

# Wheaton Precious Metals

## CRAziness averted

On 13 December, Wheaton Precious Metals (WPM) announced it had reached a 'principled settlement' for its tax dispute with the Canada Revenue Agency (CRA). Whereas the CRA had been seeking at least US\$265m from WPM in taxes, penalties and interest in relation to its reassessment for the 2005–10 tax years with subsequent years left open to similar re-assessment, under the terms of the settlement WPM will actually pay the CRA cash taxes of US\$5m for the 2011–17 tax years, US\$15m in deferred tax and US\$3–4m in interest. More importantly, the settlement creates a framework for both WPM and the CRA to assess tax in future years whereby foreign income on earnings generated by WPM's international subsidiaries will not be subject to tax in Canada.

Year end	Revenue (US\$m)	PBT* (US\$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/16	891.6	269.8	62	21	30.5	1.1
12/17	843.2	277.4	63	33	30.1	1.7
12/18e	792.8	200.4	40	34	46.9	1.8
12/19e	844.6	208.8	47	32	40.4	1.7

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

## 'Exceptional' US\$30m effect on Q418/FY18 earnings

The above taxes and interest are expected to be accounted for in WPM's Q418 results and are now included in our 'current' Q418 and FY18 forecasts. However, readers should note that nothing else has changed in our forecasts and that, inasmuch as these effects may be considered one off or exceptional, our 'previous' forecasts (see Exhibit 1) effectively represent a valid representation of 'normalised' earnings, whereas our 'current' forecast effectively represents forecast, as reported, headline earnings excluding impairments (ie the gain relating to the Primero stream renegotiation, which is included in Exhibit 4).

## Future effect c US\$1m in additional Canadian tax pa

Using FY17 as a proxy for a typical year, WPM estimates the settlement will result in WPM's recording an additional US\$3–4m in income subject to Canadian income tax, resulting in an additional tax charge of c US\$1m, per year.

## Valuation: C\$42.77 in FY20

Assuming no material purchases of additional streams (which we think unlikely), we now forecast a value per share for WPM of US\$31.95, or C\$42.77 in FY20 at average precious metals prices of US\$25.95/oz Ag and US\$1,482/oz Au (vs US\$32.48, or C\$42.97, previously). This valuation excludes the value of 20.9m shares in First Majestic held by WPM, with an immediate value of C\$150.4m, or US\$0.27 per WPM share. In the meantime, WPM's shares are trading on near-term financial ratios that are cheaper than those of its royalty/streaming 'peers' in at least 70% of financial measures considered in Exhibit 3 (see page 5), and the averages of the miners themselves in at least seven out of 12 of the same measures, despite being associated with materially less operating and cost risk.

Legal dispute with CRA settled

Metals & mining

18 December 2018

**Price** **C\$25.34**

**Market cap** **C\$11,250m**

C\$1.3384/US\$

Net debt\* (US\$m) at 30 September 2018 1,261.1

\*Cum-dividend of US\$39.9m

Shares in issue 444.0m

Free float 100.0%

Code WPM

Primary exchange TSX

Secondary exchange NYSE

### Share price performance



% 1m 3m 12m

Abs 20.4 20.2 (8.0)

Rel (local) 27.0 34.6 2.8

52-week high/low C\$29.7 C\$20.1

### Business description

Wheaton Precious Metals is the world's pre-eminent ostensibly 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 and the US.

### Next events

FY18/Q418 results March 2019

First quarterly dividend announced March 2019

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**Wheaton Precious Metals is a research client of Edison Investment Research Limited**

## WPM reaches principled settlement with CRA

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### Principles

On 13 December, WPM announced it had reached a 'principled settlement' with the CRA, which provides for a final resolution in relation to the CRA's reassessment of WPM's tax returns for the period 2005–10 and, in particular, its attempt to re-characterise income earned by WPM's foreign subsidiaries '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'.

At the time of our last detailed note on the subject (Silver Wheaton, [Q415e results, Cotabambas analysis and CRA](#), published on 15 February 2016), the CRA was claiming at least US\$265m from WPM in taxes, penalties and interest in relation to its reassessment for the 2005–10 tax years, with the status of subsequent years left 'open' or 'under audit' with regard to the potential for similar reassessments.

In the event, WPM reached an agreement with the CRA whereby:

- Foreign income on earnings generated by WPM's overseas subsidiaries will not be re-characterised for the years 2005–10 and will therefore not be subject to Canadian tax.
- The transfer pricing penalties in the reassessments for 2005–10 made by the CRA will be reversed and interest claimed adjusted accordingly (subject to some minor adjustments).
- The transfer pricing principles established between WPM and the CRA for the years 2005–10 will also apply to all taxation years after 2010 and into the future.

In compensation, the service fee charged by WPM to Wheaton International will be adjusted to:

- include capital-raising costs associated with Wheaton for the purposes of funding streaming transactions entered into by Wheaton International; and
- increase the mark-up applied to Wheaton's cost of providing services to Wheaton International, including capital raising costs, from the current 20% to 30%.

### Practice

From a practical perspective, WPM estimates the effects of the effects of the settlement to be as follows:

- Zero cash taxes for the period 2005–10, but perhaps a small interest charge.
- Cash taxes of c US\$5m payable for the period 2011–17.
- An additional US\$3–4m in interest charges for all past tax years, 2005–17, such that the overall cash outlay in direct relation to the dispute is less than US\$10m.
- US\$15m in deferred taxes recognised in WPM's income statement relating to capital raising costs, offset by a deferred tax recovery in its statement of equity.
- An implied additional US\$6–7m in Q418 relating to legal costs, such that the total effect on Q4 profit after tax is US\$30m.
- An estimate that the changes for a typical WPM year in the future (based on using FY17 as a proxy) will result in an additional US\$3–4m in income subject to Canadian income tax, resulting in an additional tax charge of c US\$1m per year.

### Mechanics

From a mechanical perspective, WPM expects to:

- receive a revised notice of reassessment for the 2005–10 tax years
- re-file its returns for subsequent years on the new basis for the 2011–17 tax years
- pay any additional taxes owing under the settlement
- then receive notices of reassessment relating to the interest charges on the additional taxes relating to the 2011-17 tax years

## Updated Q418 and FY18

All of the above are expected to be accounted for in WPM's Q418 results and are now included in our 'current' Q418 and FY18 forecasts. However, nothing else has changed with respect to our forecasts other than the effects of the settlement between WPM and the CRA. Inasmuch as these effects may be considered one-off, or exceptional, however, our 'previous' forecasts effectively represent a valid representation of 'normalised' earnings, whereas our 'current' forecast effectively represents forecast, as reported, headline earnings excluding impairments (ie the gain relating to the Primero stream renegotiation, which is included in Exhibit 4).

**Exhibit 1: Wheaton Precious Metals FY18 forecast, by quarter\***

US\$000s (unless otherwise stated)	Q118	Q218	Q318	Q418e (previous)	Q418e (current)	FY18e (previous)	FY18e (current)
Silver production (koz)	7,428	6,091	5,701	5,623	5,623	24,843	24,843
Gold production (oz)	79,657	85,292	101,552	89,516	89,516	356,017	356,017
Palladium production (oz)	0	0	8,817	5,200	5,200	14,017	14,017
Silver sales (koz)	6,343	5,972	5,018	5,627	5,627	22,960	22,960
Gold sales (oz)	69,973	87,140	89,242	89,914	89,914	336,269	336,269
Palladium sales (oz)	0	0	3,668	5,179	5,179	8,847	8,847
Avg realised Ag price (US\$/oz)	16.73	16.52	14.80	14.32	14.32	15.66	15.66
Avg realised Au price (US\$/oz)	1,330	1,305	1,210	1,213	1,213	1,261	1,261
Avg realised Pd price (US\$/oz)	N/A	N/A	955	1,111	1,111	1,046	1,046
Avg Ag cash cost (US\$/oz)	4.49	4.54	5.04	4.88	4.88	4.72	4.72
Avg Au cash cost (US\$/oz)	399	407	418	415	415	410	410
Avg Pd cash cost (US\$/oz)	N/A	N/A	169	200	200	187	187
<b>Sales</b>	<b>199,252</b>	<b>212,400</b>	<b>185,769</b>	<b>195,403</b>	<b>195,403</b>	<b>792,824</b>	<b>792,824</b>
<b>Cost of sales</b>							
Cost of sales, excluding depletion	56,414	62,580	63,202	65,809	65,809	248,005	248,005
Depletion	57,265	62,494	64,684	71,579	71,579	256,022	256,022
Total cost of sales	113,679	125,074	127,886	137,388	137,388	504,027	504,027
Earnings from operations	85,573	87,326	57,883	58,015	58,015	288,797	288,797
<b>Expenses and other income</b>							
- General and administrative**	9,757	11,972	8,779	8,750	15,250	39,258	45,758
- Foreign exchange (gain)/loss	(170)	26	0			(144)	(144)
- Net interest paid/(received)	5,591	5,659	12,877	14,970	18,470	39,097	42,597
- Other (income)/expense	2,757	466	1,301			4,524	4,524
Total expenses and other income	17,935	18,123	22,957	23,720	33,720	82,735	92,735
Earnings before income taxes	67,638	69,203	34,926	34,295	24,295	206,062	196,062
Income tax expense/(recovery)	(485)	(3,224)	905		20,000	-2,804	17,196
Marginal tax rate (%)	(0.7)	(4.7)	2.6	0.0	82.3	(1.4)	8.8
Net earnings	68,123	72,427	34,021	34,295	4,295	208,866	178,866
Ave. no. shares in issue (000s)	442,728	443,191	443,634	443,634	443,634	443,297	443,297
Basic EPS (US\$)	0.15	0.16	0.08	0.08	0.01	0.47	0.40
Diluted EPS (US\$)	0.15	0.16	0.08	0.08	0.01	0.47	0.40
DPS (US\$)	0.09	0.09	0.09	0.07	0.07	0.34	0.34

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

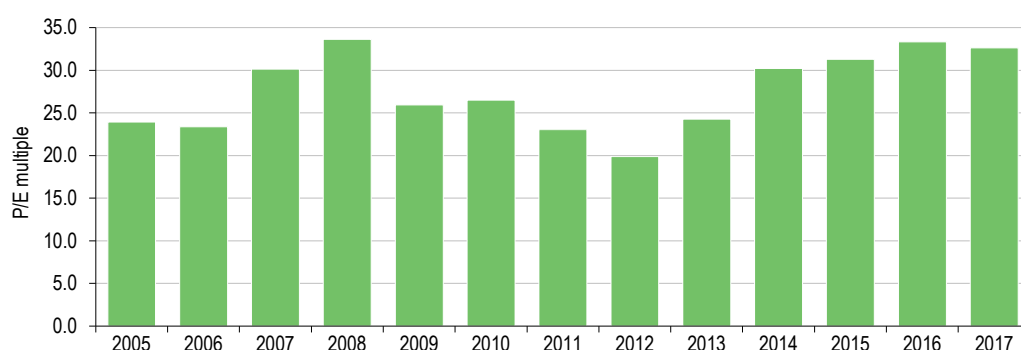
Note that these forecasts compare with a consensus forecast of US\$0.481/share (source: Bloomberg 17 December), within a range of US\$0.41–0.52 per share.

Our forecasts for FY19 (see Exhibits 3 and 4), which are based on precious metals' prices of US\$1,263/oz and US\$15.30/oz for gold and silver, respectively, compare with a consensus forecast of US\$0.525/share (source: Bloomberg 17 December) within a range of US\$0.37–0.69 per share.

## 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 40.2x Edison underlying earnings with the settlement's taxes, interest and legal fees considered as 'exceptional' or 39.4x Bloomberg consensus FY18e, currently – see Exhibit 3).

**Exhibit 2: WPM's historical current year P/E multiples**



Source: Edison Investment Research

Applying this multiple to our updated EPS forecast of US\$1.16 in FY20 (cf US\$1.18 previously to reflect an assumed additional US\$1m in Canadian tax in the intervening years) implies a potential value per share for WPM of US\$31.95, or C\$42.77 in that year (vs US\$32.48, or C\$42.97 previously). Note this valuation excludes the value of 20.9m shares in First Majestic held by WPM, with an immediate value of C\$150.4m, or US\$0.27 per WPM share (priced as at 15 November).

In the meantime, from a relative perspective, it is notable that WPM is cheaper than its royalty/streaming 'peers' in at least 70% (17 out of 24) of the valuation measures used in Exhibit 3 and on multiples that are cheaper than the averages of the miners themselves in seven out of 12 of the same valuation measures (effectively irrespective of whether Edison or consensus forecasts are used), despite being associated with materially less operational and cost risk (as WPM's costs are contractually predetermined).

**Exhibit 3: 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
<b>Royalty companies</b>						
Franco-Nevada	61.8	56.1	1.3	1.4	28.1	24.9
Royal Gold	47.9	34.8	1.3	1.4	17.4	15.5
Sandstorm Gold	75.0	47.3	0.0	0.0	16.4	14.6
Osisko	102.9	63.6	1.9	1.9	19.3	16.9
<b>Average</b>	<b>71.9</b>	<b>50.5</b>	<b>1.1</b>	<b>1.2</b>	<b>20.3</b>	<b>18.0</b>
<b>WPM (Edison forecasts)</b>	<b>40.2</b>	<b>39.0</b>	<b>1.8</b>	<b>1.8</b>	<b>17.0</b>	<b>17.0</b>
<b>WPM (consensus)</b>	<b>39.4</b>	<b>36.1</b>	<b>1.9</b>	<b>1.7</b>	<b>17.6</b>	<b>16.2</b>
<b>Gold producers</b>						
Barrick	33.1	29.6	1.0	1.0	7.5	8.3
Newmont	27.5	27.3	1.7	1.6	9.1	8.6
Goldcorp	152.0	24.4	0.9	0.9	7.8	5.3
Newcrest	23.1	17.6	1.2	1.5	9.3	8.1
Kinross	36.4	29.4	0.0	0.0	4.2	3.8
Agnico-Eagle	220.4	68.3	1.1	1.2	14.5	12.1
Eldorado	N/A	N/A	0.3	0.5	6.0	4.0
Yamana	22.3	17.1	0.9	0.9	4.0	3.7
Randgold Resources	30.7	24.8	3.2	4.1	15.1	12.2
<b>Average</b>	<b>68.2</b>	<b>29.8</b>	<b>1.2</b>	<b>1.3</b>	<b>8.6</b>	<b>7.3</b>
<b>Silver producers</b>						
Hecla	N/A	328.6	0.4	0.4	7.7	6.8
Pan American	31.2	23.7	0.9	1.4	11.2	8.9
Coeur Mining	N/A	30.1	0.0	0.0	8.4	4.0
First Majestic	N/A	64.3	0.0	0.0	14.2	8.6
Hocschild	78.5	33.4	1.9	2.1	4.6	5.4
Fresnillo	9.9	9.5	2.8	2.8	9.9	9.5
<b>Average</b>	<b>39.9</b>	<b>81.6</b>	<b>1.0</b>	<b>1.1</b>	<b>9.3</b>	<b>7.2</b>

Source: Bloomberg, Edison Investment Research. Note: Peers priced on 17 December 2018.

**Exhibit 4: Financial summary**

	US\$000s	2012	2013	2014	2015	2016	2017	2018e	2019e
Dec		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>									
Revenue		849,560	706,472	620,176	648,687	891,557	843,215	792,824	844,565
Cost of Sales		(117,489)	(139,352)	(151,097)	(190,214)	(254,434)	(243,801)	(248,005)	(262,755)
Gross Profit		732,071	567,120	469,079	458,473	637,123	599,414	544,819	581,810
EBITDA		701,232	531,812	431,219	426,236	602,684	564,741	499,061	536,052
Operating Profit (before amort. and except.)		600,003	387,659	271,039	227,655	293,982	302,361	243,039	259,340
Intangible Amortisation		0	0	0	0	0	0	0	0
Exceptionals		0	0	(68,151)	(384,922)	(71,000)	(228,680)	245,715	0
Other		788	(11,202)	(1,830)	(4,076)	(4,982)	8,129	(4,380)	0
Operating Profit		600,791	376,457	201,058	(161,343)	218,000	81,810	484,374	259,340
Net Interest		0	(6,083)	(2,277)	(4,090)	(24,193)	(24,993)	(42,597)	(50,522)
Profit Before Tax (norm)		600,003	381,576	268,762	223,565	269,789	277,368	200,442	208,818
Profit Before Tax (FRS 3)		600,791	370,374	198,781	(165,433)	193,807	56,817	441,777	208,818
Tax		(14,755)	5,121	1,045	3,391	1,330	886	(17,196)	(1,000)
Profit After Tax (norm)		586,036	375,495	267,977	222,880	266,137	286,383	178,866	207,818
Profit After Tax (FRS 3)		586,036	375,495	199,826	(162,042)	195,137	57,703	424,581	207,818
Average Number of Shares Outstanding (m)		353.9	355.6	359.4	395.8	430.5	442.0	443.3	443.6
EPS - normalised (c)		166	106	75	53	62	63	40	46.8
EPS - normalised and fully diluted (c)		165	105	74	53	62	63	40	47
EPS - (IFRS) (c)		166	106	56	(-41)	45	13	96	47
Dividend per share (c)		35	45	26	20	21	33	34	32
Gross Margin (%)		86.2	80.3	75.6	70.7	71.5	71.1	68.7	68.9
EBITDA Margin (%)		82.5	75.3	69.5	65.7	67.6	67.0	62.9	63.5
Operating Margin (before GW and except.) (%)		70.6	54.9	43.7	35.1	33.0	35.9	30.7	30.7
<b>BALANCE SHEET</b>									
Fixed Assets		2,403,958	4,288,557	4,309,270	5,526,335	6,025,227	5,579,898	6,215,876	6,011,164
Intangible Assets		2,281,234	4,242,086	4,270,971	5,494,244	5,948,443	5,454,106	6,090,084	5,885,372
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	3,596	3,830
Stocks		966	845	26,263	1,455	1,481	1,700	1,423	1,516
Debtors		6,197	4,619	4,132	1,124	2,316	3,194	2,172	2,314
Cash		778,216	95,823	308,098	103,297	124,295	98,521	0	0
Other		0	0	0	0	0	0	0	0
Current Liabilities		(49,458)	(21,134)	(16,171)	(12,568)	(19,057)	(12,143)	(504,256)	(236,019)
Creditors		(20,898)	(21,134)	(16,171)	(12,568)	(19,057)	(12,143)	(24,486)	(25,941)
Short term borrowings		(28,560)	0	0	0	0	0	(479,770)	(210,078)
Long Term Liabilities		(32,805)	(1,002,164)	(1,002,856)	(1,468,908)	(1,194,274)	(771,506)	(771,506)	(771,506)
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)	(1,506)	(1,506)
Net Assets		3,107,074	3,366,546	3,628,736	4,150,735	4,939,988	4,899,664	4,943,710	5,007,469
<b>CASH FLOW</b>									
Operating Cash Flow		720,209	540,597	434,582	435,783	608,503	564,187	508,322	537,273
Net Interest		0	(6,083)	(2,277)	(4,090)	(24,193)	(24,993)	(42,597)	(50,522)
Tax		(725)	(154)	(204)	(208)	28	(326)	(2,196)	(1,000)
Capex		(641,976)	(2,050,681)	(146,249)	(1,791,275)	(805,472)	(19,633)	(892,000)	(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)	(149,820)	(144,059)
Net Cash Flow		(33,425)	(1,618,330)	212,896	(666,559)	295,298	398,537	(578,291)	269,692
Opening net debt/(cash)		(761,581)	(728,156)	902,313	690,420	1,362,703	1,068,705	671,479	1,249,770
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	1,249,770	980,078

Source: Company sources, Edison Investment Research

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