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Silvercorp Management Misled Investors with a False Cash Flow Forecast and Delayed Negative News

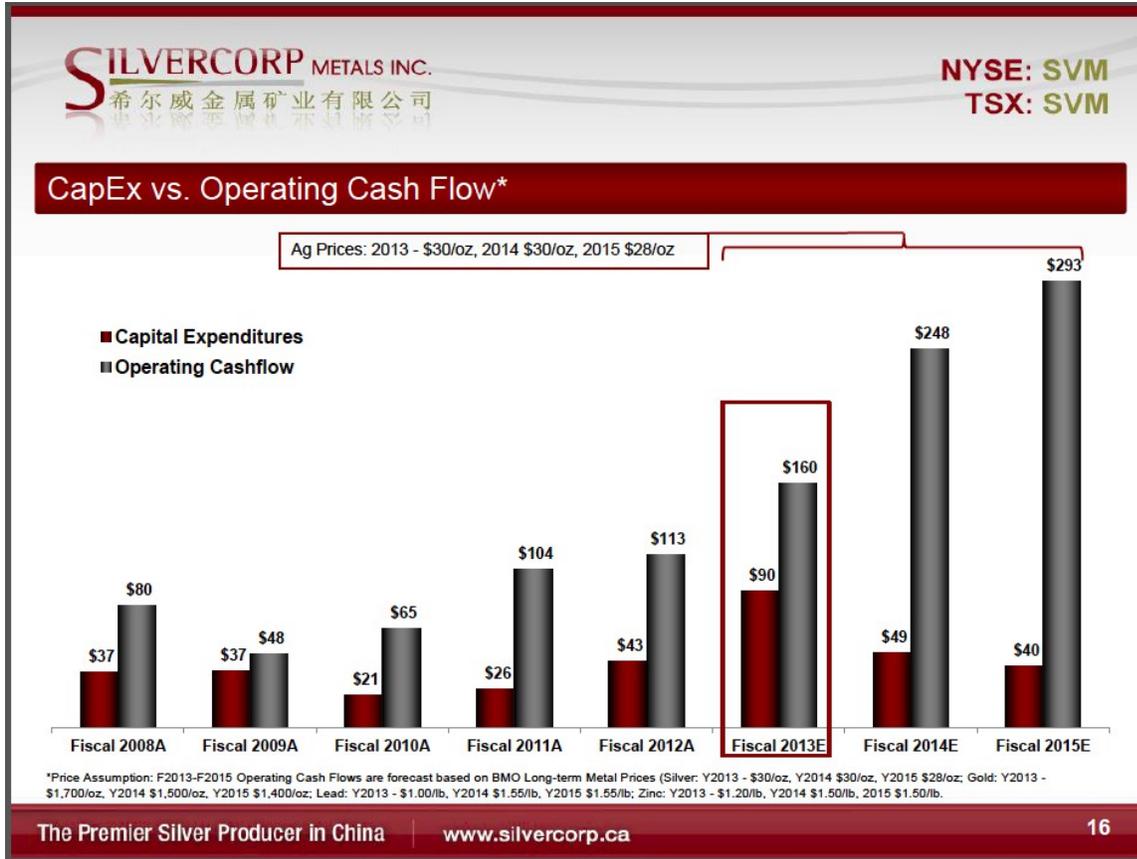
I am blowing the whistle today on Silvercorp Metals Inc. (NYSE: SVM) for misleading investors by publishing and repeatedly promoting a patently false fiscal 2013 operating cash flow forecast of \$160 million, an **increase of 42% over 2012**. SVM management published and touted this forecast despite only generating \$43 million in operating cash flow in the first half of fiscal 2013, a **decrease of 38% from 2012**. Furthermore, I will show that SVM management selectively disclosed lower operating cash flow guidance in presentations to one group of investors, while continuing to show the higher cash flow forecast to all other investors. Then in early 2013 SVM management staged a series of positive announcements to boost the stock price while delaying disclosure of negative developments including a write-down, project delay and sharply reduced production guidance.

1) SVM management misled investors by publishing and promoting a false \$160 million fiscal 2013 operating cash flow forecast

SVM management first presented their \$160 million 2013 operating cash flow forecast over halfway through the 2013 fiscal year as part of a corporate presentation entitled "[European Roadshow October 2012](#)."

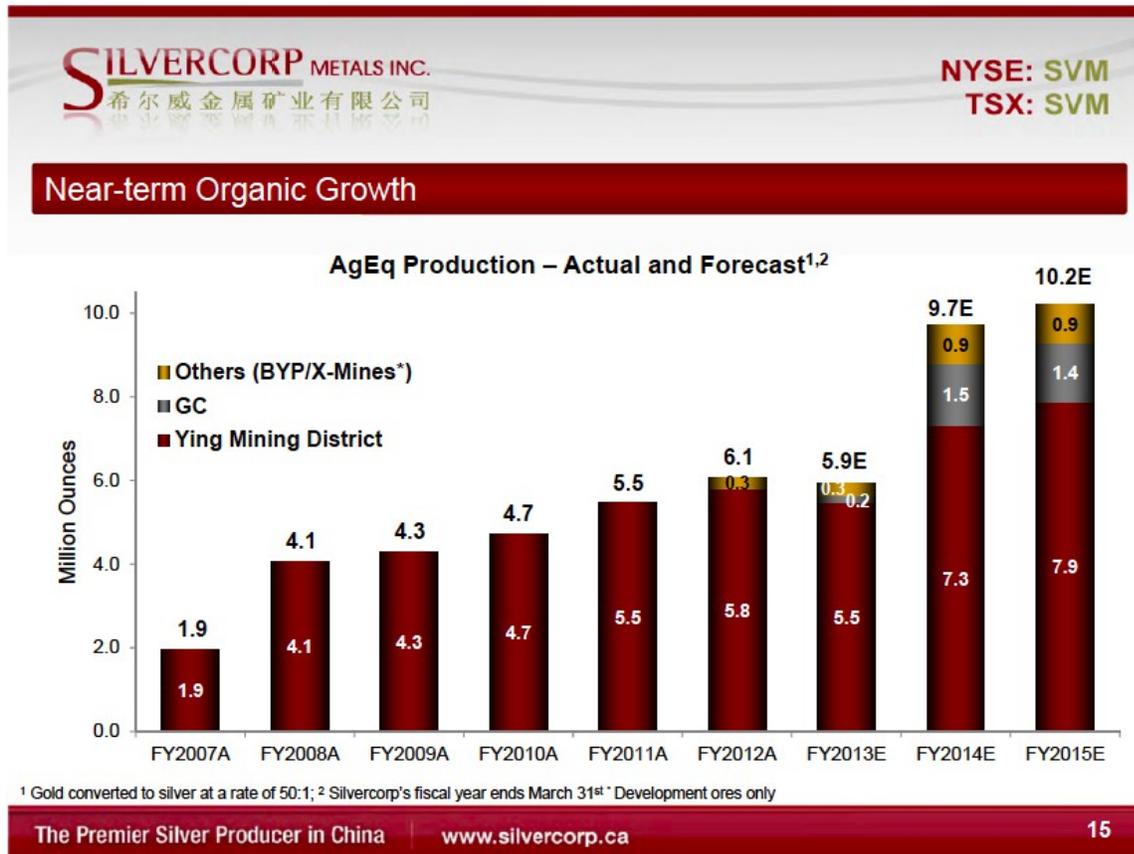
As you will see below, a simple analysis of SVM's production guidance, metals prices, and fiscal 2013 first half performance proves beyond any doubt that SVM management had to have known that their cash flow forecast was false and impossible to achieve.

Below is a copy of page 16 of the presentation in which SVM's management forecast operating cash flow would increase 42% from \$113 million in fiscal 2012 to \$160 million in fiscal 2013:



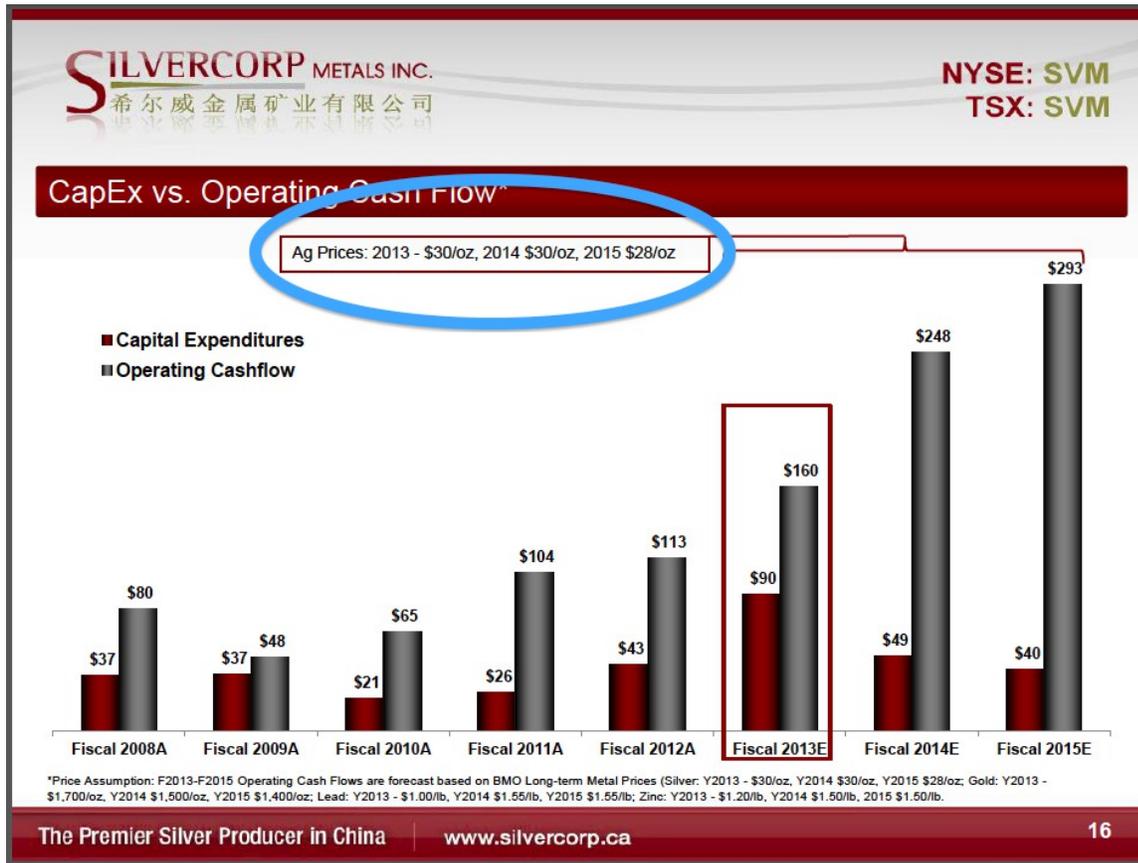
(Note: SVM added the red box highlighting in the original presentation)

However, such a huge growth in operating cash flow is all but impossible when you consider SVM's fiscal 2013 **declining** production forecast, copied below from page 15 of the same presentation:



According to the chart, SVM forecast silver equivalent production would decline from 6.1 million ounces in fiscal 2012 to 5.9 million ounces in fiscal 2013. Growing operating cash flow by 42% while production is declining is all but impossible, without an enormous increase in silver prices.

However, SVM management’s forecast assumed lower silver prices, as I highlighted at the top of their forecast below:



The \$30 per ounce silver price assumption SVM management used in their operating cash flow forecast is much lower than the \$35.88 per ounce average silver price SVM enjoyed in fiscal 2012, as found on page 3 of their 2012 MD&A filed ([here](#)). Given lower production and lower silver prices, dramatically higher operating cash flow is impossible.

The final nail in the coffin for SVM’s deceitful cash flow forecast is the fact that management first presented it over halfway through the 2013 fiscal year during which operating cash flow had already sharply declined. SVM’s actual reported operating cash flow for the first and second quarters of fiscal 2013 was only \$19.3 million and \$23.9 million, respectively. **First half 2013 operating cash flow totaled only \$43.2 million, a decline of 38% from fiscal 2012.**

In summary, SVM management issued a \$160 million operating cash flow forecast for fiscal 2013, an increase of 42% from fiscal 2012, despite:

- 1. Issuing declining production guidance for fiscal 2013**
- 2. Assuming declining silver prices from \$35.88 to \$30**
- 3. Having achieved only \$43.2 million in operating cash flow in the first half of fiscal 2013, a decline of 38% from 2012.**

I conclude that SVM management's \$160 million fiscal 2013 operating cash flow forecast was therefore intentionally false and misleading.

Question: Were the Wall Street analysts that follow SVM deceived by management's forecast?

Answer: No. At the time of SVM management's false \$160 million forecast, both BMO and Raymond James analysts forecast fiscal 2013 operating cash flow of only a little over \$80 million, half of management's guidance.

Once again it was the small investors who trusted management who were cheated. SVM management responsible for the fabricated forecast should be held accountable by securities regulators.

"I never cheated nobody. That is very important"¹



¹Rui Feng quoted in *The Globe and Mail*, "[Silvercorp's Rui Feng Fires Back](#)", 9/23/11

If SVM management asserts that the false forecast was merely a "typo" then securities regulators should wisely ask why SVM management repeatedly touted the same glaring "typo" over two months on roadshows and at investment conferences as shown below (click the links to download the actual presentations):

[October 2012 - European Roadshow](#)

[10/26/2012 - The Silver Summit 10th Anniversary \(Text Only\)](#)

[11/16/2012 - San Francisco Hard Assets Investment Conference](#)

[11/27/2012 - Raymond James East Coast Non-Deal Roadshow](#)

Investors lured into buying SVM stock based on these presentations made during this period were damaged as a result of SVM's continued stock price decline as SVM's actual reported operating cash flow continued to fall far short of management's intentionally false and misleading forecast.

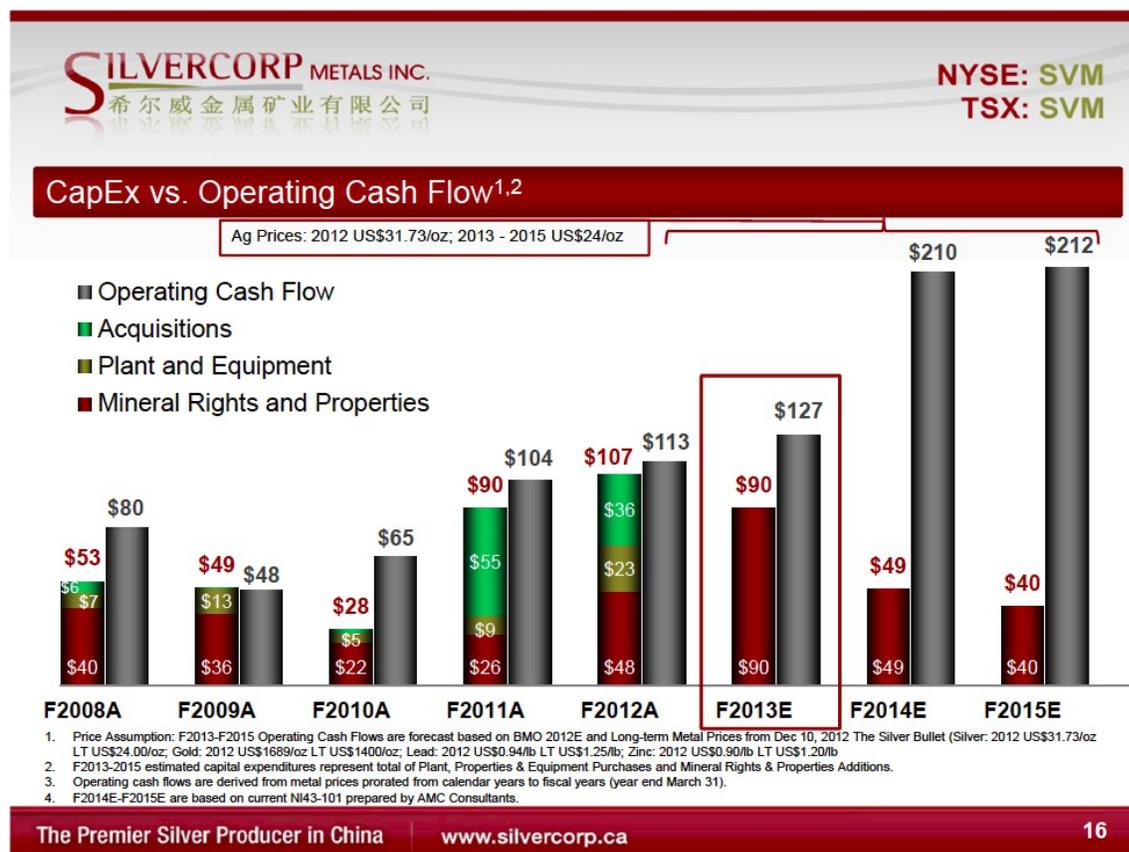
2) SVM management selectively disclosed a lower operating cash flow forecast to Global Hunter clients

On [January 15 and 16, 2013](#) (9.5 months into the fiscal year), SVM management selectively disclosed a lower \$127 million operating cash flow forecast, **privately**, in [roadshow presentations](#) to Global Hunter Securities' analysts and clients.

All other SVM investors were left in the dark by SVM management's selective disclosure. Following this negative disclosure SVM stock traded sharply lower as shown in the following chart:



A copy of slide 16 from SVM's private presentation to Global Hunter showing the lower \$127 million operating cash flow forecast appears below:



Note: On this revised slide SVM management also provided a more inclusive history of their CapEx expenditures, including plant and equipment purchases as well as acquisitions as part of CapEx. Notice how the operating cash flow is often entirely offset by the capital investments, meaning that investors will have to wait for future cash flows (that management has clearly exaggerated) to generate any real free cash flow.

3) In early 2013 SVM management staged a series of positive announcements to boost the stock price while delaying disclosure of negative news

In January 2013, faced with a stock price trading at three year lows, CEO Rui Feng bought a token number of shares and began publishing a series of positive press releases beginning 1/25/13 in a desperate and calculated effort to manipulate the stock price higher as shown below:

- 1/21/13 - SVM Chairman and CEO Rui Feng purchased 30,000 shares
- 1/25/13 - [Silvercorp: Open Letter from Chairman](#)
- 1/28/13 - SVM Audit Committee Chairman Robert Gayton purchased 4,500 shares
- 1/28/13 - [Silvercorp Announces New Management Appointments to Its Operations in China](#)

1/29/13 - [Silvercorp Share Repurchase Program Approved by TSX](#)

1/31/13 - [Silvercorp Intercepts 18.8 Metres True Width Grading 368 g/t Silver and 1.78 Percent Lead at the LM Mine West, Ying Mining District, China](#)

2/7/13 - [Silvercorp Discovers Five New High-Grade Silver Zones and Extends Known Silver Zones at the HZG Mine, Ying Mining District, China](#)

(Note: Investors who question whether the insider purchases by Rui Feng and Robert Gayton are legal, occurring prior to SVM's share buyback announcement might be disappointed to learn that such purchases, under Canadian law, may be permissible)

By late January 2013, prior to the positive PR blitz, SVM management was certainly aware of the following very materially negative developments (not disclosed until the 2/13/13 earnings release):

1. **A write down of \$9.6 million of its investment in New Pacific Metals (TSX: NUX) after NUX stock price became depressed**, at least in part, from its lack of progress developing its shuttered Tagish Lake Gold subsidiary, that in December 2012 [pled guilty to mine safety violations](#) and ignored a stop work order related to deficient equipment. Sentencing is expected later this month. As Director, CEO, and President of Tagish Lake Gold, Rui Feng should certainly know that mine safety is critical to keeping mines operating. In China, for example, mines that conceal deadly accidents can be shut down or even expropriated by the government.
2. **A very disappointing downwardly revised fiscal 2014 silver production forecast of 6.7 million ounces** (approximately 7.8 million silver equivalent ounces, according to SVM's latest investor presentation). This marks a 20% decline from SVM's previous 9.7 million ounce (silver equivalent) fiscal 2014 production forecast. This also marks the 2nd year in a row in which SVM has dramatically lowered its original production guidance.
3. **Commercial production from the GC Project was delayed another six months**, for a total of one year in cumulative delays since the pre-feasibility study published in January 2012 [valued the project at \\$73.7 million](#). The economics of the GC Project continue to favor the seller of the project, an entity controlled by a relative of CEO Rui Feng identified only as "J. Feng." The seller received a total consideration of \$60 million from SVM having only paid in \$4 million capital to the company (most of that only six months prior to the sale of the company). Nearly five years later, the GC project has yet to generate any revenues.
4. **Third quarter operating cash flow of \$27.8 million, down 12% from 2012. Nine month operating cash flow totaled only \$71 million, down 29% from 2012 and not even beginning to approach the \$160 million full year forecast.**

SVM's fourth quarter ending 3/31/13 is always its weakest, due to a 28 day shut down management claims to suffer during every Chinese New Year celebration. **By my estimate, SVM can reasonably only generate around another \$15 million in operating cash flow**

in the fourth quarter, bringing the fiscal year total to around \$86 million, a far cry from the \$127 million SVM management privately disclosed to Global Hunter clients and an even further cry from the \$160 million SVM management touted to all other SVM investors.

Confronting SVM management over false cash flow forecasts and potential Reg-FD securities law violations is impossible, as I discovered during SVM's [second quarter conference call](#) and again during SVM's third quarter conference call. **SVM management simply pretends there are no investors in the Q&A queue and ends each call without taking questions from the public.**

Cover Up? SVM management quietly removed their false operating cash flow forecast from the most recent presentation

On 2/25/13 SVM management uploaded their [latest investor presentation](#) (given to BMO clients at an investment conference). In the revised presentation, SVM management entirely removed the false and misleading \$160 million cash flow forecast. However, simply removing the lie does not change the reality that for three months SVM management intentionally touted a false and misleading cash flow forecast to investors.

Conclusion

SVM hit a low of \$3.60 following the latest earnings report and lowered guidance. Securities regulators should take action to review all the facts and hold SVM management accountable for luring investors with an intentionally false and misleading cash flow forecast and a series of positive press releases timed to precede the disclosure of very materially negative news.

Disclosure: No position as of 2/26/13. I may initiate a new short position in SVM at any time.

3/5/13 Note: After A*L published this report exposing SVM's false operating cash flow forecast, SVM management removed the 5 presentations cited in this report from its investor websites. As a result, A*L updated the links in this report to archived copies of SVM's investor presentations.