Wheaton Precious Metals

Q118 results

Serene start

Metals & mining

Wheaton Precious Metals' (WPM) silver streams outperformed our expectations in Q118, while its gold streams performed closely in line. However, after demonstrating the traditional 'flush through' effect in Q417, sales of silver and gold in Q118 reverted to close to their long-term trends, with an (albeit temporary) 14.6% under-sale of silver and a 12.2% under-sale of gold relative to production. Nevertheless, adjusted net earnings of US$69.9m and EPS of 16 cents were within 10% of our previous expectations of US$77.0m and our forecasts for FY18 remain, to all intents and purposes, unchanged (see page 7).

Year end	Revenue (US$m)	PBT* (US$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/16	891.6	269.8	62	21	35.3	1.0
12/17	843.2	277.4	63	33	34.8	1.5
12/18e	826.5	281.1	63	36	34.8	1.7
12/19e	961.9	400.8	91	42	24.2	1.9

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

First Majestic takeover of Primero concluded

On 10 May, First Majestic announced that it had closed the acquisition of Primero and hence we have adjusted our forecasts for Q218 to reflect 1.5 months under the old silver purchase agreement and 1.5 months under the new precious metals purchase agreement (cf 0 months and three months, respectively, previously). We estimate that the conclusion of the transaction could also result in an exceptional gain in the order of US$271.5-365.5m (61-83 US cents/share), pre-tax, in Q218.

Firm timeline established for resolution of tax dispute

The case 'discovery process' in relation to WPM's dispute with the Canadian Revenue Agency which is designed to provide both sides with the opportunity to arrive at an out-of-court settlement before formal proceedings commence, is now drawing to a close. In the absence of a principled settlement, the Tax Court of Canada has scheduled a trial for mid-September 2019 for a two-month period.

Valuation: Potential 32.6% IRR to shareholders

In the wake of the Primero takeover by First Majestic in mid-May, our forecast for FY18 production is 24.0Moz Ag and 345koz Au (cf 22.5Moz Ag and 355koz Au previously – the variance primarily arising from the expiry of the Primero stream over San Dimas to be replaced by the First Majestic stream in mid-May rather than end-Q1). Assuming no material purchases of additional streams (which is unlikely), we forecast a per share value for WPM of US$35.07, or C$44.78 in FY20 (at average precious metals prices of US$25.95/oz Ag and US$1,482/oz Au), implying a 32.6% pa total internal rate of return (IRR) for investors in US dollar terms over the next 2.5 years. In the meantime, WPM's shares are trading on near-term financial ratios that are cheaper than those of its royalty/streaming 'peers' on 100% of financial measures considered in Exhibit 9, and the miners themselves on 40% of the same measures, despite being associated with materially less operating and cost risk. Additional potential upside still then exists in the form of the optionality provided by the development of major assets such as Pascua-Lama, etc.

18 May 2018

Price	**C$27.97**
Market cap	**C$12,376m**
	C$1.2766/US$
Net debt* (US$m) at 31 March 2017 *Cum-dividend of US$39.9m	547.4
Shares in issue	442.7m
Free float	100%
Code	WPM
Primary exchange	TSX
Secondary exchange	NYSE

Share price performance

%	1m	3m	12m
Abs	2.4	11.7	(5.0)
Rel (local)	(2.6)	7.0	(10.1)
52-week high/low		C$28. 6	C$23.4

Business description

Wheaton Precious Metals is the world's pre-eminent pure precious metals streaming company, with c 30 high-quality, precious metals streaming and early deposit agreements relating to assets in Mexico, Peru, Canada, Brazil, Chile, Argentina, Sweden, Greece, Portugal, the US and Guyana.

Next events

Q218 results	August 2018
Third quarterly dividend announced	August 2018
Q318 results	November 2018
Fourth quarterly dividend announced	November 2018

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Edison profile page

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Investment summary

In terms of aggregate production, WPM's silver streams outperformed our expectations in Q118, while its gold streams performed closely in line. However, after demonstrating the traditional 'flush through' effect in the last quarter of FY17 whereby there was a close correlation between production and sales, sales of silver and gold in Q118 reverted to close to their long-term trends, with a 14.6% under-sale of silver (cf a long-term average of 10.5%) and a 12.2% under-sale of gold (cf a long-term average of 9.2%) relative to production. As a result, sales were 9.1% below our expectations, although this was largely offset by the total cost of sales being 12.3% lower, such that earnings from operations were just 4.6% lower. Otherwise, the main feature of the results, from a financial perspective, was a US$2.8m negative variance in 'Other expenses', which predominantly reflected a loss on fair value adjustment of the Kutcho convertible note held by WPM. A full analysis of WPM's Q1 results relative to both Q417 and our prior expectations is provided in the table below.

Exhibit 1: Wheaton Precious Metals FY17 forecast, by quarter*

US$000s (unless otherwise stated)	Q117	Q217	Q317	Q417	Q118e	Q118	Chg** (%)	Diff*** (%)	Diff*** (units)
Silver production (koz)	6,513	7,192	7,595	7,211	6,736	7,428	3.0	10.3	692
Gold production (oz)	84,863	78,127	95,897	96,474	80,670	79,657	(17.4)	(1.3)	(1,013)
AgE production (koz)	12,454	12,898	14,874	14,572	13,093	13,744	(5.7)	5.0	651
Silver sales (koz)	5,225	6,369	5,758	7,292	6,736	6,343	(13.0)	(5.8)	(393)
Gold sales (oz)	88,397	71,965	82,548	94,295	80,670	69,973	(25.8)	(13.3)	(10,697)
AgE sales (koz)	11,412	11,625	12,024	14,488	13,093	11,892	(17.9)	(9.2)	(1,201)
Avg realised Ag price (US$/oz)	17.45	17.09	16.87	16.75	16.75	16.73	(0.1)	(0.1)	(0.02)
Avg realised Au price (US$/oz)	1,208	1,263	1,283	1,277	1,320	1,330	4.2	0.8	10
Avg realised AgE price (US$/oz)	17.35	17.18	16.89	16.74	16.75	16.75	0.1	0.0	0.00
Avg Ag cash cost (US$/oz)	4.54	4.51	4.43	4.48	4.62	4.49	0.2	(2.8)	0
Avg Au cash cost (US$/oz)	391	393	396	399	396	399	0.0	0.8	3
Avg AgE cash cost (US$/oz)	5.11	4.90	4.84	4.85	4.82	4.74	(2.3)	(1.7)	(0.08)
Sales	197,951	199,684	203,034	242,547	219,314	199,252	(17.9)	(9.1)	(20,062)
Cost of sales									
Cost of sales, excluding depletion	58,291	56,981	58,234	70,295	63,077	56,414	(19.7)	(10.6)	(6,663)
Depletion	63,943	59,772	61,852	76,813	66,575	57,265	(25.4)	(14.0)	(9,310)
Total cost of sales	122,234	116,753	120,086	147,108	129,651	113,679	(22.7)	(12.3)	(15,972)
Earnings from operations	75,717	82,931	82,948	95,439	89,662	85,573	(10.3)	(4.6)	(4,089)
Expenses and other income									
- General and administrative****	7,898	9,069	8,793	8,913	8,750	9,757	9.5	11.5	1,007
- Foreign exchange (gain)/loss		41	163	66	0.0	-170	(357.6)	N/A	(170)
- Net interest paid/(received)	6,373	6,482	6,360	5,778	3,911	5,591	(3.2)	43.0	1,680
- Other (income)/expense	94	283	1,317	(10,093)	0.0	2,757	(127.3)	N/A	2,757
Total expenses and other income	14,365	15,875	16,633	4,664	12,661	17,935	284.5	41.7	5,274
Earnings before income taxes	61,352	67,056	66,315	90,775	77,001	67,638	(25.5)	(12.2)	(9,363)
Income tax expense/(recovery)	128	(556)	(263)	(195)	0.0	-485	148.7	N/A	(485)
Marginal tax rate (%)	0.2	(0.8)	(0.4)	(0.2)	0.0	-0.7	250.0	N/A	(1)
Net earnings	61,224	67,612	66,578	90,970	77,001	68,123	(25.1)	(11.5)	(8,878)
Avg no. shares in issue (000s)	441,484	441,784	442,094	442,469	442,469	442,728	0.1	0.1	259
Basic EPS (US$)	0.14	0.15	0.15	0.21	0.17	0.15	(28.6)	(11.8)	0
Diluted EPS (US$)	0.14	0.15	0.15	0.21	0.17	0.15	(28.6)	(11.8)	0
DPS (US$)	0.07	0.07	0.10	0.09	0.09	0.09	0.0	0.0	0

Source: Wheaton Precious Metals, Edison Investment Research. Note: *As reported, excluding impairments. **Q118 vs Q417. ***Q118 actual vs Q118 estimate. ****Quarterly forecasts exclude stock-based compensation costs.

Note that, if the loss on fair value adjustment of the Kutcho convertible note held by WPM is excluded from the above income statement, adjusted net earnings are US$69.9m and EPS 16 cents, which is a variance relative to our prior expectation of only 9.2%.

From an operational perspective, key features of the quarter were stronger production performances than expected by Edison at San Dimas and Antamina (both silver streams), offset by weaker performances at Sudbury, Constancia and WPM's other gold streams (partially on account of another quarter of lower grades at Minto owing to rescheduled mine sequencing as part of an extended mine plan). Antamina too experienced lower grades (albeit in line with expectations, given pit sequencing), while Salobo and Penasquito experienced higher grades, in mitigation of planned shutdowns. Finally, extended unscheduled maintenance at the Coleman mine since November 2017 resulted in lower throughput at Sudbury, although Vale reports that the mine has been returned to production since April.

In the longer term, the Pyrite Leach Project at Penasquito (which will add c 1Moz gold and 44Moz silver over the current life of the mine, by recovering 40% Au and 48% Ag currently reporting to the tailings) is reported to be 86% complete (vs 62% at the end of FY17 and 40% at the end of Q317). The carbon pre-flotation component of the project, in particular, is reported to have commenced wet commissioning during April and the balance of the project is still expected to commence commissioning three months ahead of schedule, in Q418.

San Dimas

On 12 January, First Majestic (FR, C$9.25) announced that it was to buy Primero Mining (the operator of the San Dimas mine in Mexico, over which WPM holds a silver purchase agreement). As a part of the terms of the (friendly) takeover, WPM agreed to terminate the existing silver purchase agreement (SPA) and then to enter into a precious metals purchase agreement (PMPA) with the new operator on the following terms:

- 25% of gold production plus an additional amount of gold equal to 25% of silver production converted into gold at a fixed gold:silver ratio of 70:1 (subject to certain adjustments, which could render it 50:1 or 90:1 depending on market conditions) from San Dimas cf 6.0Moz plus 50% of any excess previously (to all intents and purposes 100% of silver production in recent quarters).
- For each ounce of gold delivered, WPM will pay a production payment equal to the lesser of US$600/oz, subject to a 1% annual inflationary adjustment and the prevailing market price cf US$4.32/oz Ag in Q118 similarly subject to a 1% annual inflationary adjustment.
- First Majestic will provide a corporate guarantee over the PMPA; security for such will be limited to the San Dimas assets (similar to the guarantee over its SPA with Primero).
- To the extent that ore from certain areas outside the current area of interest is processed through the San Dimas mill, such ore will be subject to the stream.
- WPM has the right of first refusal on certain areas outside the current area of interest.

Under the First Majestic PMPA, San Dimas is expected to contribute, on average, approximately 40-50koz of gold production (equivalent to 2.80-3.15Moz Ag at an Au:Ag ratio of 70:1) annually to WPM over the next five years (company estimate). In addition to the new stream, First Majestic will also issue to WPM 20.9m FR common shares with a value at the time of writing of C$193.5m (US$151.5m, or US$0.34/share). In addition, at the time of closing, WPM agreed to release the guarantee previously provided by Goldcorp under the existing SPA in consideration of a payment of US$10m from the latter and also to extinguish the US$0.50/oz penalty for each ounce less than 215Moz delivered by 2031.

Pursuant to its announcement in January, on 10 May, First Majestic announced that it had closed the acquisition of Primero and hence we have adjusted our forecasts for Q218 on this basis (cf an assumption that the transaction would close on 31 March previously).

Q218 exceptional gain

In our note, *Majestic*, published in February 2018, we calculated a net present value of the cash flows to WPM from San Dimas for the period FY18–33 of US$252.9m at our long-term precious metals prices and customary 10% discount rate for mining companies (or US$346.9m at a 5% discount rate to reflect the lower risk attached to streaming cash flows compared to mining cash flows). This compares with a carrying value of the San Dimas stream of US$132.9m as at 31 March 2018 and, in conjunction with the FR shares to be issued to WPM under the terms of the transaction, suggests an exceptional profit for WPM in the order of US$271.5–365.5m (US$0.61–0.83 per share), pre-tax in Q218. Note, however that, owing to their exceptionality, these gains are excluded from our forecasts in Exhibits 6 and 10.

Constancia

As per Hudbay's news release, dated 26 March 2018, although negotiations to secure surface rights over Pampacancha continue to progress and it has been granted access to the land to carry out early-works activities, it anticipates that mining of this high-grade satellite deposit will now commence in 2019 (being a one-year delay cf prior expectations), in which case WPM will be entitled to an increased portion of gold from Hudbay. In 2019, the net value of the increased portion of gold is estimated to be US$7.0m to Wheaton (ie equivalent to c 7,609oz of gold at current prices).

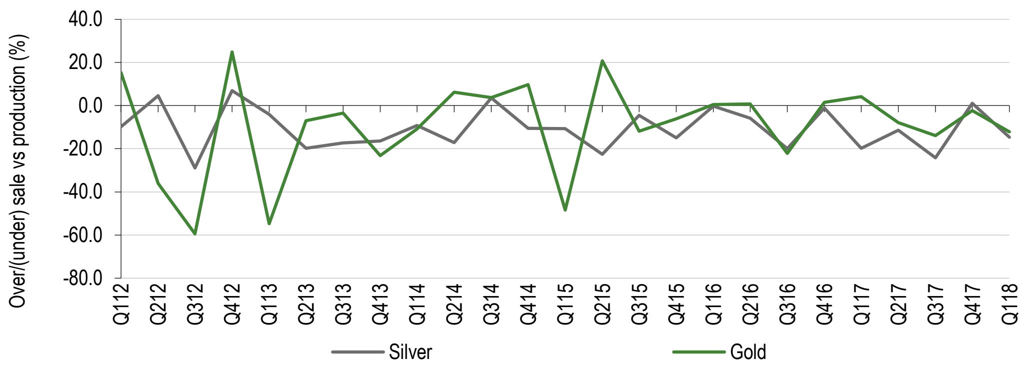
General and administrative expenses

WPM is continuing to forecast non-stock general and administrative expenses in the range of US$34–36m for the full year, ie c US$8.5–9.0m per quarter, including all employee-related expenses, charitable contributions and additional legal costs relating to WPM's dispute with the Canadian Revenue Agency (CRA). Investors should note that our financial forecasts in Exhibits 6 and 10 exclude stock-based compensation costs.

Ounces produced but not yet delivered – aka inventory

After demonstrating the traditional 'flush through' effect at the end of Q417, sales of silver and gold reverted to close to their long-term trends in Q118, with a 14.6% under-sale of silver (cf a long-term average of 10.5%) and a 12.2% under-sale of gold (cf a long-term average of 9.2%) relative to production.

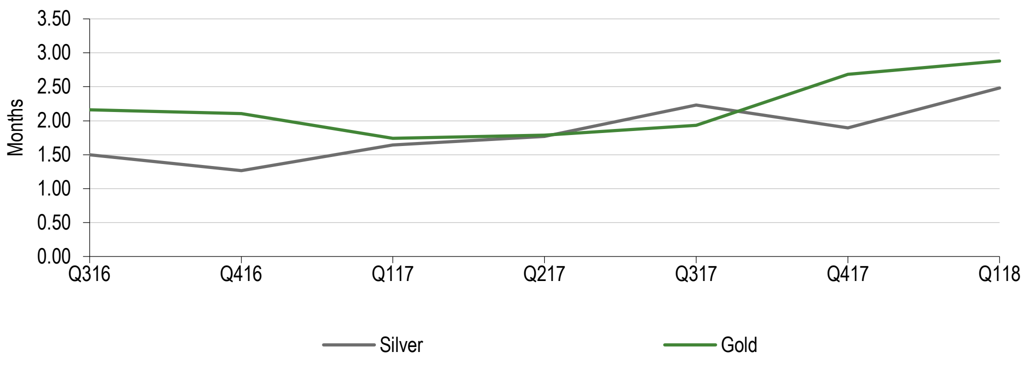
Exhibit 2: Over/(under) sale of silver and gold as a % of production, Q112–Q118



Source: Edison Investment Research, Wheaton Precious Metals

As at 31 March, payable ounces attributable to WPM produced but not yet delivered amounted to 4.8Moz silver and 84,400oz gold (cf 4.5Moz silver and 79,500oz gold reported in December). This 'inventory' equates to 2.48 months and 2.88 months of forecast FY18 silver and gold production, respectively (cf 1.89 months and 2.68 months in Q417), or 2.69 months on a silver-equivalent basis (cf 2.31 months as at end-December) and compares with WPM's target level of two months of annualised production for silver, and two to three months for gold.

Exhibit 3: WPM ounces produced but not yet delivered, Q316–Q118 (months of production)



Source: Edison Investment Research, Wheaton Precious Metals

Note that, for these purposes, the use of the term 'inventory' reflects ounces produced by WPM's operating counterparties at the mines over which it has streaming agreements, but which have not yet been delivered to WPM. It in no way reflects the other use of the term in the mining industry itself, where it typically refers to metal in circuit (among other things), and may therefore (under certain circumstances) be considered to be a consequence of metallurgical recoveries in the plant.

Our updated FY18 outlook principally reflects San Dimas timing

WPM has maintained its production guidance of 22.5Moz of silver and 355,000oz of gold for FY18, which compares with our updated FY18 forecasts as follows:

Exhibit 4: WPM's FY18 production guidance

Asset	WPM's estimated output (koz)	Our updated forecast (koz)	Our prior forecast (koz)	Comment
Silver				
Penasquito	6,500	6,159	6,279	vs 6,024koz in FY17 and 1,450koz in Q118.
San Dimas	1,000	2,404	1,000	First Majestic (FR) deal closed mid-May, not end-Q118.
Antamina	5,300	5,179	5,120	vs 6,554koz in FY17 and 1,339koz in Q118.
Constancia	2,800	2,675	2,705	vs 646koz in Q118; mining Pampacancha from FY19.
Other	6,900	7,592	7,415	9,548koz annualised rate in Q1.
Total	**22,500**	**24,009**	**22,519**	
Gold				
Salobo	240	237	234	Slight moderation from record Q417 with grade profile.
Sudbury	33	31	33	vs 6.5koz in Q118.
San Dimas	30	24	32	2.5 quarters of gold production vs 3 assumed previously.
Constancia	17	16	17	vs 3.3koz in Q118; gold production on upward profile.
Other	35	37	39	vs 8.4koz in Q118. Lower Minto grade; reduced 777 interest.
Total	**355**	**345**	**355**	

Source: Wheaton Precious Metals, Edison Investment Research. Note: Totals may not add up owing to rounding.

Note that the principal reason for the change in our forecasts (apart from incorporating Q1 actual numbers) is the updated assumption that San Dimas will contribute another half quarter's worth of silver production from 1 April to 10 May (after contributing an ahead-of-expectation 1.6Moz Ag in Q118), before the new precious metals' purchase agreement with First Majestic comes into force, which will convert San Dimas into a gold stream for WPM (hence there will only be 2.5 quarters' worth of gold contribution from San Dimas, cf three quarters' worth assumed previously).

Solid medium-term outlook

Over the next five years, including FY18, management continues to estimate average annual production of approximately 25Moz of silver and 370,000oz of gold (cf 28.5Moz of silver and 355,000oz of gold in FY17 – the difference being substantially accounted for by the First Majestic takeover of Primero and the termination of the existing San Dimas silver purchase agreement in favour of a new precious metals purchase agreement). This compares with our current expectations, which are, on average, 6.6% more conservative than guidance vs 7.2% previously (simple average):

Exhibit 5: Our forecast of WPM's precious metals production

	FY18e	FY19e	FY20e	FY21e	FY22e
Silver production (Moz)	24.0	22.3	23.0	23.9	23.7
Gold production (koz)	345	370	337	333	339

Source: Edison Investment Research

In the immediate future, silver output from Penasquito attributable to WPM is expected to recover back to its steady-state level of 7Moz as the Chile Colorado pit contributes to mill feed ahead of schedule in CY18 and grades improve once again with mine sequencing. From Q418 onwards, it will also benefit from the development of the Pyrite Leach Project, which will add an additional 1.0–1.5Moz of silver attributable to WPM per year. At the same time, mining at Constancia will start at the Pampacancha pit in FY19, which hosts significantly higher gold grades than those mined hitherto and of which WPM will now be entitled to an increased portion.

Potential future growth

WPM is a pure precious metals streaming company. As such, it is interested in gold, silver and platinum potential streams. Considering only the silver component of its investible universe, WPM estimates the size of the potential market open to it to be the lower half of the cost curve of the 70% of global silver production of c 870Moz in FY17 that is produced as a by-product of either gold or base metal mines (ie approximately 305Moz silver per year cf WPM's production of 28.5Moz Ag in FY17). Inevitably, WPM's investible universe would be further refined by the requirement for the operations to be located in good mining jurisdictions, with relatively low political risk. Nevertheless, such figures serve to illustrate the fact that WPM's marketplace is far from saturated or mature.

As a consequence, WPM reports that it is busy on the corporate development front, with 6–8 potential deals that could close within the next 12 months, each with a value in the US$100–600m range.

While it is difficult, or impossible, to predict potential future stream acquisition targets with any degree of certainty, it is perhaps possible to highlight four that may be of interest to WPM in due course and regarding which it already has strong, existing counterparty relationships:

- the platinum group metal (PGM) by-product stream at Sudbury;
- the 75% of the silver output at Pascua-Lama that is currently not subject to any streaming arrangement (subject to permitting and development); and
- the 50% of the gold output at Constancia that is currently not subject to any streaming arrangement.

The other major source of organic production growth for WPM is Salobo (which accounted for 77% of WPM's gold division's output in Q118). The operator, Vale, is studying expansion scenarios and is deploying four drill rigs to test the deposit at depth. Given the open-ended nature of the deposit and depending on the work that Vale does and the decision that it makes, any expansion could add as much as 100% to gold output attributable to WPM from Salobo per year – albeit at the cost of an additional payment from WPM. Mill throughput at the Salobo mine was reported to be running at 98% of its 24Mtpa nameplate capacity in Q118. If throughput capacity is expanded within a predetermined period and depending on the grade of material processed, WPM will be required to make an additional payment to Vale regarding its 75% gold stream. The additional payments range in size from US$113m if throughput is expanded beyond 28Mtpa by 1 January 2036, to US$953m if throughput is expanded beyond 40Mtpa by 1 January 2021.

In the event that Salobo were to be expanded from 24Mtpa to 36Mtpa by the addition of a further 12Mtpa processing line by 1 January 2023, for example – thereby attracting an estimated c US$603m incremental payment from WPM to Vale – we estimate that it would increase our estimate of WPM's earnings by a material c US$0.11 per share from the date of the expansion.

FY18 by quarter

We have honed our silver price for FY18 to US$16.63/oz in Q2, followed by US$16.67/oz thereafter, to reflect recent movements in the spot market. Our gold price forecast remains unchanged at US$1,320/oz for the remainder of the year.

In the aftermath of these changes, our updated basic EPS forecast for FY18 remains unchanged, at US$0.63/sh, cf an average consensus estimate (source: Bloomberg, 14 May) of 61c within a range of 53–66c (cf a consensus of 61.8c, within a range of 49–77c, in March). Broken down by quarter, our estimates are as follows:

Exhibit 6: Wheaton Precious Metals FY18 forecast, by quarter*

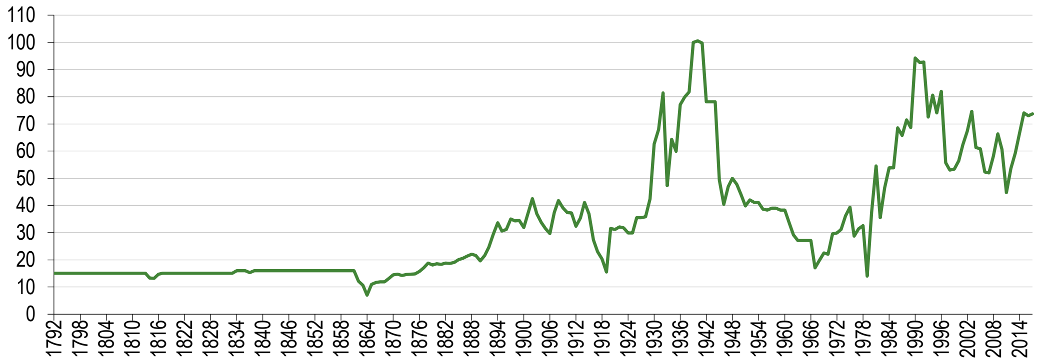
US$000s (unless otherwise stated)	Q118	Q218e	Q318e	Q418e	FY18e (current)	FY18e (previous)
Silver production (koz)	7,428	6,059	5,261	5,261	24,009	22,519
Gold production (oz)	79,657	85,413	90,156	90,156	345,381	354,555
AgE production (koz)	13,744	12,859	12,400	12,400	51,418	50,787
Silver sales (koz)	6,343	6,059	5,261	5,261	22,924	22,519
Gold sales (oz)	69,973	85,413	90,156	90,156	335,697	354,555
AgE sales (koz)	11,892	12,859	12,400	12,400	49,564	50,787
Avg realised Ag price (US$/oz)	16.73	16.63	16.67	16.67	16.68	16.57
Avg realised Au price (US$/oz)	1,330	1,324	1,320	1,320	1,323	1,320
Avg realised AgE price (US$/oz)	16.75	16.63	16.67	16.67	16.68	16.56
Avg Ag cash cost (US$/oz)	4.49	4.52	4.55	4.55	4.52	4.59
Avg Au cash cost (US$/oz)	399	407	417	417	411	414
Avg AgE cash cost (US$/oz)	4.74	4.83	4.96	4.96	4.88	4.93
Sales	199,252	213,836	206,708	206,708	826,503	841,266
Cost of sales						
Cost of sales, excluding depletion	56,414	62,137	61,548	61,548	241,646	250,299
Depletion	57,265	62,937	62,355	62,355	244,912	260,910
Total cost of sales	113,679	125,074	123,903	123,903	486,558	511,209
Earnings from operations	85,573	88,762	82,805	82,805	339,945	330,056
Expenses and other income						
- General and administrative**	9,757	8,750	8,750	8,750	36,007	35,000
- Foreign exchange (gain)/loss	(170)	0	0	0	(170)	0
- Net interest paid/(received)	5,591	5,751	5,751	5,751	22,844	15,645
- Other (income)/expense	2,757	0	0	0	2,757	0
Total expenses and other income	17,935	14,501	14,501	14,501	61,438	50,645
Earnings before income taxes	67,638	74,261	68,304	68,304	278,507	279,411
Income tax expense/(recovery)	(485)	0	0	0	(485)	0
Marginal tax rate (%)	(0.7)	0.0	0.0	0.0	(0.2)	0.0
Net earnings	68,123	74,261	68,304	68,304	278,992	279,411
Ave. no. shares in issue (000s)	442,728	442,728	442,728	442,728	442,728	442,469
Basic EPS (US$)	0.15	0.17	0.15	0.15	0.63	0.63
Diluted EPS (US$)	0.15	0.17	0.15	0.15	0.63	0.63
DPS (US$)	0.09	0.09	0.09	0.09	0.36	0.37

Source: Wheaton Precious Metals, Edison Investment Research. Note: *Excluding impairments. **Forecasts exclude stock-based compensation costs. Totals may not add up owing to rounding.

Note that, as a result of the conversion of the San Dimas stream from a silver one to (effectively) a gold one, we expect WPM to become a majority gold streaming company from Q218 onwards on an annual basis (albeit there will inevitably be some quarterly fluctuations depending on the balance of production, sales, etc).

In the meantime, our FY19 EPS forecast (see Exhibit 10) has been made on the basis of assumed precious metals prices of US$22.21/oz Ag and US$1,263/oz Au (see our report, Mining overview, Unlocking the price to NPV discount, published in November 2017) – as much to demonstrate WPM's operational gearing to a normalisation of the gold:silver ratio from its current, (almost) unprecedented, level of 79.1x:

Exhibit 7: Gold price as a multiple of silver price, 1792–2017



Source: Edison Investment Research (underlying data South African Chamber of Mines, Bloomberg and www.kitco.com)

Miscellaneous

Tradewind

On 25 April, WPM made a strategic investment of US$1.0m by participating in a private placement undertaken by Tradewind, a financial technology company that uses blockchain to streamline digital gold trading. Tradewind has built a technology platform for digitising the trading, settlement and ownership of precious metals. Its platform combines exchange technology with Vaultchain™ Gold (Tradewind's blockchain technology tailored for precious metals), which can be applied to WPM's trading arm.

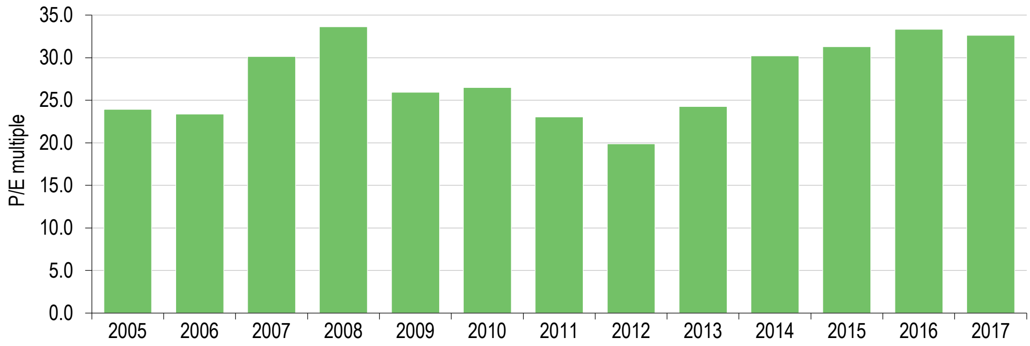
Kutcho

WPM has an early deposit agreement with the Kutcho Copper Corporation (formerly Desert Star, market cap C$23.9m) whereby it will advance to US$65m in instalments (upon achieving a predetermined set of milestones) in return for the right to purchase 100% of the silver and gold production from the Kutcho project in British Columbia at 20% of the spot price of the metals over the life of the mine. In the meantime, on 14 December, WPM acquired 6,153,846 shares and half-warrants in Kutcho for a total consideration of C$4m (US$3m) to give it a 12.88% equity stake in the company. Additionally, it advanced Kutcho US$16m (C$20m) in exchange for a subordinated secured convertible term debt loan agreement receivable, bearing interest at a rate of 10% pa (NB which was responsible for the unrealised US$1.8m fair value loss included in US$2.8m of 'Other expenses' in Exhibit 1).

Valuation

Excluding FY04 (part-year), WPM's shares have historically traded on a contemporary average P/E multiple of 27.6x current year basic underlying EPS, ie excluding impairments (cf 34.8x Edison or 36.0x Bloomberg consensus FY18e, currently – see Exhibit 9).

Exhibit 8: WPM's historic current year P/E multiples



Source: Edison Investment Research

Applying this multiple to our EPS forecast of US$1.27 in FY20 (cf US$1.28 previously as a result of a recent increase in the US dollar LIBOR rate and therefore the rate of interest that we apply to WPM's net debt) implies a potential share value for WPM shares of US$35.07, or C$44.78 (cf US$35.13, or C$45.93 previously) in that year (excluding the US$0.34/share value of its equity interest in First Majestic).

In the meantime, from a relative perspective, it is notable that WPM is cheaper than its royalty/streaming 'peers' in 100% (24 out of 24) of the valuation measures used in Exhibit 9 and on multiples that are cheaper than the miners themselves in 40% (36 out of 90) of the same valuation measures, despite being associated with materially less operational and cost risk (as WPM's costs over time are contractually predetermined).

Exhibit 9: WPM comparative valuation vs a sample of operating and royalty/streaming companies

	P/E (x)		Yield (%)		P/CF (x)	
	Year 1	Year 2	Year 1	Year 2	Year 1	Year 2
Royalty companies						
Franco-Nevada	60.8	54.2	1.3	1.3	26.9	24.0
Royal Gold	50.5	40.7	1.1	1.1	20.6	18.0
Sandstorm Gold	66.5	50.9	0.0	0.0	18.6	15.8
Osisko	72.7	40.0	1.4	1.5	25.0	18.6
Average	**62.6**	**46.4**	**0.9**	**1.0**	**22.8**	**19.1**
WPM (Edison forecasts)	**34.8**	**24.2**	**1.7**	**1.9**	**18.1**	**15.0**
WPM (consensus)	**36.0**	**29.2**	**1.6**	**1.8**	**18.5**	**16.3**
Gold producers						
Barrick	17.9	18.0	0.9	0.9	6.1	6.5
Newmont	27.2	23.5	1.4	1.4	10.0	9.0
Goldcorp	31.4	18.8	0.6	0.6	8.5	6.6
Newcrest	41.7	18.2	1.0	1.6	12.0	8.6
Kinross	18.5	22.3	0.0	3.3	4.4	4.4
Agnico-Eagle	77.3	45.6	1.0	1.0	14.6	12.4
Eldorado	59.5	119.0	0.0	0.3	6.9	5.0
Yamana	27.5	18.4	0.7	0.7	4.6	4.2
Randgold Resources	23.5	21.1	3.9	4.7	13.0	12.3
Average	**36.1**	**33.9**	**1.0**	**1.6**	**8.9**	**7.7**
Silver producers						
Hecla	75.2	25.4	0.2	0.2	10.9	7.0
Pan American	22.2	19.9	0.6	1.0	10.7	9.1
Coeur Mining	N/A	31.6	0.0	0.0	12.2	6.5
First Majestic	139.4	32.2	0.0	0.0	12.1	7.6
Hocschild	29.0	17.6	1.3	1.4	5.8	5.1
Fresnillo	26.7	22.8	1.9	2.2	14.7	13.0
Average	**58.5**	**24.9**	**0.7**	**0.8**	**11.0**	**8.0**

Source: Bloomberg, Edison Investment Research. Note: Peers priced on 11 May 2018.

Financials – solid equity base

As at 31 March 2018, WPM had US$115.6m in cash (before a dividend of US$39.9m payable on or about 7 June) and US$663.0m of debt outstanding under its US$2bn revolving credit facility (which attracts an interest rate of Libor plus 120–220bp and matures in February 2022), such that it had net debt of US$547.4m overall, after US$125.3m (US$0.28/share) of cash inflows from operating activities during the quarter. Relative to the company's Q1 balance sheet equity of US$4,925.5m, this level of net debt equated to a financial gearing (net debt/equity) ratio of 12.7% and a leverage (net debt/[net debt+equity]) ratio of 10.0%. It also compares with a net debt position of US$671.5m as at 31 December 2017, and is consistent with WPM continuing to sustainably generate c US$100–150m per quarter from operating activities before financing and investing activities. Otherwise, assuming the operational performance set out in Exhibit 6, we estimate that WPM's net debt position will have declined organically, to US$366.3m by the end of FY18 (equating to gearing of 7.3% and leverage of 6.8%), and that WPM will be net-debt-free late in FY19, all other things being equal and contingent on its making no further major acquisitions (which is unlikely, in our view). Self-evidently, such a level of debt is well within the tolerances required by its banking covenants that:

- net debt should be no more than 0.75x tangible net worth (which was US$4,925.5m as at end-Q118); and
- interest should be no less than 3x covered by EBITDA (we estimate that net interest was covered 22.7x in FY17).

Note that the C$191.7m letter of guarantee that WPM has posted regarding 50% of the disputed taxes relating to its dispute with the CRA (see below) has been determined under a separate agreement and is therefore specifically excluded from calculations regarding WPM's banking covenants.

Canadian Revenue Agency

There have been no further substantive developments regarding WPM's dispute with the CRA since our update note of 15 February 2016.

WPM notes that the CRA's position is that the transfer pricing provisions of the Income Tax Act (Canada) in relation to income earned by WPM's foreign subsidiaries should apply "such that the income of Silver Wheaton [sic] subject to tax in Canada should be increased by an amount equal to substantially all of the income earned outside of Canada by the company's foreign subsidiaries for the 2005-2010 taxation years". Should this interpretation be upheld, we would expect it to have potentially profound consequences for Canada's status as a supplier of finance and capital to overseas destinations in general (ie not just for the mining industry).

In 2017, WPM's CEO, Randy Smallwood, was quoted as saying that the company is willing to settle its tax dispute with the CRA via a payment of C$5–10m "with gritted teeth", but still believes no payment should be required. As such, the C$5–10m quoted should be interpreted not as an admission of guilt, but rather an appreciation of the costs involved in going to a full trial and also of the effect that the issue is having on WPM's share price rating relative to its peers (see Exhibit 9).

In the meantime, WPM remains in the case 'discovery process' with the CRA, designed to provide both sides with the opportunity to arrive at an out-of-court settlement before formal proceedings commence. If a 'principled' settlement cannot be reached, however, the Tax Court of Canada has now scheduled the trial for mid-September 2019 for a two-month period.

Exhibit 10: Financial summary

US$000s	2012	2013	2014	2015	2016	2017	2018e	2019e
Dec	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS								
Revenue	849,560	706,472	620,176	648,687	891,557	843,215	826,503	961,946
Cost of Sales	(117,489)	(139,352)	(151,097)	(190,214)	(254,434)	(243,801)	(241,646)	(267,566)
Gross Profit	732,071	567,120	469,079	458,473	637,123	599,414	584,857	694,380
EBITDA	701,232	531,812	431,219	426,236	602,684	564,741	548,850	658,373
Operating Profit (before amort. and except.)	600,003	387,659	271,039	227,655	293,982	302,361	303,938	415,585
Intangible Amortisation	0	0	0	0	0	0	0	0
Exceptionals	0	0	(68,151)	(384,922)	(71,000)	(228,680)	0	0
Other	788	(11,202)	(1,830)	(4,076)	(4,982)	8,129	(2,587)	0
Operating Profit	600,791	376,457	201,058	(161,343)	218,000	81,810	301,351	415,585
Net Interest	0	(6,083)	(2,277)	(4,090)	(24,193)	(24,993)	(22,844)	(14,807)
Profit Before Tax (norm)	600,003	381,576	268,762	223,565	269,789	277,368	281,094	400,778
Profit Before Tax (FRS 3)	600,791	370,374	198,781	(165,433)	193,807	56,817	278,507	400,778
Tax	(14,755)	5,121	1,045	3,391	1,330	886	485	0
Profit After Tax (norm)	586,036	375,495	267,977	222,880	266,137	286,383	278,992	400,778
Profit After Tax (FRS 3)	586,036	375,495	199,826	(162,042)	195,137	57,703	278,992	400,778
Average Number of Shares Outstanding (m)	353.9	355.6	359.4	395.8	430.5	442.0	442.7	442.5
EPS - normalised (c)	166	106	75	53	62	63	63	91
EPS - normalised and fully diluted (c)	165	105	74	53	62	63	63	90
EPS - (IFRS) (c)	166	106	56	(-41)	45	13	63	91
Dividend per share (c)	35	45	26	20	21	33	36	42
Gross Margin (%)	86.2	80.3	75.6	70.7	71.5	71.1	70.8	72.2
EBITDA Margin (%)	82.5	75.3	69.5	65.7	67.6	67.0	66.4	68.4
Operating Margin (before GW and except.) (%)	70.6	54.9	43.7	35.1	33.0	35.9	36.8	43.2
BALANCE SHEET								
Fixed Assets	2,403,958	4,288,557	4,309,270	5,526,335	6,025,227	5,579,898	5,406,986	5,236,198
Intangible Assets	2,281,234	4,242,086	4,270,971	5,494,244	5,948,443	5,454,106	5,281,194	5,110,406
Tangible Assets	1,347	5,670	5,427	12,315	12,163	30,060	30,060	30,060
Investments	121,377	40,801	32,872	19,776	64,621	95,732	95,732	95,732
Current Assets	785,379	101,287	338,493	105,876	128,092	103,415	407,472	796,061
Stocks	966	845	26,263	1,455	1,481	1,700	1,484	1,727
Debtors	6,197	4,619	4,132	1,124	2,316	3,194	2,264	2,635
Cash	778,216	95,823	308,098	103,297	124,295	98,521	403,723	791,699
Other	0	0	0	0	0	0	0	0
Current Liabilities	(49,458)	(21,134)	(16,171)	(12,568)	(19,057)	(12,143)	(23,859)	(26,415)
Creditors	(20,898)	(21,134)	(16,171)	(12,568)	(19,057)	(12,143)	(23,859)	(26,415)
Short term borrowings	(28,560)	0	0	0	0	0	0	0
Long Term Liabilities	(32,805)	(1,002,164)	(1,002,856)	(1,468,908)	(1,194,274)	(771,506)	(771,991)	(771,991)
Long term borrowings	(21,500)	(998,136)	(998,518)	(1,466,000)	(1,193,000)	(770,000)	(770,000)	(770,000)
Other long term liabilities	(11,305)	(4,028)	(4,338)	(2,908)	(1,274)	(1,506)	(1,991)	(1,991)
Net Assets	3,107,074	3,366,546	3,628,736	4,150,735	4,939,988	4,899,664	5,018,608	5,233,853
CASH FLOW								
Operating Cash Flow	720,209	540,597	434,582	435,783	608,503	564,187	559,124	660,315
Net Interest	0	(6,083)	(2,277)	(4,090)	(24,193)	(24,993)	(22,844)	(14,807)
Tax	(725)	(154)	(204)	(208)	28	(326)	970	0
Capex	(641,976)	(2,050,681)	(146,249)	(1,791,275)	(805,472)	(19,633)	(72,000)	(72,000)
Acquisitions/disposals	0	0	0	0	0	0	0	0
Financing	12,919	58,004	6,819	761,824	595,140	1,236	0	0
Dividends	(123,852)	(160,013)	(79,775)	(68,593)	(78,708)	(121,934)	(160,048)	(185,533)
Net Cash Flow	(33,425)	(1,618,330)	212,896	(666,559)	295,298	398,537	305,202	387,975
Opening net debt/(cash)	(761,581)	(728,156)	902,313	690,420	1,362,703	1,068,705	671,479	366,277
HP finance leases initiated	0	0	0	0	0	0	0	0
Other	0	(12,139)	(1,003)	(5,724)	(1,300)	(1,311)	0	0
Closing net debt/(cash)	(728,156)	902,313	690,420	1,362,703	1,068,705	671,479	366,277	(21,699)

Source: Company sources, Edison Investment Research

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