Will This Precious Metals Stock Continue its Outperformance?

Description

In 2018, markets have seen their fair share of volatility and year-to-date (YTD), the TSX has posted flat returns. Despite this, there have been some significant outperformers hitting new 52-week highs.

Let's take a look at one of those companies, **Wheaten Precious Metals Corp.** (TSX:WPM)(NYSE:WPM). Formerly called Silver Wheaten, the company's name change was precipitated by a metal diversification strategy away from a silver-focused one. The company has returned a healthy 19.4% YTD, thereby far outpacing the broader index.

What do they do?

Wheaten Precious Metals is a streaming company. It does not operate any mines and enters into royal and streaming deals with producers. I am a big fan of these models, as the company is not burdened by high capital expenditure costs.

Wheaten currently has 22 streaming agreements with 15 operating partners. The company expects to generate 49% of revenues from silver, 47% of revenues from gold and 4% of revenues from cobalt. The company's investment in the latter is what's behind the most recent share price increase.

What's the big deal about cobalt?

Ninety-six per cent of the company's revenues is expected to come from gold and silver, both of which have posted negative returns YTD. So why has the company's share price returned double-digits? In a word: cobalt.

Since the beginning of 2017, the price of cobalt as been on a meteoric rise. The metal has appreciated almost 200%, hitting new 52-week highs in late March. Although the metal has since cratered and is trading at a loss in 2018, it is still up well over 100% of over the past year.

Why the sudden interest in cobalt after years of stagnation? Cobalt is a key metal in the fabrication of lithium-ion batteries for electric vehicles. As the demand for electric vehicles has boomed, so, too, has the demand for cobalt. Demand for the metal is expected to double by 2025.

Voisey's Bay

The company's foray into cobalt came with its $390 million deal to acquired 42.4% of Vale's cobalt production at Voisey's Bay. Once Vale has delivered 31 million pounds of cobalt, the percentage drops to 24.3% of production.

Wheaten is expected to start receiving deliveries in 2021, and the deal is expected to be a boon to cash flows. The company should receive approximately 2.6 million pounds of cobalt through the first 10 years of the mine's life. This is equal to about 80,000 ounces of gold. At today's gold spot price of $1,333 an ounce, that adds $106 million a year to its coffers.

Not bad considering the company only paid $390 million up front to acquire the rights.

Not without risks

The deal only makes sense as long as cobalt continues its strong run. At this point, all signs point to bullish electronic car demand. Although the Voisey's Bay deal was a positive one, the company still expects to generate the vast majority of its revenues from gold and silver.

In the first quarter of 2017 demand for gold was the lowest since the first quarter of 2018. Likewise, silver demand dropped 2% year-over-year in 2017. Outlook is expected to be stable, but don't expect any sudden surge in demand.

Given the company's current valuations, it is a little pricey. I like the company's diversification into cobalt, but it's not a big enough deal to justify the company's current share price appreciation. I'd therefore wait for a dip before investing.

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