolio.

A special business model

Silver Wheaton is not a producer of gold and silver; it simply provides upfront funding to mining companies to help them move their projects from development to production. In return for the cash infusion, Silver Wheaton is given long-term or life-of-mine rights to purchase gold and silver produced at the mine for very attractive prices.

How attractive?

Silver Wheaton reported silver equivalent cash costs of US\$4.44 per ounce in Q1 2016. Silver currently sells for US\$16.35 per ounce.

The streaming deals are normally negotiated on mines set up to produce base metals such as zinc and copper. The gold and silver output is considered "by-product."

Mining companies turn to Silver Wheaton because the streaming agreement offers a way to raise funds without taking on new debt or diluting shareholders through the issuance of new shares.

This has been especially helpful in recent years because base metals are in a prolonged slump and many of the miners are carrying significant debt. The miners are also faced with very low stock prices.

The outlook for gold and silver

Gold primarily moves in response to changes in the value of the U.S. dollar with respect to a basket of other currencies. The big rally in the first part of 2016 occurred as a result of reduced expectations for interest rate hikes in the United States. Higher rates tend to push the U.S. dollar higher, making gold

more expensive for international buyers. Higher rates also increase the opportunity cost of owning gold, which doesn't pay you anything.

The market originally expected four rate hikes in 2016. Expectations are now set at one or two, and that has been positive for the gold market. A disappointing jobs report in the U.S. is responsible for the renewed surge in gold and market moves will remain data driven in the near term.

Silver tends to tag along with gold in response to moves in the U.S. dollar, but there is also a demand component. Silver has a number of industrial uses, including its role as a key input in the production of solar panels.

With solar technology improving, the costs have come down to the point where large-scale industrial installations are popping up all around the globe. As countries continue to move toward green energy solutions, solar demand should grow.

Roughly 70% of primary silver supply comes from base metal mines. The commodity rout has forced most mining companies to delay or shelve new projects, and that could create a silver shortage in the coming years.

Risks

Silver Wheaton isn't without risks. The company is currently battling the Canada Revenue Agency (CRA) over taxes owed on revenue generated by foreign subsidiaries. If Silver Wheaton loses the case, it could be on the hook for nearly \$800 million in additional payments.

Should you buy?

Silver Wheaton traded for \$40 per share in 2012, so the stock certainly has the potential to get there on further gains in gold and silver prices. If you are looking for a way to bet on the precious metals rally, Silver Wheaton is a great way to play it without taking on the operational risks that come with owning the miners.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

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

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Date

2025/08/05

Date Created

2016/06/03

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