Thursday, May 13, 2010

Hallgarten & Company

Initiating Coverage

Christopher Ecclestone
cecclestone@hallgartenco.com

Silvermex Resources (TSX: SMR)
Strategy: Long

Key Metrics		
Price (CAD)	$	0.42
12-Month Target Price (CAD)	$	0.92
Upside to Target		119%
12mth hi-low (CAD)	$0.14-$0.61	
Market Cap (CAD mn)	$	33.3
Shares Outstanding (millions)		79.2
Fully diluted (millions)		103.3

	FY09*	FY10e	FY11e	FY12e
Consensus EPS		n/a	n/a	n/a
Hallgarten EPS		($0.05)	($0.05)	($0.01)
Actual EPS	($0.10)			
P/E	n.a	n.a	n.a	0.0
Dividend	0.00	0.00	0.00	0.00
Yield %	0%	0%	0%	0%

*ending April

Silvermex Resources

Corralling a Whole District

+ Silvermex has accumulated most of a mining district in Mexico. It is moving forward towards production (some of the mines are past producers)
+ Construction should begin in the second half of 2010 with an eight to ten month build period giving production in mid-2011.
+ Immediate financing needs were satisfied by a placement in February and the company is now working on the financing of the mine build. The company's "Big Brother" Silver Standard (also a 6% shareholder) is making introductions and helping expedite the process.
+ A new management infusion has brought on board some veteran heavyweights from Hecla Mining.
+ The company also has two other mining projects in other parts of Mexico that can be turned on once cashflow from the Rosario complex of mines can be deployed to the cause

✘ The financing environment in general remains tough for raising more substantial amounts of money

✘ The company has payment commitments for purchases of properties to Silver Standard and Aurcana. Some of these must be met concurrently with the financing of the mine build

✘ We remain of the opinion that silver deserves to be closer to $15 than $18 and thus if this situation comes to pass then silver stocks will experience negative sentiment. However, Silvermex is very viable at $15 silver (and $1 per lb lead & zinc) and does not require higher prices.

Escaping the cycle of eternally cycling

Silvermex Resources has been around for a while and we must confess was rather indistinct form the vast heaving mass of silver wannabes in the Mexican space. We even heard a rather frightening statistic back in 2008 that there were 300 TSX listed miners moving and shaking in Mexico. "Surviving" maybe, "moving and shaking" not so sure. Many of these one now needs to hold a mirror up to, to see if there are signs of breathing. Silvermex seems to have pulled away from the pack in recent months and got real. Long-term holders have been rewarded accordingly with a hefty run-up in the price. However in light of its prospects we regard the move thus far as only the beginning of a move up into the ranks of producers and thus "survivors" in the Mexican mining space.

Silvermex is a silver exploration and development company focused on the La Rastra section of the Rosario mining district in the state of Sinaloa. Silvermex is developing silver resources at multiple projects in this zone.

It main focus in 2010 is to move forward flagship projects towards production. These are the past-producing San Marcial, San Juan and Las Plumosas silver mines that have significant high-grade, near-surface silver resources and extensive infrastructure in place to accelerate the advancement to production.

Compare and contrast

Over time we have come to look at a number of Mexican base and precious metals miners giving one the ability to make comparisons. In the case of Silvermex the most obvious comparison that strikes us is with Dia Bras (DIB.v), company that is likewise forging ahead in the silver/polymetallic space. While Dia Bras has been producing for years, Silvermex is over a year away from being able to start shipping ore however like Dia Bras it has multiple mines across a district and a good milling infrastructure.

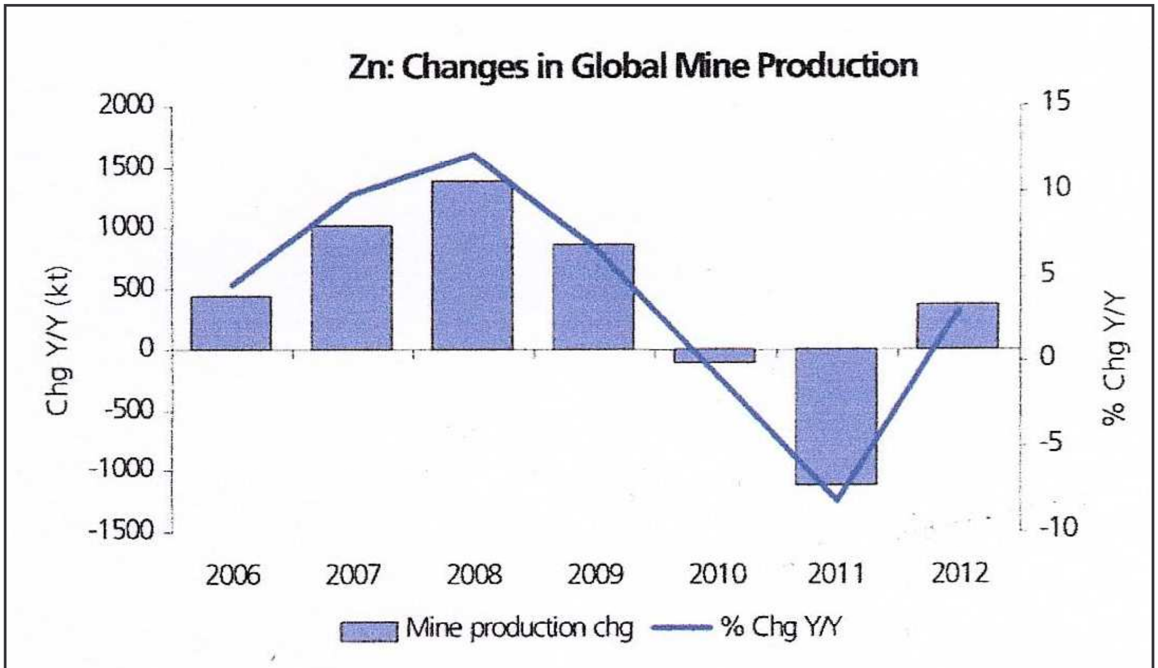
The market's treatment of the two stories though could not be more different as the price comparison chart below over a six-month period displays. While Dia Bras has stagnated Silvermex has forged ahead.

Having looked at the operations and finances of both companies we cannot help but be struck by the logic that emanates form a potential combination of the two operations.

Zinc – potential unappreciated

Zinc is important to Silvermex as it will feature in the output of the Rosario mine(s) and at La Frazada should it make it into production. At the risk of sounding like a cracked record we reiterate our enthusiasm for zinc, a highly relevant issue for Silvermex and many silver producers. The zinc equation is rather simple. At a price per pound of under 70 cts most producers of zinc are losing money. Some were sustained, when went zinc first turned turtle, by their by-product credits from silver or lead but then those too slipped beneath the waves and some of the classic Ag-Pb-Zn mines were losing money on all three product lines. Some others, most particularly the Australians, got some brief relief by the

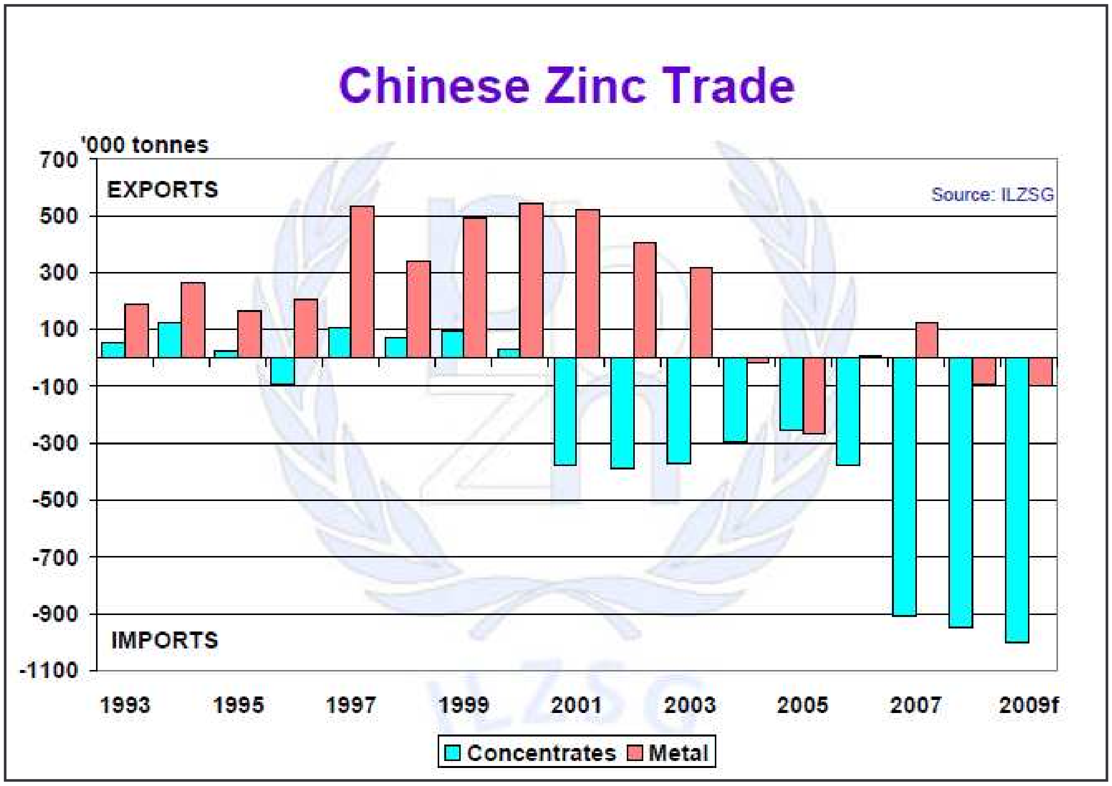
Australian dollar plunging in late 2008 from 92cts to the USD to a nearly 60 cts in the space of a month. However, not to be outdone, the zinc price lost 40% in the same time, largely negating the currency move. The net result was a swathe of mine closures and mothballing across the globe. Some have reopened, some have gone for good.



Source: Brook Hunt, UBS estimates

For a long time China was not only a source of large-scale exports but also a price spoiler due to its own low internal costs combined with an innate disinterest in "commercial" considerations (as we have noted elsewhere in the Rare Earths space). The chart that follows shows that Chinese metal exports evaporated early last decade and then it became a massive net importer.

We are permanent bulls on the zinc space for the long term and found it hard to stomach in 2009 that those with a negative opinion on zinc were citing the Chinese demand issue as the reason to not like zinc. With China's growth for 2009 having been in the order of 8-10% in most opinions and a similar forecast for 2010 it was exceedingly hard to see how this massive net importer was likely to return to its old exporter status.



We would also note that China was firstly (from 2001 on) an importer of concentrates and an almost equal exporter of metals. As energy costs rose in China, the trade became almost one way and particularly so in more recent years as the more marginal and dangerous coal mines were shut down and competition for scarce energy resources between sectors in China became more ferocious. Thus it became an exporter of processed metal rather than mere concentrates. There are no reports to indicate that China is anywhere near resolving its energy dilemma so there could even be the paradox of them importing more finished metal rather than less.

In any case such a trend is not a requirement for sustained zinc concentrate demand with China as the end user. Merely the ongoing growth in China will continue to increase its share of global zinc consumption and its zinc output is clearly inadequate for its own needs. These issues were compounded by chronic low grades in zinc mining in China and inefficiencies that resulted in a general perception amongst informed zinc-watchers that while the major Western producers had a breakeven price of around US 80 cents per lb, the Chinese had a breakeven that was often speculated to be around US$1.20. This is reason enough for the Chinese to have been massive zinc stockpile buyers during 2009, lifting the price from a low around 46 cents to nearly their breakeven price. Is it no surprise that the zinc price should have been walloped once it finally got over $1.20 per lb in a brief flurry early in 2010?

The zinc price like so many other key metals is now subject to “market-making” by the Chinese. This is not necessarily a bad thing as speculators (largely hedge funds) serially distorted via “pump and dumps” the nickel, zinc and uranium markets in the run-up to the slump of 2008. It seems the Chinese are more interested in orderly markets where Western producers get a fair though not outrageous return on their production than Western end-users that beggared a whole swathe of the base metals industry (leading to the annihilation of virtually all the US and Canadian majors) between 1973 and 2003. "Better the tender mercies of the Chinese than the gouging of Western industrialists" should be the mantra of the surviving and up-and-coming base metals miners as they head into a new decade.

The broader commodity outlook

Our view on trading ranges for the commodities of relevance to Silvermex in 2010 are:

- Gold - $950-$1,200
- Silver $14.50-$18
- Zinc $0.95 -$1.20
- Lead - $0.95 - $1.15
- Oil - $68-$98

Gold has virtually no relevance to the Silvermex story but oil has some importance. Of the other commodities we see silver peaking at $18 before a strong retreat. Zinc and lead are the commodities we feel most inclined to see rise and stay up towards the top of these trading ranges.

Sinaloa - Consolidating a district

A method to Silvermex's recent actions is starting to take form. It started off with the San Marcial property and then the recent buy added the San Juan/Plumosas mine at the other extremity of the "district" and with this came a collection of old mines in between which would appear to be on the same trend. The La Rastra district is situated along the western edge of the Sierra Madre Occidental geological province. This linear belt of volcanic rocks, approximately 1,500 km long by 250 km wide, is known to host many important gold and silver producing mines and prospects. The province is divided into two main Tertiary volcanic units referred to as the Upper and Lower Volcanic groups, both of which are separated unconformably by a period of erosion and associated with local felsic intrusive activity. The contact between the two volcanic groups is highly prospective for precious metal mineralization, as a majority of the other known gold and silver mines and prospects in the belt occur close to, if not just below, the contact interval.

This district is known historically as a significant area for silver, gold, lead and zinc production as early as the 1600's. During the 1780's and well into the early 1900's there are local references which indicate that the La Rastra to San Marcial corridor was an active silver-gold camp with over 20 known prospects and mines within a 15 km radius. Specifically these would include prospects such as Plomosas, El Saltito, Papayal and San Marcial.

Lightening Silver Standard's Load

As is well-known Silver Standard (NASDAQ:SSRI) has become a major in the silver space with its Pirquita's property in Argentina. This focus on world-scale properties has resulted in it spinning out smaller prospects and mines to companies that will devote themselves full-time to moving these deposits into production. The Shafter mine in Texas that was hived off to Aurcana being an example.

In March 2009, Silvermex also joined the queue and picked up, from SSRI, the San Marcial property that is now the building block for its district wide efforts. Under the terms of the agreement Silvermex can acquire a 100% interest in San Marcial by issuing three million common shares in three stages by February 1, 2011 at a deemed share value of $0.75 per share for the first one million shares and based on the market price of the shares of Silvermex at the time of each subsequent issuance. Silvermex must also pay US$15 million (less the deemed value of the 3 million common shares issued) in either cash or shares at the election of Silver Standard, by February 1, 2011. The US$15 million purchase price was based on Silver Standard's resource estimate of 14.26 million ounces of inferred silver resources on the property, prior to additional drilling by Silvermex. Silvermex must also expend US$1 million on exploration by February 1, 2011.

San Marcial – the anchor

The San Marcial property is located a few tens of kilometres from the Pacific Ocean in the Sierra Madre mountains in the state of Sinaloa. The property is approximately 100 kms south east of Mazatlan in the La Rastra mining district. The term San Marcial project refers to the area covered by the historical exploration programs and Silvermex's 2008 exploration program.

The current mineral resource at San Marcial was detailed in the NI43-101 Technical Report dated November 23, 2007 (and updated on November 5, 2008) was prepared by Micon International Ltd. This reports an indicated mineral resource of 18.0 million ozs silver, 55.3 million lbs of zinc (Zn) and 29.9 million lbs of lead (Pb) and an inferred mineral resource of 4.4 million ozs silver, 34.7 million pounds of zinc (Zn) and 19.5 million lbs of lead (Pb).

The block model resource estimate (shown below) is based on a cut-off grade of 30 grams of silver per tonne for open pit resources and a cut-off grade of 80 grams of silver per tonne for underground resources.

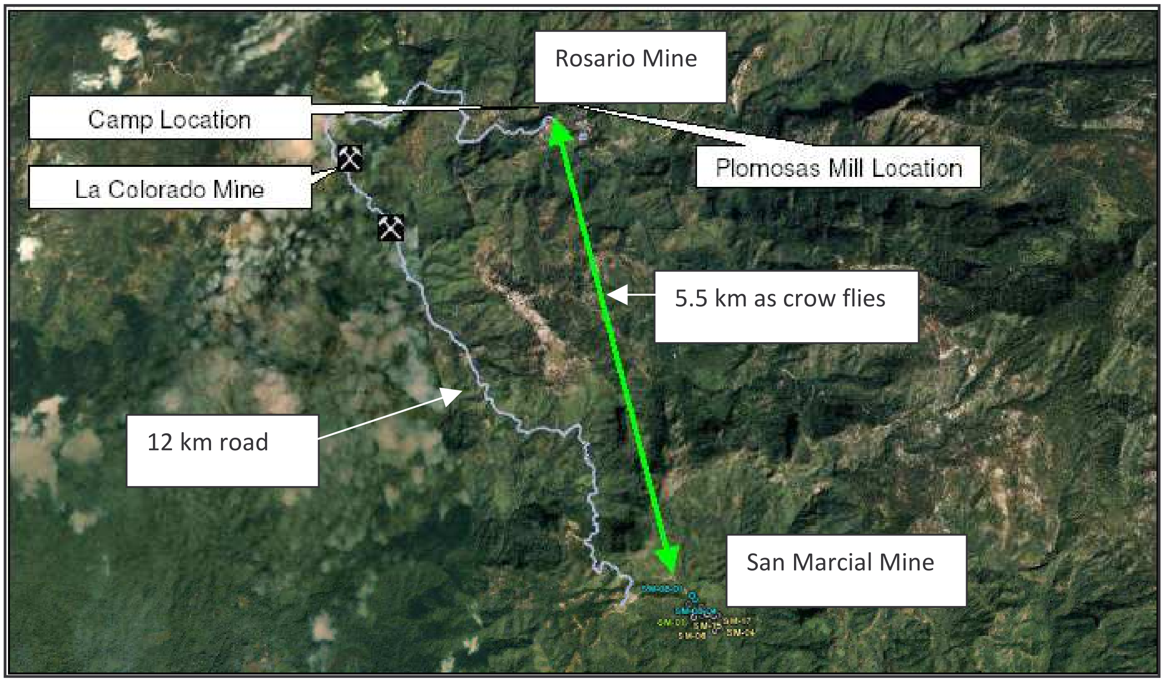
		Grade			Contained Metal		
Category	Tonnes	Ag (g/t)	Pb (%)	Zn (%)	Ag (oz)	Pb (lb)	Zn (lb)
Indicated	3,755,893	149.2	0.36	0.67	18,021,221	29,931,874	55,328,145
Inferred	3,075,403	44.21	0.29	0.51	4,371,018	19,525,788	34,690,817

Preliminary resource modeling has determined that the resource at San Marcial hosts a near-surface, potentially bulk-mineable, high-grade resource of 1.13 million tonnes grading 321 g/t containing 11.6 million ounces of silver. The existing resource is open at depth and along strike and has been traced on surface for 1.6 kms.

Aurcana's loss is….

In early December 2009 Silvermex completed the acquisition of all of the shares of Aurcana de Mexico S.A. de C.V. from Aurcana Corporation (AUN.v), thus gaining control of the past-producing San Juan /Las Plomosas Silver/Gold/Lead/Zinc mine complex and a 8,515-hectare property position strategically located within five kilometers (as the crow flies) of the company's aforementioned San Marcial silver project. Rather confusingly this new purchase is termed the Rosario complex when there is a more famous mine (now closed) called Rosario gave the whole district its name. The package purchased from Aurcana is comprised of two past producing mines, the Plomosas-La Cruz mine and the San Juan Mine. The mines were operated by Grupo Mexico until 2001. Historic production on the Rosario Project by Grupo Mexico, the prior operator, averaged 600 t/d from 1986 to 2000. During this production period a total of 2.5 million tonnes of ore were extracted which averaged 190.5 g/t of silver, 0.92 g/t of gold, 2.02% of zinc and 2.38% of lead. Operations were ceased in 2001 due to low metal prices and a regional labor dispute.

This is essentially the consolidation of a sub-district to obtain economies of scale.



The San Juan/Las Plomosas deal

This transaction was first announced in May 2009. Many months of haggling resulted in a final agreement in mid-October 2009. Under the terms of the rather complex agreement Silvermex committed to:

- pay, on or before the 15th of November 15 2009, CAD$250,000
- reimburse Aurcana for all maintenance expenses incurred from August 1, 2009 to November 15, 2009 less any amounts due from the sale of certain equipment to Aurcana.
- issue 1,000,000 common shares to Aurcana upon closing.
- upon commencement of commercial production or within 24 months from the Effective Date (October 9th 2009), Silvermex will issue an additional 1,000,000 common shares
- upon the earlier of six months from the commencement of commercial production or 30 months from the Effective Date Silvermex will pay to Aurcana an aggregate of US$2.5million in five instalments of US$500,000 over a 36 month period. Aurcana at its election may take common shares in lieu of cash payments effective as of instalment three.

- ❖ assume the payment obligations to Grupo Mexico due on August 7, 2009 (US$366,893 paid by Silvermex) and US$731,500 plus IVA due on February 7, 2010.

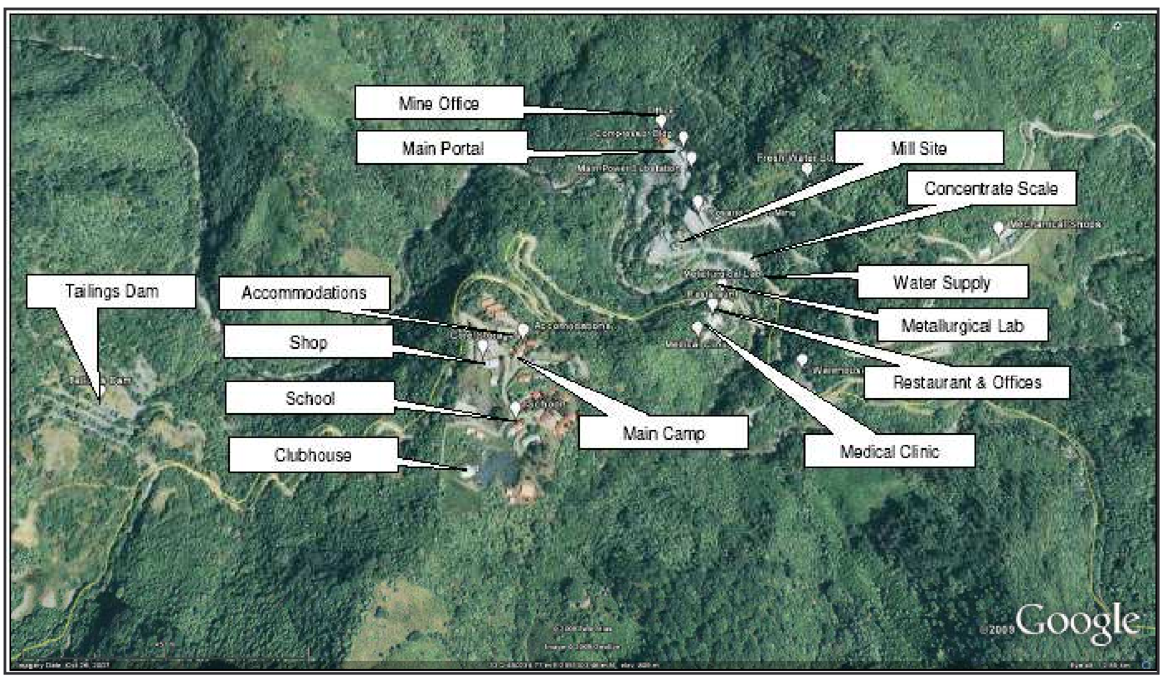
It should be noted that, presumably to lower the flow of stock back to the market, the 2,000,000 common shares issued to Aurcana are subject to a voluntary escrow and will be released at a rate of 25% every three months, commencing three months from the date of issuance.

The Nature of the Latest Asset Purchase

The assets acquired include all facilities and infrastructure at the Rosario complex including:

- ❖ 20-year surface rights agreement in good standing
- ❖ 30-year water use permit
- ❖ underground workings
- ❖ tailings dam
- ❖ a 60 km - 33 KV power line
- ❖ offices, shops, infirmary, warehouses and assay lab
- ❖ a 120-man camp

The aerial view below shows the Rosario camp and its infrastructure.



Aurcana invested approximately $11 million in property payments, exploration, upgrades and renovations to the mine and mill site including upgrading of electrical substations and wiring, camp and accommodations, mine dewatering and detailed engineering of an 800 tpd mill designed to be installed on the existing foundations and structures.

The Rosario Mill

The Rosario mill is shown in the photo below when it was last operating in 2001. Conveyors and other internal equipment was stripped out and sold after the mine closure. However, the structure itself has been under care and maintenance since that time, with Aurcana having refurbished it in recent times.

Plomosas-La Cruz Mine

The Plomosas Mine had been partially refurbished by Aurcana in preparation for an 800 tpd operation. It currently has 323,278 tonnes of historic reserves with grades of 92 g/t of silver, 3.7% of zinc, 2.5% of lead and 1 g/t of gold and 286,613 tonnes of historic inferred resources with grades of 161.3 g/t of silver, 3.21% zinc, 2.23% lead and 1.2 gt of gold.

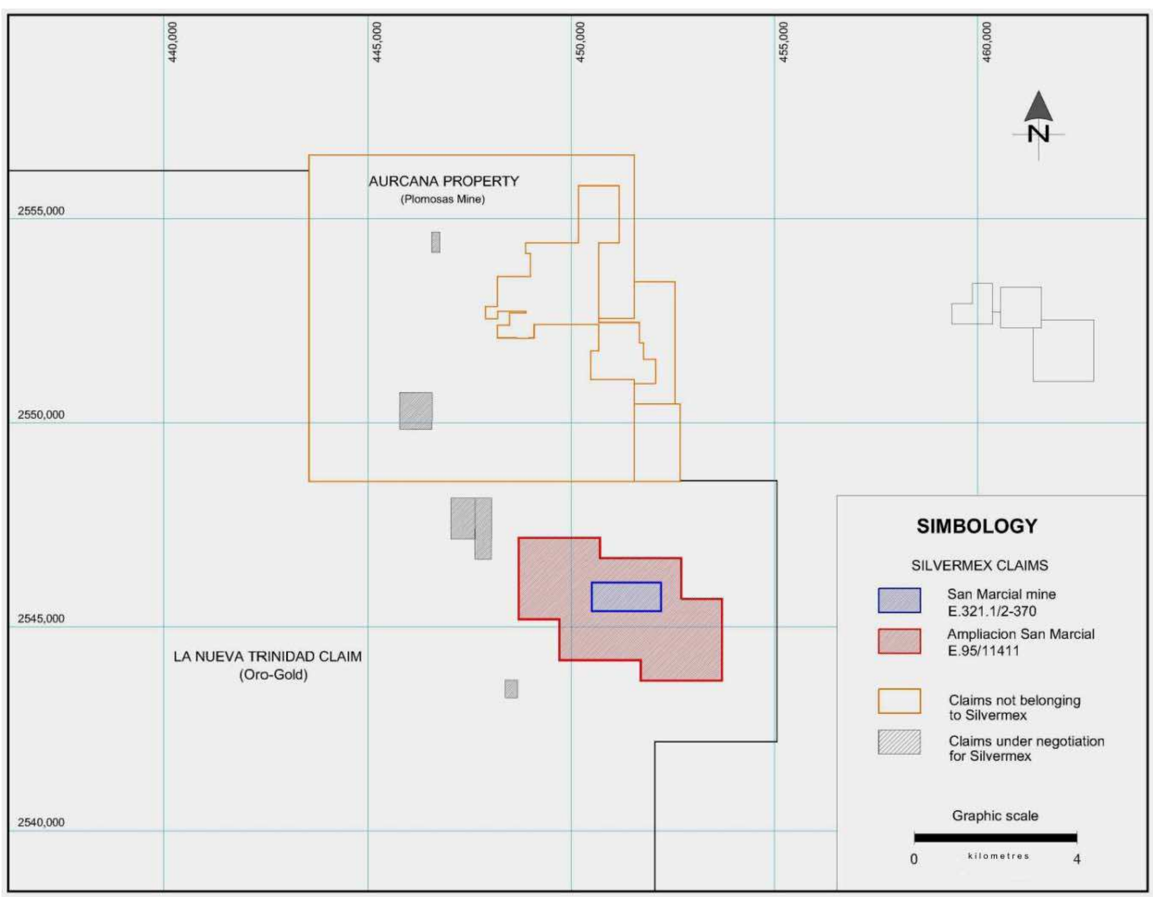
The historic reserves are located in a number of mineral zones that include the Veta Plomosas, Plomositas, Lead-Zinc Stock Work, and Silver Stock Work. Silvermex will focus on the potential that remains within these zones and intends to expand the resource from areas remaining between old mine levels along strike and below the lowest level exploited. The stock work zones have potential for tonnage expansion along the strike and dip of the Plomosas fault structure.

San Juan Mine

The San Juan Mine at Rosario is four kms from the Rosario mill site and is strategically located along trend between the San Marcial Mine and the Plomosas Mine.

San Juan is a high priority target with 230,511 tonnes of historic inferred resources with average grades of 327.8 grams per tonne silver, 3.90% zinc, 1.70% lead and 0.2 grams per tonne gold. Developed workings consist of several hundred metres of drifts and cross cuts on two levels. Two adits provide access to the San Juan prospect. A decline has been driven into the San Juan Vein and has tested the vein structure over a vertical distance of 40 metres. Historic drill intersections suggest that the zone remains open at depth.

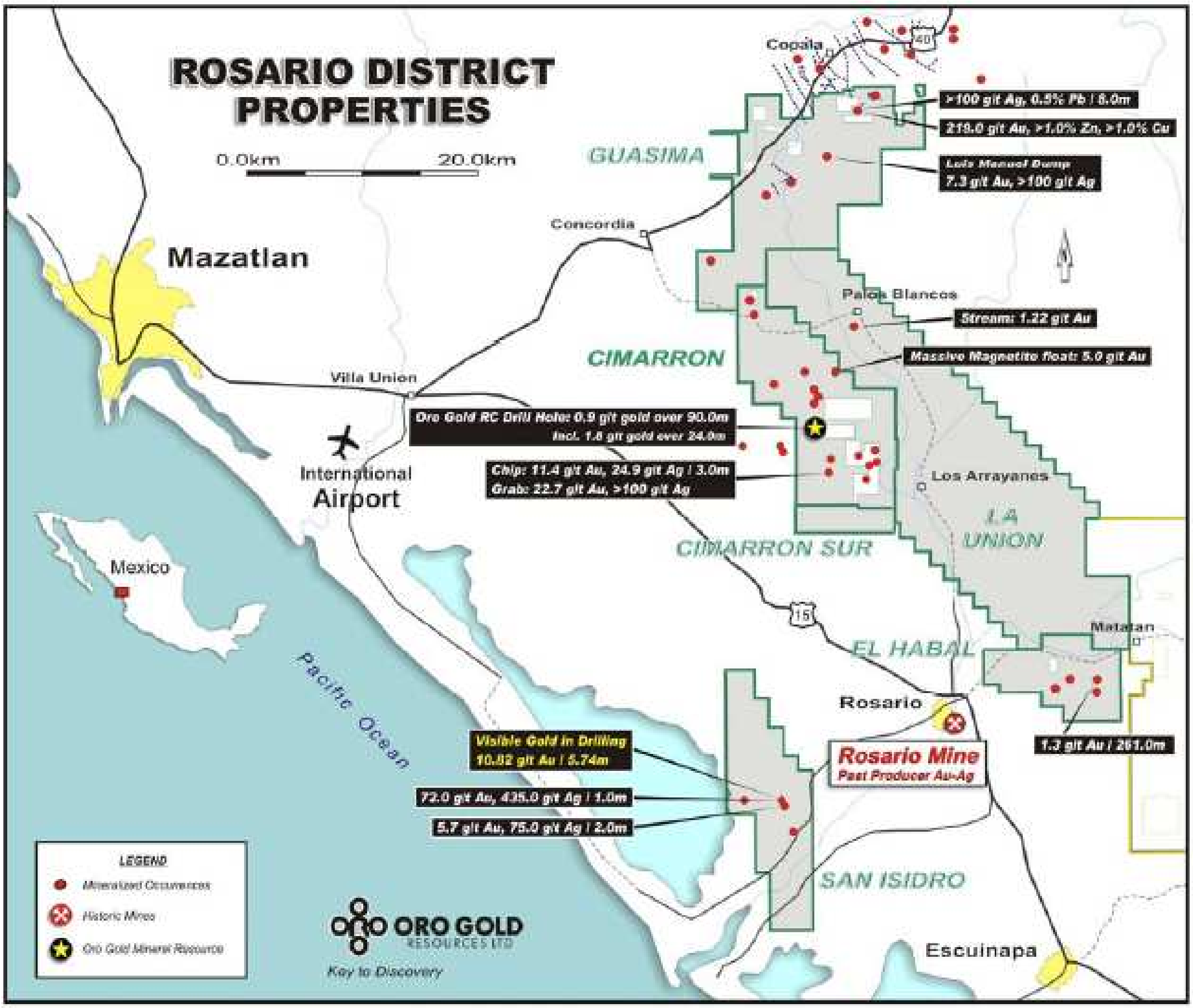
In the case of both of the mines purchased from Aurcana the historic reserves and resources do not conform to NI 43-101 requirements for reporting purposes and, as such, Silvermex does not treat these historic estimates as current reserves or resources.



Source: Silvermex

Near neighbours…

The Silvermex properties are part of a larger district called Rosario that encompasses a town of the same name and a significant former producing mine that used to be owned by Peñoles that is now abandoned and flooded. The immediate (and surrounding) neighbour of Silvermex is a Canadian company called Oro Gold (OGR.v). The map below shows the broader district with Oro's substantial land holdings. The map on the preceding page shows Silvermex's tenements with the Aurcana properties (now Silvermex's) to the north and Oro Gold's surrounding San Marcial and bordering the Ex-Aurcana blocks. Oro's titles actually separate Silvermex's two main holdings.

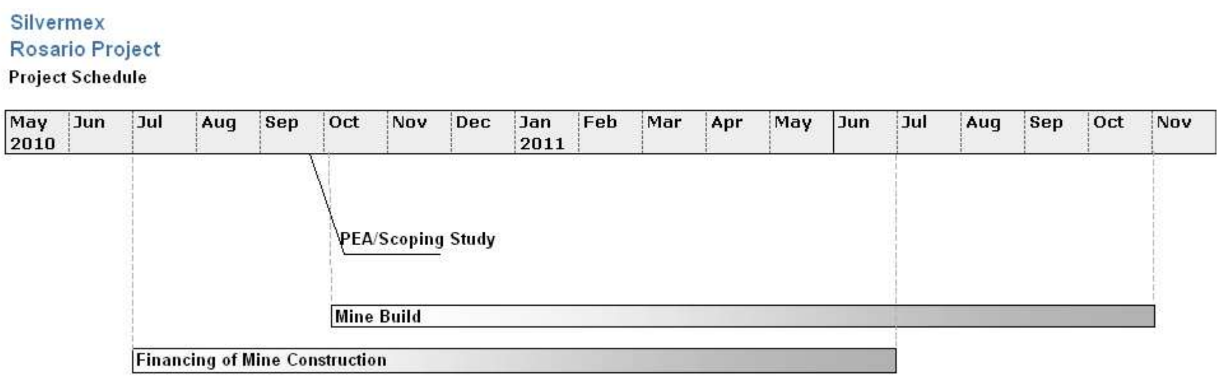


In recent years the Nueva Trinidad properties had been farmed out to another junior by Oro Gold. That company spent around $1.5mn on exploration towards its earn-in commitment before succumbing to the global financial crisis, At this point the property reverted to Oro Gold. With Oro firmly focused on its Taunus property the assets surrounding Silvermex only really make sense in Silvermex's possession for with its central mill it can exploit what would be otherwise sub-economic deposits within its hinterland.

Investors should not be surprised to see some sort of transaction to consolidate these territories under Silvermex's control.

Time line

The company's presentations are somewhat deficient in not spelling out the time frame to production. After some discussions with the management we concocted our own visualization of the tcurrent thinking on when Rosario should be in production. AS can be noted, the PEA and Scoping study are moving forward concurrently and should be released in August/September of 2010, with construction planned to start almost immediately with an 8-12 month build period.



Financing

As it ramps up to production Silvermex will clearly have substantial financing needs. Beyond that there are the residual payment commitments to Silver Standard and Aurcana for the asset purchases. In the short term the company held a financing earlier this year that resulted in the announcement on the 8th of February that it had fully subscribed a total of 15,350,655 units pursuant to the private placement announced on February 2, 2010 for gross proceeds of $6,907,750. This issue was undertaken by Global Hunter Securities (amongst others) with whom Hallgarten has a relationship on research distribution.

The fully subscribed units included an over allotment of 1,350,655 units above the previously announced 14,000,000 unit private placement. At the current time the company have around $6.5mn in cash on hand and feels that this will be down to around $4.2mn by the time the scoping study/PEA is out in August or September.

Then comes the real challenge of funding the mine build. The company has a large amount of infrastructure in place already, both above ground and in the mine workings. It estimates that in situ equipment and structures shave around $45mn off the cost that this project would face if it was *de novo*. This leaves around $20mn (at current estimates in the absence of the final scoping study) to be funded for the Capex.

The symbiotic relationship with Silver Standard is already coming into play here with the Big Brother steering Silvermex in the direction of some financing sources, both financial institutions and equipment finance sources. Thus the expected mix is going to be debt, trade finance, an equity portion and varied offtake options. The latter could be plain vanilla offtake or be mixed in with debt as a silver loan or a Silver Wheaton-like deal. The company is rightly wary of the traditional Silver Wheaton arrangement where the price offered for the forward sale is usually onerously low. It is no surprise then that transactions between miners and SLW seem to be few and farther between these days.

Other Projects

Before the Rosario complex was even a twinkle in Silvermex's eye, its main projects were the Penasco Quemado and La Frazada properties in the states of Sonora and Nayairt respectively. While not as large as the Rosario complex in terms of silver ounces they do have compensatory features that might signal that they will be rapidly dusted off once Rosario is in production. The silver-only and low-grade nature of Penasco is compensated for by its shallowness and thus suitability for open-pit mining. La Frazada looks most attractive as a second-mover for Silvermex as it has extensive underground working (while still being relatively shallow) and has very substantial base metals components and a strong silver grade. Recoveries at 90% are also very attractive.

Mine	Penasco Quemado	La Frazada
Location and Size:	Sonora, Mexico 20,000 has	Nayarit, Mexico – 360 Ha
Mineral Resource – Silver (Ag):	11.43 million Ozs Silver	8.58 million Ozs Silver (254.7 g/t)
Mineral Resource – Lead (Pb):		21.9 million lbs Lead (0.87%)
Mineral Resource – Zinc (Zn):		62.44 million lbs Zinc (2.52%)
Silver Grade - Tonnage:	96.7 g/t Ag – 3,671,877 tonnes	M&I: 250.50 g/t – 582,700 tonnes Inferred: 224.88 g/t – 533,700 tonnes
Deposit Model:	Open-Pit	Underground Mining
Underground workings:	n/a	Extensive underground workings on 6 levels
Proximity to surface:	On-Surface	Near -Surface
Drill Depth:	100 meters	200 meters
Strike Length:	3 kms	3 kms
Depth Potential		Open
Metallurgical Testing:	Positive (78% - Recovery - 48hr Leach Test)	90% + Recoveries
Production:	Past - 1972	Past - 1997
Ownership:	100% owned	100% Owned

While not assets that are imminently going to contribute to the companies cashflow we might note that Silvermex might be valued at its current market capitalization solely on the prospects of these two assets (as indeed it was pre-2008). In that context the Rosario complex is almost a "freebie".

Management

Silvermex was long a sort of informal sister company to Timmins Gold. Despite its name, the latter was dedicated to exploration and production in Mexico and recently kick-started its San Francisco mine there. Clearly the burden of juggling two pre-production stories was too heavy for the Timmins directors and thus a separation of sorts took place with those well-known Toronto figures Bruce Bragagnolo and Arturo Bonillas decided to focus on Timmins. This development coincided with some veteran Hecla management becoming available and thus the profile of Silvermex was changed to one with veteran large-scale mining players coming on board. We have not covered Hecla Mining Company (HL) since the middle of the last decade so cannot comment on how that stock has progressed except to say that it certainly has a higher profile now than it did in those days.

The roles of Chairrman (and director) at Silvermex are now held by Art Brown. He retired in 2006 as Chairman of Hecla. During his 39-year tenure at Hecla, he held several senior operating positions becoming President in 1986 and was named Chairman and Chief Executive Officer in 1987. He graduated from Witwatersrand Technical College, South Africa, as a mining engineer in 1961. Following his graduation, he worked at Cementation Co. in Canada until 1967, when he began his career with Hecla as an industrial engineer. He is a former Director of the National Mining Association and served as a Director of The Gold Institute and The Silver Institute (Past President).

The CEO (and a director) is Duane Nelson who has been with Silvermex since 2006. He has over 25 years of private and public sector experience with a focus on early-stage projects.

Michael H. Callahan serves as a Director and President. Formerly he served as Vice President of Hecla and President of its Venezuelan operations (2000-2003). He originally joined Hecla in 1989 and held a variety of positions including Director, Accounting & Information Services and Senior Financial Analyst before being named Vice President. He has also served as Vice President Corporate Development from 2002 to 2006.

Joseph J. Ovsenek is one of the Directors representing the interests of Silver Standard where he is currently the Senior Vice President. He holds a Bachelor of Law degree from the University of Toronto. He is a registered professional engineer, and holds a Bachelor of Applied Science degree from the University of British Columbia.

The other Silver Standrad presence is Kenneth C. McNaughton who likewise serves as a Silvermex Director. He has been the Vice President, Exploration for Silver Standard since 1991. He holds a Bachelor of Applied Science degree and a Master of Applied Science degree in geological engineering from the University of Windsor

The CFO is Hallein Darby who is a chartered accountant with over 20 years experience in public accounting, resource and regulatory enviroments. She was a Vice President and a director of client services at Pacific Opportunity Capital Ltd. and a Senior Securities Analyst with the B.C. Securities Commission.

Earnings

There is less of a dilemma in making an earnings model for Silvermex in finding the appropriate inputs than in identifying when the revenue streams are likely to kick in. The company is somewhat novel also in having an April fiscal year. Thus if production is going to kick in from the last quarter (calendar year) of 2011 then that would represent a point somewhere in the second quarter of Silvermex's FY12, which makes it sound significantly more distant than it really is.

Our model for the earnings going forward for Silvermex are shown in the table on the following page:

Silvermex

FY ending April 30th In Millions of USD (except for per share items)	FY14E	FY13E	4Q13	3Q13	2Q13	1Q13	FY12E	4Q12	3Q12	2Q12	1Q12	FY11E	FY10E	FY09
Total Revenue	**39.19**	**34.75**	**9.80**	**9.80**	**9.80**	**5.36**	**7.10**	**3.56**	**2.65**	**0.88**	**0.00**	**0.00**	**0.00**	**0.01**
Production Cost	20.04	17.15	5.01	5.01	5.01	2.11	3.12	1.51	1.21	0.40	0.00	0.00	0.00	0.00
NSR payable	0.78	0.69	0.20	0.20	0.20	0.11	0.14	0.07	0.05	0.02	0.00	0.00	0.00	0.00
Gross Profit	**18.36**	**16.91**	**4.59**	**4.59**	**4.59**	**3.14**	**3.84**	**1.98**	**1.39**	**0.46**	**0.00**	**0.00**	**0.00**	**0.01**
Selling/General/Admin. Expenses	2.30	2.10	0.60	0.50	0.50	0.50	1.75	0.50	0.45	0.45	0.35	1.90	1.80	1.77
Research & Development	2.60	2.40	0.60	0.60	0.60	0.60	1.37	0.60	0.59	0.15	0.04	4.20	4.20	
Depreciation/Amortization	3.27	2.90	0.82	0.82	0.82	0.45	0.59	0.30	0.22	0.07	0.00	0.00	0.00	0.00
Operating Income	**10.19**	**9.52**	**2.57**	**2.67**	**2.67**	**1.60**	**0.13**	**0.58**	**0.14**	**-0.21**	**-0.39**	**-6.10**	**-6.00**	**-1.76**
Net Interest (expense)	-1.30	-1.40	-0.35	-0.35	-0.35	-0.35	-1.48	-0.35	-0.38	-0.38	-0.38	-0.80	0.03	0.01
Asset mgt	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.53
Income Before Tax	**8.89**	**8.12**	**2.22**	**2.32**	**2.32**	**1.25**	**-1.35**	**0.23**	**-0.24**	**-0.58**	**-0.76**	**-6.90**	**-5.97**	**-0.21**
Tax	-2.67	-2.43	-0.67	-0.70	-0.70	-0.37	0.40	-0.07	0.07	0.17	0.23	2.07	1.79	0.06
Net Income	**6.23**	**5.68**	**1.56**	**1.63**	**1.63**	**0.87**	**-0.94**	**0.16**	**-0.17**	**-0.41**	**-0.53**	**-4.83**	**-4.18**	**-3.29**
Diluted Weighted Average Shares	89.198	89.198	89.198	89.198	89.198	89.198	89.198	89.198	89.198	89.198	89.198	89.198	79.198	34.43
Diluted EPS	0.07	0.06	0.02	0.02	0.02	0.01	-0.01	0.00	0.00	0.00	-0.01	-0.05	-0.05	-0.10
Production														
Silver (ozs)	1,897,913	1,828,370	474,478	474,478	474,478	191,272	99,937	113,726	74,953	24,984	-	-	-	-
Gold (ozs)	1,489	2,132	372	372	372	351	365	299	273	91	-	-	-	-
Lead (lbs)	3,357,209	4,557,340	839,302	839,302	839,302	774,749	670,956	593,728	503,217	167,739	-	-	-	-
Zinc (lbs)	5,689,085	7,496,358	1,422,271	1,422,271	1,422,271	1,332,614	968,484	928,447	726,363	242,121	-	-	-	-

The assumptions which underpin these projections are:

- Production will commence with Plumosas, adding San Juan two quarters later and then San Marcial one quarter after that
- Daily throughput will be 805 tpd at the mill when all three mines are at full initial operating capacity
- The company believes it could operate at 1,500 tpd milling with an upgrade of the mill. However we have not factored this into the FY14 estimates when this would presumably take place.
- We are assuming $15 per oz silver, and $1 per lb for lead and zinc with $1,100 per oz gold
- The assumed production by volume per quarter is shown at the bottom of the table
- We assume a financing at CAD 80 cts that would involve the issuance of 10 million new shares with the funds applied to the mine build and meeting payments commitments. This might be in late 2010 or early 2011.
- We assume CAD/USD parity

The financial outcome of such a scenario is that there is an initial revenue and net revenue flow in FY12 with the company registering a loss of just under $1mn for the full year. As production ramps up in FY13 (two thirds of which is actually calendar year 2012) the total sales of mine output could reach nearly USD$35mn with a maiden profit of $5.7mn. In FY14, we are looking for sales of nearly $40mn and a bottom line of around $6.23mn.

Risks

The prime concerns would be:

- Mexico - vague rumblings continue on the issue of a possible royalty. Many other mining jurisdictions have headed in this direction in recent years to maximize returns. With oil production volumes trending lower Mexico needs to replace revenues
- Commodity prices – silver is rather rich at $18. Recent financial turmoil has pulled it back but it could retreat to $15. This is not dangerous for the economics of Silvermex’s project but does effect general sentiment towards silver stocks.
- Financing - the problem here is less raising the money for the mine build for there are a number of avenues that can be pursued. More pressing is the issue of paying off Silver Standard (who we suspect may anyway prefer equity as the mine moves closer to production) and Aurcana (who have recently finally been able to get their own mine, Shafter, financed but who still need money).

Conclusion

Maybe we are mistaken but it would appear that a number of major silver projects in Mexico moved into production in the period 2005-2009 and that now there is something of a lull in the flow. The first flush of projects was the result of silver busting out of its $7-8 trading zone where it long dwelt and rising above $10. This combined with better financing markets to generate a number of significant companies in the Mexican silver production space.

In the immediate future it is not so clear as to where the new production shall come from. The crunch of 2008 cut off financing options sending some companies into oblivion or caused them to shed projects or stall them. The ongoing tough times has caused some to focus down on their first priority and pull other second and third projects on the backburner (Aurcana being a case in point). Thus Silvermex is likely to be one of the few new silver production stories in 2011.

Its two original projects lack nothing in terms of interest but the opportunity to exploit the misfortune of some (Aurcana) or the upsizing of others (Silver Standard) brought Silvermex the sizeable Rosario district and its potential for economies of scale. This has pushed the original company makers into a secondary role. The goal now is to get the market's attention as an up and coming producer. Issues about whether the company had the management depth to deal with production were addressed by the drafting on board of the ex-Hecla executives bringing some ballast to the boardroom.

The prime task now is not proving the management's credibility or that of the project, but rather facing the financing challenges. Fortunately the options are broadening with the recovery in financial markets and the onset of more competition in the silver loan business. Supplier financing of mine equipment is also improving. Hopefully the move to production can be don with minimal further dilution.

At this stage, with a market capitalization of only slightly over CAD$30mn, one does not have to indulge in fantasies to envision the possibilities for a significant move up in the valuation which would still not put the company in an overpriced category. Our twelve month target price is CAD$0.92, which while representing an uplift of 124%, would only put the company at a market capitalisation of around $70mn. In light of this we are adding a **Long** position in Silvermex to the Model Mining Portfolio with a twelve month target price of CAD$0.92.


Silvermex Resources
SMR.V
Mar 31, 2010
0.60
0.55
0.50
0.45
0.40
0.35
0.30
0.25
0.20
0.15
© Yahoo
May 09
Jul 09
Sep 09
Nov 09
Jan 10
Mar 10
Volume
3.0
2.0
1.0
0.0
Millions

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.

Hallgarten's Equity Research rating system consists of LONG, SHORT and NEUTRAL recommendations. LONG suggests capital appreciation to our target price during the next twelve months, while SHORT suggests capital depreciation to our target price during the next twelve months. NEUTRAL denotes a stock that is not likely to provide outstanding performance in either direction during the next twelve months, or it is a stock that we do not wish to place a rating on at the present time. Information contained herein is based on sources that we believe to be reliable, but we do not guarantee their accuracy. Prices and opinions concerning the composition of market sectors included in this report reflect the judgments of this date and are subject to change without notice. This report is for information puposes only and is not intended as an offer to sell or as a solicitation to buy securities.

Hallgarten & Company or persons associated do not own securities of the securities described herein and may not make purchases or sales within one month, before or after, the publication of this report. Hallgarten policy does not permit any analyst to own shares in any company that he/she covers. Additional information is available upon request.

Web access at:

Research: www.hallgartenco.com

60 Madison Ave, 6th Floor, New York, NY, 10010