

FP INVESTING

FP TRADINGDESK.COM

SILVER WHEATON'S PROSPECTS IMPROVING, Q4 RESULTS SHOULD BE BETTER THAN Q3

Whether or not you like silver, **Silver Wheaton Corp.** is a buy. That's the word from Scotiabank mining analyst Trevor Turnbull.

Silver Wheaton is the largest metals streaming company in the world, which means it doesn't actually mine silver, but rather buys the output of other companies at a discount on future production.

Silver Wheaton is in the midst of growing production at a rate of 70%, from 28 million to 48 million ounces of silver by 2016. Mr. Turnbull noted that much of this expansion has begun and is anchored by low-cost assets such as Penasquito in Mexico and Pascua Lama in Chile and Argentina.

The analyst also pointed out that difficult financing conditions for miners continue to benefit Silver Wheaton.

"The company has \$1.1-billion in available cash and credit to act opportunistic-

ally," he told clients, adding that a credit facility expansion to as much as \$1-billion from \$400-million currently is also possible, if needed.

Mr. Turnbull expects the fourth quarter will be a big improvement for Silver Wheaton after its third-quarter results suffered from several sales lags.

While the analyst believes an audit by the Canada Revenue Agency may negatively impact its share price, he thinks Silver Wheaton makes a compelling case why its corporate structure exceeds all the requirements for being fully operational out of the Cayman Islands.

"We believe the CRA will agree," Mr. Turnbull said, reiterating a sector outperform rating and US\$51 one-year price target on the stock.

Jonathan Ratner

SILVER WHEATON CORP.
SLW/TSX, \$36.81, up 27¢

GOLD TEMPORARILY WOUNDED BY SELLOFF, RECOVERS SLIGHTLY TO US\$1,727 THURSDAY

Gold's sharp selloff of nearly \$25 at the open of U.S. trading on Wednesday prompted many theories, including some blaming a "fat finger" erroneous trade.

Once the dust settled, traders pointed to stop-loss orders being triggered by computer-driven trading programs, funds taking end-of-month profits on their long positions, and options-related selling driven by contract expirations.

Regardless of the reasons behind the pullback, it makes Friday's technical breakout for gold a distant memory.

"This is another test of downside buying interest but it also highlights the commitment issues that reside when the market attempts to climb higher," said Edell Tully, a strategist with UBS in London.

In trying to determine a

floor for gold prices, he looked back to October as a primary guide.

Mr. Tully is confident that confirmation of central bank buying in October prevented the market from falling substantially below US\$1,700. He expects this underlying buying interest will come into play once again.

"All in all, gold is temporarily wounded, nothing more, nothing less," the strategist said. "Despite all the selling [on Wednesday] which was largely concentrated on the floor, we observed very little client appetite to follow the trend. That is a positive indicator to remember."

Bullion climbed for the first time in four days Thursday, rising US\$10.70 to US\$1,727.20.

Jonathan Ratner



JIN LEE / BLOOMBERG NEWS FILES

Traders work in the gold and silver options pit at the New York Mercantile Exchange. A variety of causes were cited for gold's US\$25 plunge Wednesday.

CP's rolling recovery may come off the rails, analyst says

'UNACHIEVABLE' GOAL

SCOTT DEVEAU

Canadian Pacific Railway Ltd.'s goals for improving its operations are "unachievable" and a double-digit correction may be lying in the wings in the coming months, one analyst warned investors Thursday.

Walter Spracklin, an analyst at Spracklin Markets, splashed cold water on CP's red-hot stock in the lead up to its investor meeting next week, where the company's new

management under recently appointed chief executive, Hunter Harrison, is expected to unveil its turnaround plan.

Mr. Harrison, appointed CEO in June after a lengthy proxy battle led by Bill Ackman's Pershing Square Capital Management L.P., has set an aggressive goal of improving the railway's operating ratio to 65% from 77.1% within four years.

Shares in the railway have surged since his appointment, allowing long-time Canadian investors to take a profit and rebalance their portfolios while several U.S. hedge funds

moved into the stock riding on Pershing Square's coattails.

Some analysts have argued these U.S. funds plan to hold the stock until Mr. Harrison achieves his goals, but Mr. Spracklin expects them to exit much sooner.

"The thesis is buy on the hype and sell on the news, and the hype is going to go right up to the [investor meeting]," he said. "I would expect to see the hangover coming in after this event."

He said he expects the sell-off to begin in the weeks after the investor meeting Dec. 4 and 5, and to accelerate as rail

data for the winter months start to come in.

Analysts on average estimate first-quarter earnings will come in at \$1.06 per share, more than 30% higher than the best first-quarter on record for the company.

Mr. Spracklin said he expects earnings revisions in the coming months that could bring that estimate down by as much as 15%, and that, all combined, shareholders could see a "double-digit" decline in the share price in the coming months.

"As a hedge fund, do I want to be long in this stock for the next three to six months? No,

I want out," he said, adding that much of the upside has already been priced in with CP's shares trading around \$93. "I haven't met one hedge fund with a four-year time horizon," he added.

Moreover, Mr. Spracklin said he believes Mr. Harrison's 65% operating ratio target can't be achieved in the time frame given due to several headwinds the railway will face, including a challenging economic environment, pension issues, restrictive customer contracts, potential labour disruptions and unknown network constraints.

As a result, he expects management to widen its guidance to a range of 64% to 66% by 2016.

"In our view, the scope of potential operating improvement at CP is substantial and we believe the new CEO is the right person for the job," Mr. Spracklin said.

"Where our outlook differs from the current guidance is on the timing and magnitude."

Mr. Spracklin said if CP's shares decline to the low \$80 range, he would encourage investors to buy the stock.

But as of now, he has a sector perform rating on the stock and a \$91 price target.

Financial Post
sdeveau@nationalpost.com

BUY & SELL

BIG-PICTURE VIEWS, CURRENT ISSUES, OUTLOOK AND PICKS. BY JONATHAN RATNER



DARREN CALABRESE / NATIONAL POST

Steven Palmer, manager of the AlphaNorth Partners fund, said Canadian small-cap stocks have "gone through one of these brutal bear markets but I believe we hit a bottom in June." Small caps usually do well in the winter, he said.

Winters warm for small caps

MANAGER PROFILE

Manager: Steven Palmer, AlphaNorth Asset Management
Fund: AlphaNorth Partners Fund

Description: Long-biased hedge fund focused on Canadian micro and small caps
AUM: \$75-million
Performance: 1-year: -15.4%; 2-year: 18.8%; 3-year: 28.8% (as of Oct. 31, 2012)
Fees: 2% management, 20% performance

Technical indicators are looking up for Canadian small caps because the TSX Venture Index in December has risen nearly 80% of the time over the past decade.

Steven Palmer, president and chief investment officer at Toronto-based AlphaNorth Asset Management, tracked the index back to 1982 when it had a different name and found December, January and February are by far the year's best-performing months.

He noted Canadian small caps are down about 50% since March 2011, while the S&P/TSX composite index and the S&P 500 have done quite well.

"It's gone through one of these brutal bear markets, but I believe that we hit a bottom in June. TSX Venture stocks don't tend to meander sideways for very long. They

tend to either go straight up or straight down, and they've been basically going straight down for a year-and-a-half with just minor relief rallies."

If Palmer's call proves correct, returns for micro and small caps could be dramatic given the depressed levels these stocks currently trade at.

"I also look at sentiment indicators, which look very similar to the first quarter of 2009," said the hedge fund manager, who also runs the AlphaNorth Growth Fund. "I can identify many companies trading at less than cash value or where the fundamentals have improved considerably, but the stock is lower."

Palmer's been bullish on the broader market since the fall of 2011 and his portfolios have been fully invested in recent months. The fund's sector weightings are roughly 43% technology, 27% metals, 12% biotech, 11% energy and 7% precious metals.

"Resources have been hit the hardest in recent months on concerns that China is slowing," the manager said.

But some of the life science companies he owns have performed well of late. "It's been forever since we've seen that. Nothing seems to be working in resource land, so perhaps investors are circling back to sectors that have been in a bear market for much longer."

Financial Post
jratner@nationalpost.com

BUY

HULDRA SILVER INC. Ticker **HDA/TSX-V**

The position: Recently added to position held for about four months.

Why do you like it? Huldra recently started processing ore at its 100%-owned silver mine in British Columbia. "We like that the asset is in Canada and is high grade," Palmer said.

His valuation of approximately 2x earnings in 2013 is based on current commodity prices.

Biggest risk: A short mine life, but the resource could significantly expand with modest drilling next summer.

BSM TECHNOLOGIES INC. Ticker **GPS/TSX-V**

The position: Ongoing purchases since new management took over in 2008.

Why do you like it? BSM, which tracks mobile and fixed assets using GPS, has been a turnaround story, Palmer said. "Management has done a great job of lowering costs while winning some significant new contracts."

He noted BSM's cash position has been building in recent quarters and the company has been buying back shares. "We believe it on the cusp of significant gains," he said.

Biggest risk: Contracts don't roll out in a timely manner and follow-on orders are weak.

TRIMEL PHARMACEUTICALS CORP. Ticker **TRL/TSX**

The position: Added on weakness since purchasing at IPO.

Why do you like it? Trimel's most advanced product for male testosterone replacement therapy will announce Phase III data in the next couple of months.

"The interim data has been very positive and we believe the odds of a successful trial are much higher than most Phase III trials," Palmer said.

"Upon successful results, we expect a partnership deal and a New Drug Application filing, which would add significant value to the company."

He also noted the company is developing other products to treat female sexual dysfunction and Parkinson's disease.

Biggest risk: An unsuccessful trial.

SELL

TRANSCANADA CORP. Ticker **TRP/TSX**

The position: Avoid.

Why don't you like it? Despite the lack of earnings-per-share growth over the past six years, analysts are forecasting 20% growth in 2013 and 11% in 2014 for TransCanada, which trades at a price/earnings multiple of 20x 2013 consensus earnings.

"Investors should be skeptical as analyst estimates have been revised down in each of the past four years," he said. "There are many growth companies that trade at less than 10x earnings which offer better risk/reward."

Potential positive: Investor risk aversion persists, causing yields to further decline and provide support for stable dividend-paying companies.