



# HALLGARTEN & COMPANY

## Coverage Update

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# Silvercorp (SVM.to, SVM:NYSE)

## Strategy: Strong Buy

## Attack of the Poison Pen

Key Metrics			
	FY11	FY12e	FY13e
Price (CAD)	\$7.04		
12-Month Target Price (CAD)	\$12.50		
Upside to Target	78%		
12mth hi-low CAD	\$5.86 - \$16.32		
Market Cap (CAD mn)	\$1,232.7		
<b>Shares Outstanding (mns)</b>	175.1		
<b>Fully Diluted (mns)</b>	176.0		
Consensus EPS		\$0.69	\$0.78
Hallgarten EPS		\$0.82	\$0.79
Actual EPS	\$0.410		
P/E	17.2	8.6	8.9
Dividend	0.08	0.12	0.14
Yield	1.1%	1.7%	2.0%



# Silvercorp

## Doing Battle with a Mystery Assailant

- ✖ A Poison Pen writer with a Shorting agenda has been attacking the stock with errant claims in an attempt to tar the company with the same brush as the Chinese RTO scams
- ✖ A second (though only slightly more transparent) Poison Pen writer has surfaced in the form of Alfred Little.
- + The company came out of the gates strongly with a rebuttal of the Poison Pen claims and is now investigating the matter, with authorities throwing their weight behind the hunt
- + A Buy Back program is in operation which uses minimal cash but makes Shorting an uphill task for the miscreants
- + Production continues to uptrend and the company is aggressively bolting on acquisitions (at low prices)
- + The company is moving forward fast with its Canadian silver property, Silvertip that may even start DSO output within the next 12 months
- + The company has a very sizable cash position of over \$230.5mn at the current time with capex requirements over the next two years that might, at a stretch, use up one third of that amount
- + A dividend payer, which potentially makes attractive to the heavyweight institutional audience
- ✖ We remain bearish on Silver, which we regard as overpriced at current levels.

### Attack of the Poison Pens

In the general wave of bad vibes surrounding the Chinese RTO listed sector in North America, Silvercorp has been caught in the backwash. Or at least it looked like mere backwash until late August. Even then it was hard to discriminate the malaise in the mining markets in general, from the specific travails of the silver miners after they went off the boil in early May and then the overlay of the China wobbles.

Thus it might be said that Silvercorp was suffering a triple whammy up until early August when a new dynamic came into play. Substantial shorting became apparent (approximately 23 million shares or 13% of issued shares) and then the killer blow was the dispatch of a poison pen letter to the press and the company's auditors

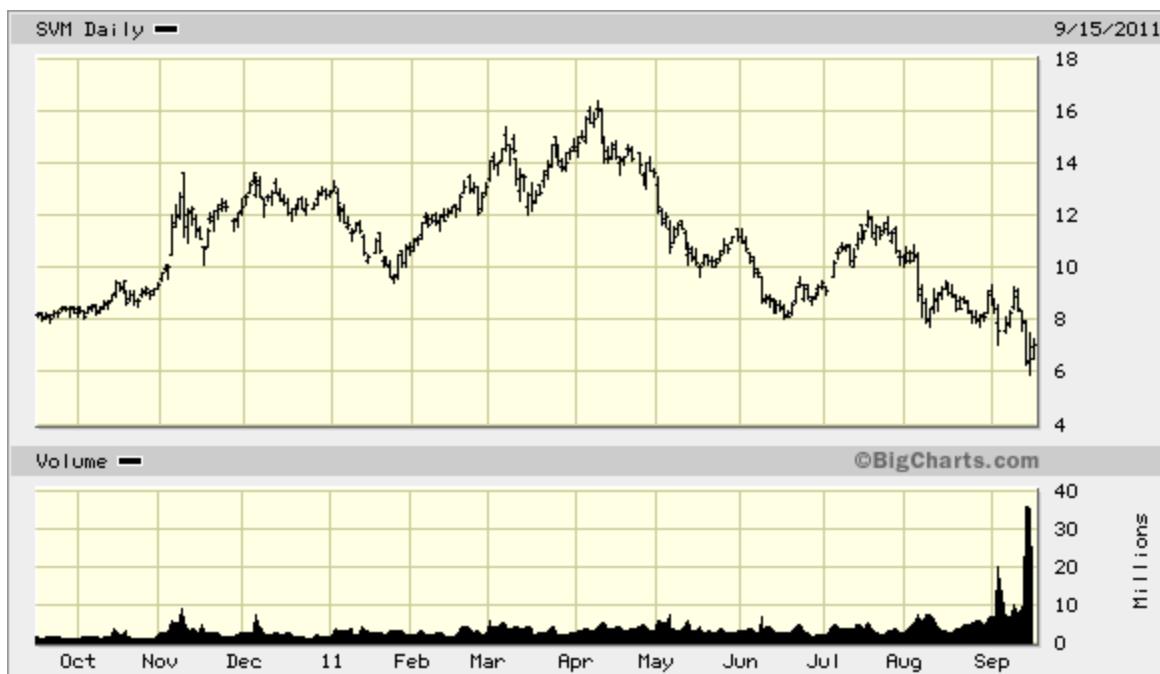
### Silent Whispers

On the 2<sup>nd</sup> of September the company came out with a press release essentially “calling out” the Shorters. Now in recent times we have seen other companies complaining of Short action in their stock (St Elias Mines, being a deserving case for shorting) but in this case the company revealed that it had come into possession of a copy of an anonymous letter dated August 29, 2011 addressed to the Ontario Securities Commission, Silvercorp’s Auditors, and various media outlets maliciously alleging a “Potential \$1.3 Billion Accounting Fraud at Silvercorp”. Clearly the author fancied themselves as a “Muddy Waters

Wannabe" but the key difference here is that at Sino Forest (and the other RTO's exposed) the author of the allegations made himself public and was prepared to face questioning.

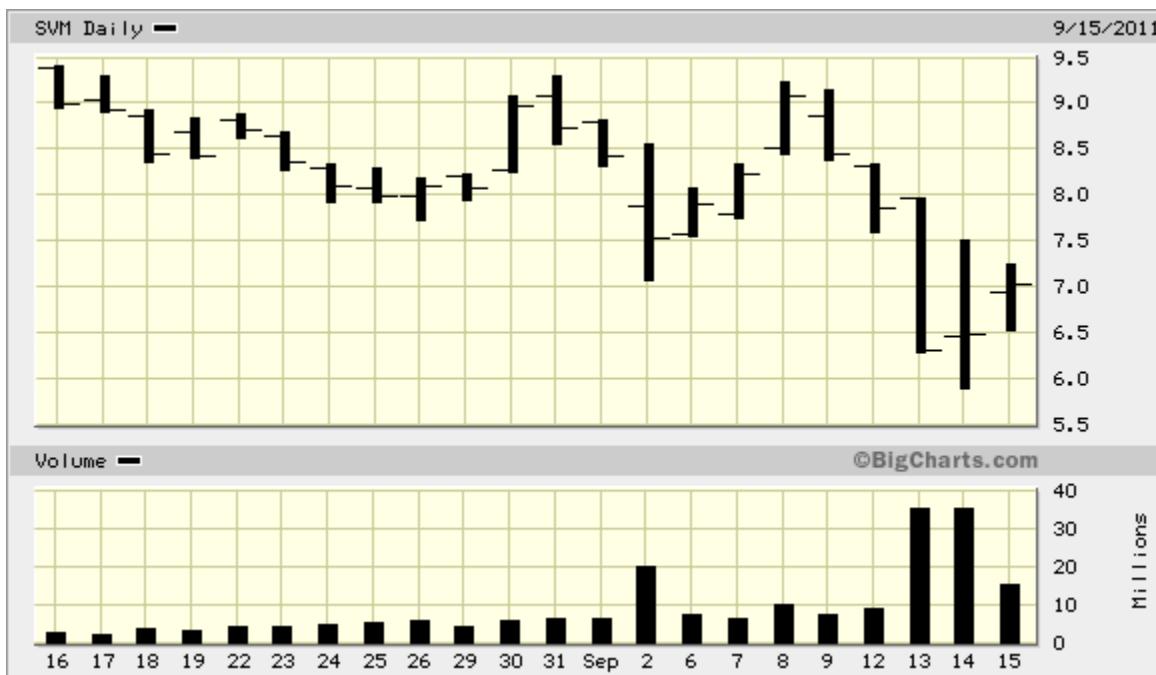
In Silvercorp's case the anonymous author (in a perverse piece of "honest disclosure") stated that his firm held a short position in Silvercorp's shares and intended to make his concerns known through internet postings. This also smacks of the campaign against Farallon, before it was taken over last year which is still winding its way through the courts.

To grapple with the problem swiftly the company established a task force of independent directors consisting of Dr. Robert Gayton, Paul Simpson, LL.B. and Earl Drake (Canada's former ambassador to China) to work with regulatory authorities to immediately investigate and discover the identity of the party behind these allegations.



As we can see from the chart above the slide began in mid-April. The chart that follows shows the silver price which peaked around the 26<sup>th</sup> of April and went into a rapid descent. Silver lost \$15 (from \$50 – thus down 30%) in a matter of days. SVM only declined from around \$16 to around \$12 (a 25% retreat) in the same period. May was not great but a rally began until on June 2<sup>nd</sup>, Sino-Forest was exposed and all things Chinese in Western markets were cast under a cloud.

However, SVM managed to escape that debacle's centripetal force within a couple of weeks and started marching higher. By mid-July it had risen nearly 50% from its lows and we suspect it was then that the Poison Pen shorter came up with their plan to muddy the waters at Silvercorp with some misinformation. The letter hit the wires in late August resulting in another leg down to \$7 before the company's gutsy response resulted in a stinging rally that must have produced some palpitations at the Poison Pen writer's lair, wherever that might be.



### The Response

The company didn't let grass grow under its feet and immediately sent out a response dismissing the claims. The difference here between SVM and the others in the morass of the Chinese RTO business is that SVM has Western auditors, had all its numbers to hand and had nothing to hide. This is night and day to the ham-fisted obfuscation of the RTO ne'er-do-wells.

The Poison Pen writer's main allegation is that while Silvercorp reported net profit of US\$66 million to the SEC in calendar 2010 and that financial filings (purportedly) available from the Chinese State Administration of Industry and Commerce show SVM reporting a loss of US\$0.5 million for calendar 2010. The company responded by stating that the allegation is false and offered the following evidence:

- The company referred investors to the SAIC website (<http://wznj.saic.gov.cn>) which corroborates, for Silvercorp's four Chinese operating subsidiaries, that: (i) Henan Found filed net after income tax profit for calendar year 2010 of RMB 514,786,392; (ii) Henan Huawei filed a net loss of RMB 6,091,388; (iii) Guangdong Found filed a net loss of RMB 4,758,879; and (iv) Anhui Yangtze filed a net loss of RMB 1,214,663. On a consolidated basis, the net profit of these four Companies was RMB 502,721,462 (US\$ 73 million). In addition on the first page of each filed SAIC document there is an anti-fraud code displayed which can independently verify those reports on the Chinese Certified Professional Accountant website.
- As further evidence of the company's net profit, it provided copies of the 2010 Annual Income Tax Filing Forms for Henan Found and Henan Huawei, which include a receipt issued by the State Tax Bureau of the Luoning County of Henan Province. In the 2010 Annual Income Tax Filing Form, Henan Found reported net revenue of RMB964,812,316 (US\$140.1 million), and a pre-

income tax net profit of RMB590,727,919 and paid income tax payable of RMB74,441,229.

- In China, on each sale of goods the seller must charge Value Added Tax, and the receipt issued for the paid value added tax must be approved and is stamped by the government. The company posted details on its website showing a reconciliation of the Value Added Tax paid by Henan Found on its revenues along with copies of the government receipts.

The Poison Pen letter then goes on to allege that Silvercorp's cash position is grossly overstated, an assertion that is easily disproved by bank statements, which show that, as at June 30, 2011, SVM had a cash position of US\$230.5 million.

Showing a woeful appreciation of how "book value" transfers are done between group companies in emerging markets, the Poison Pen writer also alleges that Henan Found's 22.5% JV partner, the Henan Non-Ferrous Geological and Mineral Resources Co. Ltd., which is a State-owned Enterprise, sold a 5% interest in Henan Found for US\$7 million, implying the Henan Found assets are worth only US\$140 million. The anonymous author fails to mention that the transfer was to an affiliate. Based on the joint venture contract and articles of association of Henan Found, the 22.5% joint venture partner can assign its interest to an affiliate.

In a new one on us the mystery writer challenges the company's NI 43-101 resource. While we do not worship at the altar of NI 43-101s ourselves, and have had our differences about why they should be regarded as the *be all and end all* of resource calculation, we have never gone so far as to have the temerity to slag off the author on the rather spurious basis of the resource being "too good to be true". One must concede that SVM's SGX Mine within its Ying mining district does have some of the highest grades in the industry but the grades are high with its most recent NI 43-101 report measured grades at the SGX Ying mine are 845g/t for silver. One is not buying Silvercorp for skinny grades. The mineral resource estimate for SGX was prepared by Mel Klohn L.P. Geol. of Spokane Valley, Washington, who is a Qualified Person with the firm of B.K Exploration Associates. As such the poison pen writer is also impugning the Canadian regulators' definition of who might be a Qualified Person. Maybe that then is why the regulators in Canada have moved so swiftly

Silvercorp is of course listed in both Canada and the US so the machinations of the Shorter fall under the purview of both the SEC and the OSC. While the OSC has shown itself to be relatively toothless on Short raids (and a variety of other matters) in the past, the SEC if it picks up a case tends to have sharper teeth and more of a tendency to go in dogged pursuit. Meanwhile Silvercorp has committed itself to pursuing all legal options, whether in Canada, the United States, or China, to recover damages incurred by the company as a result of these allegations. The game has taken rather a serious turn and the mystery Shorter could find themselves strung out to dry on multiple fronts should a solid lead on their identity emerge.

Indeed in an announcement this week, the BCSC, in a departure from their usual policy of keeping investigations confidential, announced on the 9<sup>th</sup> of September that in order to conduct a balanced and thorough review it was publicly asking the author of the anonymous letter to come forward. The BCSC is examining both the nature of the complaint and the allegations contained in the letter. The BCSC is also asking anyone else who may have information related to the allegations or the identity of the author to contact the BCSC Enforcement division. The hounds have been set loose in the woods and the Poison

Pen Shorter, who ought to be known to whatever investment bank that was supplying stock loans, must be putting on their camouflage facepaint and going to ground as the scent is picked up. If they never thought it would go as far as the DNA on the postage stamps.. they should think again.

### **Further Muddying of the Waters**

Desperately trying to avoid the fate of being a one-hit wonder, like some 1970s band, Muddy Waters waded into the fray with his tweeting of a link to the “Alfred Little” blog with its revelations about SVM’s claimed misdeeds. While this Edwardian-sounding blog at first glance had a touch less of the furtive than the initial Poison Pen letter it was, upon further examination, just as below the radar (and below the belt). In fact a reading of its screed would indicate that AL’s efforts to “uncover” SVM date back to June at least and thus the sneaking suspicion that AL and the original Poison Pen sender are one and the same and that the latest outing is designed to make the campaign appear more mainstream. Muddy Waters has potentially strapped on the suicide vest for his short career as a sage on China by casting his lot in with the underbelly of the Shorting whispernet. Maybe his next career move could be Dancing with the Stars or Celebrity Apprentice.

### **The Buy Back**

As the company was swimming in cash in the middle of the year and whatever investments (or acquisitions) it needed to make could be met out of cashflow, on June 17, 2011 it announced that it would commence a Normal Course Issuer Bid to acquire up to 10 million common shares from June 29, 2011 to June 28, 2012. This would amount to 5.7% of the 175,047,941 common shares then issued and outstanding. The rationale given was that prevailing market conditions had resulted in Silvercorp’s shares being undervalued relative to the immediate and long term value of Silvercorp’s portfolio of producing and development properties in China and Canada.

The arrangement was that the maximum number of shares that may be purchased on the TSX during any trading day may not exceed 25% of the average daily trading volume on the TSX, excluding purchases made by Silvercorp under its Normal Course Issuer Bid, based on the previous six completed calendar months, for a daily total of 215,990 common shares. This limit (which had permitted exceptions) was determined in accordance with TSX regulatory requirements and does not apply to purchases made by Silvercorp on the NYSE.

The company has announced that, up until the current time, it had acquired a total of 2.318 mn of its common shares at an average price of CDN\$8.12. This is a mere bagatelle compared to the cash on hand so we expect the company might start to push the program harder once they have the shorters on the run.

Such buybacks are not very common in the mining space and we naturally prefer dividends, coming from the more Anglo-Australian viewpoint. However, in this case with shorters doing such damage, a stock buyback makes the task of shorters trying to make money into one of Sisyphean proportions. In any case the amount of money involved is minimal compared to the company’s cash mountain.

## Recent Acquisitions

Frustrating the arguments of those that claim that Silvercorp's money could be better spent on M&A, was its recent acquisition of a mine and mill complex in China at a price that bordered on the derisory. This goes to show that Silvercorp's stature and resources put it ahead of other potential buyers and it manages to snap up bargains without needing to dent its cash mountain.

Such was the case again when it announced, on the 22<sup>nd</sup> of August, that its 77.5% owned subsidiary, Henan Found Mining Co. was acquiring a 90% equity interest in Zhongxing Mining Co. Ltd and Chuanxin Mining Co. Ltd., two local private mining companies, with common owners, in Luoyang City, Henan Province. The total cash payment for the acquisition of both companies was approximately US\$10.4 million (including US\$4.3 million for the equity interest and US\$6.1 million cash payment for outstanding debt). Henan Found has already made 80% of the required total payment and has taken control of the assets.

The main assets of Zhongxing include the high grade XBG silver-gold-lead-zinc mine and Chuanxin's main assets include a 350 tpd flotation mill (though there is an environmental permit to construct a 1,000 t/d flotation mill). There is an associated tailings management facility.

The XBG Mine is located about 120 km southwest of the Silvercorp's Ying Mine and is about a three hour drive from Luoyang City and the Ying Mine. The XBG mine includes a mining permit covering 26.36 km<sup>2</sup> (until November 2022) and the adjacent NTM gold exploration permit covering 2.54 km<sup>2</sup>. The mill was built in 2009 within the mining permit area. Due to the close proximity, the XBG project will be managed by the Ying Mine's management team.

The XBG mine area was a focus of artisanal mining for gold and silver from the late 1980s. Zhongxing carried out exploration/mine development and small-scale tunnel mining after its mining permit was issued in November 2010. By the end of July 2011, a total of 4,500 meters of mine tunnels and several shallow shafts were developed in the mine area. Based on Zhongxing's records, over 20,000 tonnes of silver-lead-zinc ore were mined of which about 12,000 tonnes of ore were milled at the on-site flotation mill. Metal recoveries from the test milling were reported to be over 90% for silver and lead and 80% for gold and zinc.

## Geology

The XBG project area is situated in the east extension of the Qinling Mountain Belt near the margin of the Northern China Craton in the same regional mineralization belt as the Ying Mining Camp and is one of the largest silver-gold and base metal belts and largest silver producing region in China. Exploration activities were limited to regional scale surface mapping, 1:50,000 scale stream sediment geochemical survey, and limited surface trenching. This identified twelve mineralized Ag-Au-Pb-Zn veins/structures and three Au veins/structures. The silver-gold-lead-zinc mineralization is hosted in quartz-sericite-chlorite-carbonate-fluorite veins cross-cutting Proterozoic age andesite flows. The vein system trends NNE, NEE, and NW and is steeply dipping with an extension for a few hundred meters to over 2,000 meters along strike and up to 210 m along the dipping direction (with true width ranging from 0.2 to 3.8 m). The veins contained 14 to 856 g/t Ag, 0.10 to 63.18 g/t Au, 0.15 to 36.17% Pb, and 0.10 to 15.33% Zn. No drilling was ever performed on the property; therefore, no resource was defined.

Silvercorp's geologists visited the property three times in June and July 2011 collecting over 35 channel and bulk samples from five actively mined veins. The highlights of assay results are listed below.

Vein		True Thickness (m)	Ag (g/t)	Au		
#	Location			(g/t)	Pb (%)	Zn (%)
X1	YS Shaft, North Vein Drift	1.2	251	1.2	11.54	0.53
	YS Shaft, South Vein Drift					
	Including	2.3	128	9.47	2.56	0.74
		0.3	856	63.18	12.78	0.41
	Ore Stockpile at YS	Bulk sample	37	10.44	0.61	0.1
X2	Road Cut Outcrop	3.8	87	0.44	1.05	0.7
X8	Adit at YS Valley East	Stope's Bulk sample	165	0.55	19.32	0.53
	Vein Drift at YS Valley East	0.8	84	0.88	5.99	2.66
	Vein Drift at YS Valley West	0.83	195	0.42	10.44	8.03
	Ore Stockpile at mill	Bulk sample (massive Galena)	352	0.28	65.93	4.76
X9	Vein Drift at YS Valley West	0.4	84	1.25	2.82	1.9
X12	Vein Drift at Dachunshu	0.8	151	1.31	0.77	0.81

Source: Silvercorp

The company is planning a comprehensive exploration program that includes surface and underground mapping and sampling, and surface and underground diamond drilling will be carried out to explore the existing veins and discover additional veins. The exploration program is expected to be self-funded by cash-flow generated from continuing mining activities from the existing tunnels and processed from the existing 350 t/d floatation mill.

Silvercorp's intention is to consolidate the majority of the mineralization belt of the XBG Mine area through Henan Found, which is currently in the final process of acquiring yet another silver-gold-lead-zinc mine covered by a 14 km<sup>2</sup> mining permit and equipped with a new 500 tpd floatation/CIL mill. This mine is located about 6 km to the northwest of the XBG mine. Silvercorp commented that Henan Found is also negotiating acquisition opportunities with several other silver-gold-lead-zinc property owners in the XBG project area.

### Outside China

One of the other paradoxes of the recent attack on the company is that the company is evolving outside China. With its push into mining in Canada the (absence of) parallels with the China-only RTO stories becomes more poignant. While the RTOs sheltered behind the hermetic wall of distance, language, culture and locally sourced accountants, Silvercorp's move into Canada is exactly the type of deal which companies with a devious agenda would not pursue due to the easily verifiable nature of the assets and financial transactions related to them. Several years ago with China-focused miners out of favour (maybe rightly so), Silvercorp struck out to rebalance its business to a broader geographical base. To this end it launched its abortive bid for the wily Klondex and then more recently it secured the Silvertip mine in British Columbia that is now moving towards production.

## Pursuing Canadian assets

In late February 2010, the company revealed that it had signed an agreement with Silver Standard Resources (SSRI) to purchase a 100% interest in the Silvertip advanced stage high-grade silver-lead-zinc carbonate replacement deposit system. Total consideration for the project is CAD\$15 mn with up to 50% to be paid in Silvercorp common shares and the balance in cash. Further mineral claim staking by Silvercorp has increased the land package to approximately 800 km2.

The Silvertip property hosts an advanced-stage, high-grade silver-lead-zinc. The property covers 216 km2 just south of the Yukon border in northern British Columbia, Canada. The site is readily accessible by a 25-kilometre road from the Alaska Highway. The project was previously explored by various operators/owners from 1955 to 2000 with more than CAD\$40mn in exploration work carried out, including 2,400 metres of underground tunnel development and 71,472 metres of surface and underground drilling in 491 holes. The most recent exploration work was carried out by Imperial Metals, which owned the project from 1996 to 2002. No exploration work was conducted by Silver Standard after they acquired the project in 2002.

Silvercorp commissioned a resource evaluation reviewing all available exploration reports and data and compiling a new geological model for the Silvertip project. This model includes exploration results from a 1999-2000 drill campaign designed to test geophysical anomalies discovered in the summer of 1999 by Imperial Metals. In that campaign, drill hole SSD-99-65 intercepted 31.4 metres grading 318.4 g/t silver, 5.52% lead and 8.65% zinc. Subsequently, in the winter of 2000, 22 underground diamond drill holes delineated the high-grade “65 Zone”.

This latest NI 43-101 compliant resource dated February 19, 2010, including the “65 Zone” as well as significant drill hole interception readings as follows:

### **Silvertip 2010 Resource Calculation (Including exploration results up to and including the winter of 2010)**

	<b>Tonnes</b>	<b>Silver(g/t)</b>	<b>In Situ Contained Silver (oz)</b>	<b>Lead(%)</b>	<b>Zinc (%)</b>	<b>Gold (g/t)</b>
<b>At &gt;200 g/t Silver Equivalent Cut-off</b>						
Indicated	2,349,055	352	26,556,459	6.73	9.41	0.54
Inferred	459,896	343	5,069,380	6.18	9.81	0.23
<b>At &gt;400 g/t Silver Equivalent Cut-off</b>						
Indicated	1,976,664	398	25,263,518	7.65	10.35	0.58
Inferred	357,713	413	4,747,390	7.50	11.05	0.26
<b>At &gt;1,000 g/t Silver Equivalent Cut-off</b>						
Indicated	705,373	631	14,309,987	12.24	13.18	0.79
Inferred	120,569	739	2,864,647	12.99	14.59	0.51

\*Silver Equivalent is calculated using metal prices of US\$12.13/oz Ag, US\$728/oz Au, US\$0.804/lb Pb and US\$0.847/lb Zn and metal recoveries of 69.2% for silver, 80.4% for lead, 84.7% for zinc and 50% for gold.

\*\*The increase in the resource is mainly attributed to the inclusion of the “Zone 65” resource. The conversion of tonnes from the Inferred to the Indicated category is based on the drill-demonstrated continuity of the mineralization.

Source: Silvercorp

In light of the above, the company claims that “the Silvertip project ranks among one of the highest grade silver-lead-zinc carbonate replacement deposits in North America”. We can see why Silver Standard with its focus on very large projects did not pursue this opportunity, but it seems strange that such an advanced (and long explored) asset should have been passed around for so long with so little progress.

### **Fast-tracking Silvertip**

To our knowledge a mine plan is not extant but we would note the presence of a significant tunnel network at the mine that is a legacy of previous exploration efforts. Silvercorp intends to apply for a provincial Small Mine Permit for an operation with a capacity of under 75,000 tonnes per year. Once permitted, Silvercorp plans to start mining those high-grade pockets (those outlined in the resource using >1,000 g/t silver equivalent cut-off grades) that are already accessible from existing tunnels. The company intends to treat initial production as Direct Shipping Ore (DSO) and send this off to its Chinese facilities to be milled. This will cost around \$10mn to kickstart (including dewatering) against \$49mn for a full operation with a mill. The company feels the DSO will be worth around \$2,000 per tonne in content value though shipping will be quite a hit, with so much ore going so far to be milled. The cash flows to be generated from these early operations will then be used to finance further exploration programs, a full feasibility study, a full mining permitting process, and future expansion of mining operations.

The first step will be to obtain the necessary permits to de-water the existing underground workings, which is expected to take approximately six months. Once obtained, an underground exploration program, which will include a bulk sample, exploration drilling and a geotechnical assessment, will be carried out.

Preliminary metallurgical testwork was conducted by CSMA Minerals laboratory in the UK back in 1998. These showed that with a lead concentrate grade of 65%, silver and lead recoveries are 69.2% and 80.4%, respectively, and a 61% zinc concentrate grade has a zinc recovery of 84.7%. Silvercorp will perform additional mineralogy study and a metallurgical test program to further increase metal recoveries.

A surface drill program was carried out over the summer months of 2010 where previous drill holes had intercepted extensive mineralized zones that were not included in the 2010 resource estimation as the drill holes were too widely spaced. Furthermore, several geophysical and geochemical anomalies located within five kilometres of the existing resource areas along the same shale-limestone contact zone previously identified to host high-grade mineralization will also be drill tested. The total capital expenditure budget for calendar year 2010 at the Silvertip project was approximately \$4-5 million.

### **The Renmimbi Dilemma**

Silver bugs are still in mourning for the price tumble in May that dethroned their god. We think they should be very happy with the current \$40 silver price though we feel it should be closer to the low \$30s. Thus the only real rain that could fall on this parade would be a stronger pace to the revaluation of the yuan and inflationary tendencies. Conservative estimates are talking of a 4% move in the currency against the dollar in calendar year 2011. That would raise costs by an equivalent amount while revenues

would remain tied to the dollar denominated silver price (which we feel is in danger of downward correction). A larger move in the yuan though is not out of the question, particularly as a means of dampening incipient inflationary trends, and would certainly be justified in light of the severe cumulative undervaluation of the yuan in recent years. The inflation adds a further twist with costs of workers on the move upwards while energy costs, namely oil inputs, are experiencing a steady rise in recent times.

### **Earnings Outlook**

We shall not dwell too much on the earnings prospects in this note, except to say that they are good.

Our earnings projections are shown in the table two pages onwards. Key components in this are our perception of silver being between \$30 and \$40 with our preference being towards the lower end for conservative projection purposes. Zinc and Lead are metals that we see in the next few months remaining in the \$1-\$1.15 range, however farther out (18 months) we would not be surprised if these were to near \$1.50 per lb.



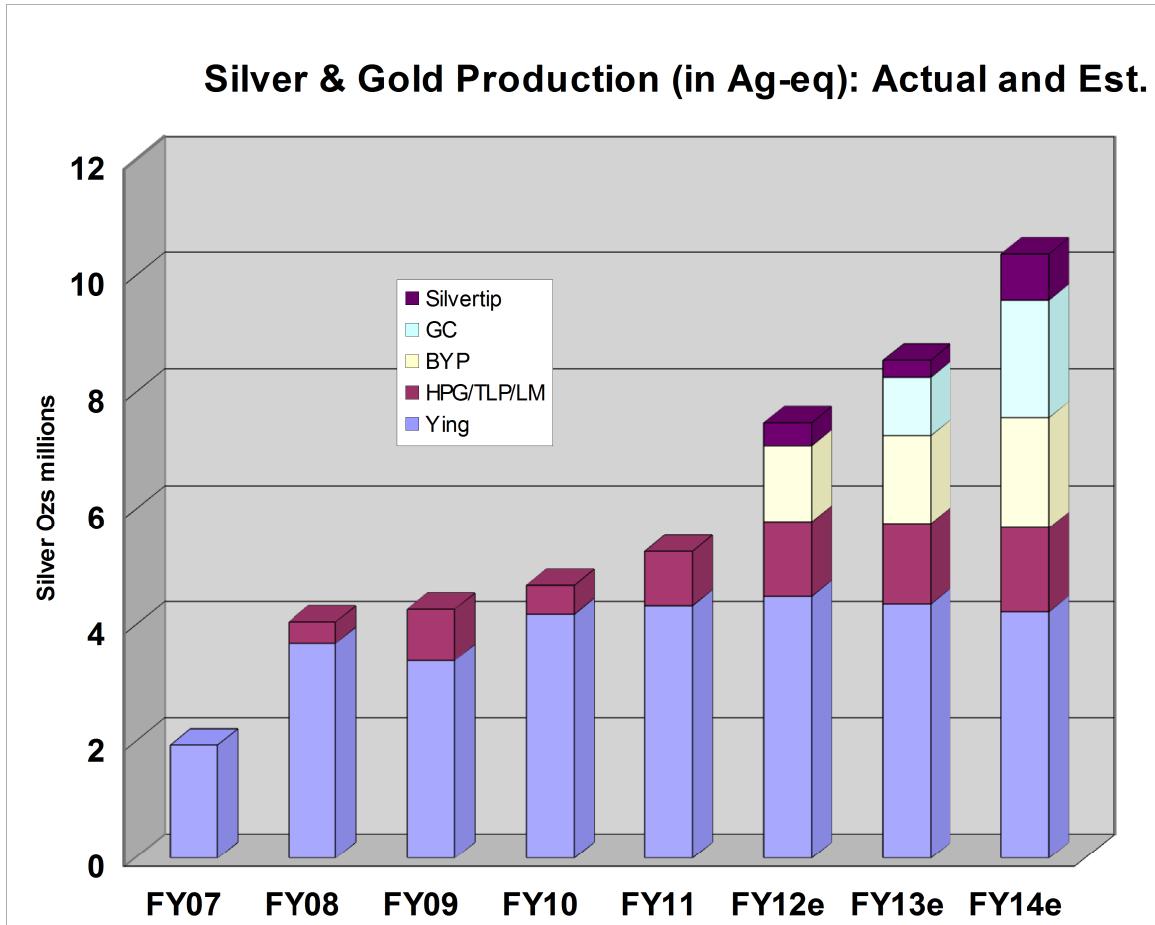
The chart on the following page shows the company's estimation of its production by volume and one can note that the advent of BYP significantly changes what would have been a couple of dull years coming up for Silvercorp as Ying (and associated mines) peaked and the company awaited GC and Silvertip for a bumper year in 2014. Now with the addition of BYP (and moving some Silvertip start-up volume earlier) the outlook is for FY12 to be another year of substantial additions to production and thus a smoother upward rise in total Ag equivalent production.

The plan to high-grade Silvertip with DSO despatch in the relative short-term should give the company some non-Chinese production in the FY12 also.

Other points of note:

- ▲ shares on issue will fall due to the stock buy-back

- ▲ we use an average silver price of \$37 for FY12
- ▲ we used \$30 for FY13 silver price
- ▲ Silvertip volume will probably fall off in the second year after the initial high-grading exercise
- ▲ we suspect the dividend rate will creep up
- ▲ we have not factored in a special dividend
- ▲ EPS of 82.1cts in FY12, trending down to 78.8 cts in the following year due to using a lower silver price even though volumes rise



Source: Silvercorp/Hallgarten



Silvercorp																		
In Millions of USD FY ending March	FY13e	FY12e	1Q12	FY11	4Q11	3Q11	2Q11	1Q11	FY10	4Q10	3Q10	2Q10	1Q10	FY09	4Q09	3Q09	FY08	FY07
Total Revenue	270.10	277.70	69.72	167.33	42.42	51.84	36.34	36.73	107.16	28.224	31.28	25.09	22.57	83.52	17.39	15.17	108.36	42.79
Cost of Revenue	38.00	42.00	11.47	35.46	8.58	9.98	8.24	8.66	24.00	7.839	7.05	6	5.9	35.69	6.38	9.93	23.32	9.61
Gross Profit	232.10	235.70	58.25	131.87	33.85	41.86	28.10	28.07	47.84	20.385	24.23	19.09	16.67	47.84	11.01	5.24	85.04	33.19
SG&A Expenses	19.00	18.00	6.08	16.00	4.18	4.01	3.27	4.55	11.71	2.835	3.02	2.58	3.37	11.36	2.26	2.69	9.67	5.84
Exploration	7.00	6.00	1.79	3.32	0.83	0.06	1.11	1.33	4.91	0.702	0.94	0.96	2.31	2.33	0.5	0.2	1.82	0.87
Depreciation/Amortization	9.50	9.00	2.59	6.49	1.30	1.98	1.68	1.53	3.90	1.108	0.41	0.17	0.2	0.82	0.02	0.35	0.52	0.13
Unusual Expense (Income)				-0.20	-0.03		0.38	-0.54	0.39	0.243	0	-0.08	0.78	50.71	2.91	47.43	0	0
Other Operating Expenses	1.00	1.00		0.60	0.05	0.04	0.46	0.04			0.03	0.03	0.03	0.12	0.04	0.03	0.06	0.07
Total Operating Expense	74.50	76.00	21.93	61.66	14.90	16.07	15.14	15.56	44.91	12.727	12.24	9.74	11.07	98.14	11.44	61.46	36	16.51
Operating Income	195.60	201.70	47.79	105.66	27.52	35.77	21.20	21.17	-14.62	15.497	19.04	15.35	11.5	-14.62	5.96	-46.29	72.36	26.28
Gain (Loss) on Assets held/sold	4.00	4.00	-0.08	6.65	-1.96	7.16	1.00	0.45	-1.96	-0.24	-0.24	-0.87	-0.26	-1.15	-0.31	-0.83	0.52	0
Net Interest (expense)	3.00	2.00	0.65	1.37	0.43	0.38	0.32	0.25	0.75	0.206								
Forex gain (loss)			-0.52	-2.76	-1.42	-1.34												
Other, Net	0.60	0.50	0.18	0.51	0.17	0.14	0.09	0.11	0.34	0.52	0.07	0.05	0.16	0.48	0	0.36	4.47	4.18
Income Before Tax	203.20	208.20	46.82	110.54	24.11	41.98	22.61	21.83	-15.40	15.359	18.99	14.54	11.56	-15.4	5.73	-46.53	79.69	32.05
Tax	33.87	34.70	12.57	21.06	7.10	5.10	5.61	3.25	8.56	2.135	2.68	2.35	1.39	-0.93	2.48	-6.44	0.56	1.53
Income After Tax	169.33	173.50	42.84	89.48	17.01	36.88	17.00	18.58	51.89	13.224	16.31	12.19	10.17	-14.47	3.25	-40.09	79.13	30.52
Minority Interest	-33.87	-34.70	-8.60	-20.63	-4.45	-7.15	-4.55	-4.48	-13.34	-3.464	-3.9	-3.3	-2.68	-1.53	-2.01	6.4	-19.2	-6.79
Net Income Before Extra. Items	135.47	138.80	34.24	68.85	12.56	29.74	12.45	14.10	38.55	9.76	12.41	8.89	7.49	-16	1.24	-33.7	59.94	23.72
Net profit	135.47	138.80	34.24	68.85	12.56	29.74	12.45	14.10	38.55	9.76	12.41	8.89	7.49	-16	1.24	-33.7	59.94	23.72
Diluted Weighted Average Shares	172	169	176.048	167.806	168	166.965	164.934	164.673	162.287	163.614	163.91	163.36	162.92	152.35	155	151.69	147.66	149.67
Diluted EPS	0.788	0.821	0.195	0.410	0.075	0.178	0.075	0.086	0.238	0.060	0.076	0.054	0.046	-0.105	0.008	-0.222	0.406	0.158
Dividends per Share	0.24	0.12	0.02	0.08	0.02	0.02	0.02	0.02	0.08	0.02	0.02	0.02	0.02	0.06	0.02	0.02	0.05	0



## Offense is the Best Defense

Germany's Von Schlieffen Plan before the First World War consisted of swinging through neutral Belgium and coming around the back of the French defences. At this point in SVM's evolution it is important that the company realises that it is in a total war situation, not just batting away gadflies, because the erosion of share price and reputation that can be dealt to a company by even the most unfounded allegations can be long and painful to reverse. Thus the share buyback seemed like a very valid response creating an uphill battle for the shorters. In the wake of the second attack and another leg down in the stock price we feel more extreme offensive action is required. To us the most effective death blow to the shorters would be:

- ↗ a very sizable cash dividend of around 40 cts per share with an almost immediate ex-date (this has the negative of tax implications for some holders but is a widely used practice in overcashed Australian companies that want to avoid predators). This might cost less than \$80mn.
- ↗ a possible less taxing alternative would be a demerger of Silvertip (also with a chunky cash component loaded into the spin-off). The ex-date could not be as near-term as a straight dividend but the mere threat of having to deal with a corporate action of this magnitude would send the Shorters scurrying to cover.

When the going gets tough, the tough get going.

## Conclusion

In this case the Deep Throat merely looks Deeply Ignorant. In trying to spin a quick buck from following in the footsteps of Muddy Waters, he has instead stepped into a submerged pothole and gone in over his head. The desperate attempt to follow in the Muddy paw prints was too fast and over-reaching with the result that the Shorter didn't get enough of his facts straight. The culprit may indeed have achieved his goal in the few days after the initial letter started circulating getting a steep down-dip from which he could quickly exit and go on to fight another day. He didn't quite figure though that his target was not made of the same dubious cloth as Sino Forest. Indeed he could not see the mines for the non-existent trees. Not all financial sleuths are born equal.

When we last wrote on Silvercorp in March we said that it was "seemingly doing everything right. In fact, too right, because its valuation is rather rich in our estimation. The ultimate dilemma for a miner in current times is that once the company has a P/E ratio amply cashed up and has relatively insignificant expenditure requirements on capex or exploration". This prompted us to call it a weak Buy. The price of silver briefly hit \$50 and had retreated.. it may retreat more. However, Silvercorp's fundamentals have strengthened, its cashpile is substantial and its stock is nearly half the levels of when we last wrote. Moreover, for those of us that are not silver-centric the company has substantial Lead and Zinc production and an important sideline in gold production.

Thus we are upgrading Silvercorp to a **Strong Buy** with 12 month target price of \$12.50.

## Important disclosures

I, Christopher Ecclestone, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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