Silver Wheaton Corp.: Is This Stock Attractive Today?

Description

Silver Wheaton Corp. (TSX:SLW)(NYSE:SLW) is down 25% from the 2016 high, and investors who missed the big rally earlier in the year are wondering if this is the right time to buy the stock.

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

The streaming model

Silver Wheaton doesn't own any mines; it simply provides upfront cash to mining companies to help them move their projects from development to production.

In return for the cash infusion, Silver Wheaton secures the rights to buy gold or silver produced at the mine for a very attractive price. The agreements normally run for several years or, in some cases, the life of the mine's operation.

How much does Silver Wheaton pay?

In Q2 2016 Silver Wheaton's average cash cost of silver was US$4.46 per ounce, and the company paid just US$401 per ounce of gold. With silver currently selling for US$17.50 per ounce and gold at US$1,260, the margins are pretty good.

Why would a mining company agree to such a deal?

Most of the contracts are negotiated on mines that produce base metals, so the gold and silver are simply by-products in the production process.

Copper and zinc have been in a slump for most of the past five years, and that has hurt the balance sheets and stock prices of the mining companies. As a result, raising cash has become more difficult, so Silver Wheaton provides an alternative source of funds.

If base metals can extend their recent recovery, Silver Wheaton's ability to get rock-bottom prices will begin to diminish, but opportunities remain abundant in the current market environment.

Gold and silver outlook

Gold took off in the first half of 2016 as investors realized the expected series of interest rate hikes in the United States weren't going to materialize.

The metal had been under pressure leading into the year because higher rates increase the opportunity cost of holding non-yielding bullion. Rising interest rates in the United States also tend to push up the value of the U.S. dollar, in which gold is priced.

The Brexit vote initially gave the rally an extra boost, but the move was short-lived, and the price of the yellow metal has been falling since early July.

What's going on?

Market watchers have become increasingly concerned the Fed will get aggressive in 2017. That has resulted in some profit taking in the gold market, and all the stocks connected to the space are pulling back.

Silver is impacted by the same factors as gold, but the market also has an industrial component, as the metal is used to produce a number of products, including solar panels. The world is moving more toward renewable energy, and demand for large-scale solar installations is expected to rise.

The silver market is currently in balance, or even slightly oversupplied, but that could change in the coming years.

Why?

More than two-thirds of silver output comes from base metal mines, so the market is somewhat dependent on new copper and zinc developments. Mining companies in those sectors are reducing investment in new facilities, and Silver Wheaton expects global silver production to fall 100 million ounces in the next five years.

Should you buy?

If you are a long-term bull on gold and silver, Silver Wheaton is a great way to play the rally. The stock offers a predictable cost base and doesn't come with the direct risks faced by the mining companies.

At the moment, however, the market looks like it might continue its downward trend. Considering Silver Wheaton is still up 70% on the year, there is room for further pain if gold and silver continue to slide.

As such, I would wait for the pullback to run its course before buying the stock.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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

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