

## Big Profits from the Gold Bull Market

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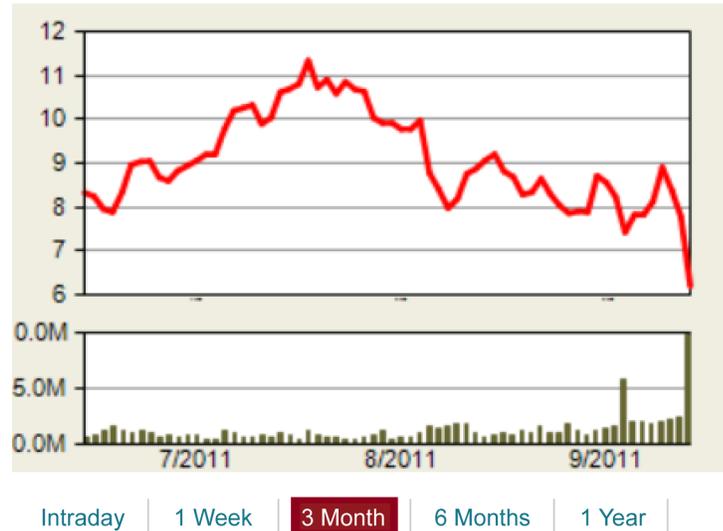
September 15, 2011

### Silvercorp

Casey Recommendation

Buy 1 tranche at \$8, Strong Buy at \$7

Symbol	Current Price 09/15/2011	First Recommended 10/15/2009	Gain / Loss to Date
T.SVM	\$6.61	\$4.89	+ \$1.72 + 35.17%
SVM	\$6.69		



### Recent Company News

Date: 9-13-2011

(US\$6.30, 175.06M SO, \$1.10B MCap, www.silvercorp.ca)

Re: <http://alfredlittle.com/2011/09/13/silvercorp-metals-questionable-customers-geologists-production-quality-and-serious-related-party-failures/>

**Comments:** Silvercorp was hit by another accusation of wrongdoing today (which you can view in the link above), and the stock plummeted 19.6%. Our first impression of this report is much the same as the other one – biased, long on innuendo, short on proof, and in some cases, flat out wrong. Let’s go through the accusations one-by-one so you can see why we are not panicking about our position...

The report states that their “investigator” picked up a couple rocks that fell off an ore truck and the assays showed much lower grade material than SVM reports. The report notes this sample is not scientific, and promises better data in the future, but that doesn’t stop them from publishing nonsense numbers now. They also counted the trucks entering the mill and say there are not enough to add up to the tonnage of ore SVM says it’s processing – but how many days did they count? How many days did they count when there was a power issue at the mine, or one of the mill circuits was down for maintenance? What does it really prove to have a guy skulking about the bushes taking pictures and picking up rocks?

One very important fact that seems to have escaped the authors of the report is that SVM direct-ships high-grade ore to a smelter. This is a very significant part of production that does not go to the mill, and that would affect the number of trucks entering the mill, as well as the grade of the ore going to the mill (or falling off a truck along the way).

The report also falsely claims that Silvercorp's narrow veins cannot be mined without dilution, reducing the average grade. This is simply not true. There's a technique called "resuing" by which you tunnel next to the ore, and then take only the ore to the mill. The ore needs to be just right, but SVM's massive sulfide veins are just right for this. Plus, there are areas where the veins are meters wide, and still grading kilos per tonne, so they can be mined directly. Louis James has been there and seen this, and saw it in multiple places in multiple levels of the mine.

The report also makes a big fuss about how large SVM's MCap is compared to its resources and reserves. They say SVM "should" have more resources. This is more nonsense. It's very common for vein deposits to have only a year or two in reserves drilled off in advance. Yes, that's a risk factor, but its normal – drilling off the whole deposit in advance is just too expensive. Nobody does it. Furthermore, SVM trades at lower multiples and metrics than many other silver producers, probably because of the "China discount." It is simply not overvalued, compared to its peers. This accusation smacks of dishonesty.

Another fuss relates to SVM buying a project from a relative of Rui Feng's – but that, too, was disclosed at the time. Whether or not the relative made a profit is not relevant; what matters is how much the property is worth to SVM. The report states, "SVM's independent directors need to explain how this could possibly be a fair price." But the appropriate place for such a challenge is directly to management, or at a shareholder's meeting. Since these avenues were apparently not tried, one must question the motives of the company's attackers.

The report makes another big fuss about SVM selling concentrate to a smelter in which it owns a 15% stake. This ignores the fact that this was fully disclosed when SVM made the investment, and that SVM made the investment to ensure better terms for its sales and security for its contracts. This is not a bad thing, but a very good thing. The authors say they were "shocked" to see this well known and fully disclosed fact, but that's a crock.

More apparently damning are statistics quoted from Chinese authorities that appear to show much lower production rates and average grades than SVM is reporting. There's a link in the report to a Chinese document and an English translation referring to the "yuelianggou" mine showing these much lower production numbers (there's no link to the source for the lower grades). The Chinese report may even be real and the translation correct – but that doesn't necessarily mean what the authors of the report are suggesting it does. The Ying Mine is not one hole in the ground, but a mine complex made of many physical components, and legal ones too. Yuelianggou may be one of these components, and not the whole thing.

Keep in mind what these accusations are: an anonymous report from a group who is short the stock. We do not place much credence in parties who have an open interest in seeing the share price fall and hide behind trees to take pictures instead of confronting management directly. Again, Louis James has been to the company's mines twice and refutes these claims, and Jeff Clark has opted to attend the company's mine tour in two weeks in lieu of our own Summit.

Could we be wrong? Well, it's possible. But think about what that would mean. It would imply CEO Rui Feng doesn't care about all the billions of dollars he could make going forward and has sold his soul for a few hundred million now. We doubt that. It would also have to mean the 43-101 Qualifying Persons who sign off on SVM's reports are incompetent. Further, the auditors would all have to be crooked. Quite frankly, this would have to be Bre-X and Enron all rolled into one for the accusations to be true. This seems so improbable that we're willing to bet on it being false.

What if we are wrong? If we are, our shares could go to zero. The company would be toast, and so would our money. We can't tell you this isn't possible, but we see the odds of this being extremely low.

Management told us the report is "baseless." They're working to refute it and will issue a press release "very soon." The British Columbia Securities Commission is now involved and is asking the parties to come forward, a departure from their usual policy of keeping investigations confidential. The company also has a task force devoted to the issue, and has sought the assistance of various regulatory and law enforcement authorities in both Canada and the US, and are carrying out their own investigation.

What to do? We still view this as an opportunity, with the caveat that the onslaught of short selling may not be over. And if a third report came out, it would hit the stock even harder. Or, the accusers could be caught or proven wrong and the stock could soar. Either way, panicking is not the right course. We're not changing our recommendation. If you have your full allotment of the stock, hold. If you have room to add shares to your portfolio, we'd still view this as an opportunity. In the interests of full disclosure, some members of Casey Research were filled on bids today.

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