SOLITARIO EXPLORATION & ROYALTY CORP.
Form 10-Q
November 07, 2011

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended **September 30, 2011**

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from_______to_______

Commission File Number. **001-39278**

SOLITARIO EXPLORATION & ROYALTY CORP.

(Exact name of registrant as specified in its charter)

Colorado	84-1285791
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.
4251 Kipling St. Suite 390, Wheat Ridge, CO	80033

(Address of principal executive offices) (Zip Code)
(303) 534-1030
(Registrant's telephone number, including area code)

Indicate by checkmark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES S NO £

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every

Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES S NO £

Indicate by check mark whether the registrant is a large accelerated filer, accelerated filer, a non-accelerated filer or a smaller reporting company. See the definition of “accelerated filer”, “large accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer £	Accelerated filer £	Non-accelerated filer (do not check if a smaller reporting company) £	Smaller reporting company S

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES £ NO S

There were 34,204,958 shares of $0.01 par value common stock outstanding as of November 1, 2011.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

SOLITARIO EXPLORATION & ROYALTY CORP.

CONSOLIDATED BALANCE SHEETS

(in thousands of U.S. dollars, except share and per share amounts)	September 30, 2011 (unaudited)	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 3,320	$ 478
Investments in marketable equity securities, at fair value	2,527	5,214
Prepaid expenses and other	561	421
Total current assets	6,408	6,113
Mineral properties, net	8,883	6,153
Investments in marketable equity securities, at fair value	10,836	14,557
Equity method investment	1,782	2,276
Other assets	325	509
Total assets	$ 28,234	$ 29,608
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 710	$ 630
Short-term margin loan	2,000	2,823
Current portion long-term debt	714	481
Deferred income taxes	951	1,945
Other	124	100
Total current liabilities	4,499	5,979
Long-term debt, net of discount	2,036	2,604
Deferred income taxes	3,123	4,474
Stock option liability	—	2,775
Commitments and contingencies		
Shareholders' Equity:		
Solitario shareholders' equity:		
Preferred stock, $0.01 par value, authorized 10,000,000 shares (none issued and outstanding at September 30, 2011 and December 31, 2010)	—	—
Common stock, $0.01 par value, authorized 100,000,000 shares (34,194,958 and 29,750,242, respectively, shares issued and outstanding at September 30, 2011and December 31, 2010)	342	297

Additional paid-in capital	48,826	36,799
Accumulated deficit	(37,920)	(36,996)
Accumulated other comprehensive income	7,758	11,786
Total Solitario shareholders' equity	19,006	11,886
Noncontrolling interest	(90)	1,890
Contra-noncontrolling interest	(340)	—
Total shareholders' equity	18,576	13,776
Total liabilities and shareholders' equity	$ 28,234	$ 29,608

See Notes to Unaudited Condensed Consolidated Financial Statements

SOLITARIO EXPLORATION & ROYALTY CORP.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(in thousands except per share amounts)	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Property and joint venture revenue				
Joint venture property payments	$200	$200	$200	$200
Costs, expenses and other:				
Exploration expense	1,724	584	3,486	2,312
Depreciation and amortization	13	12	34	56
General and administrative	625	592	2,270	2,152
Loss (Gain) on derivative instruments	193	66	122	(52)
Interest expense	63	—	223	—
Asset write downs	—	16	—	55
Interest and dividend income	(61)	(35)	(118)	(88)
Gain on sale of assets	—	—	—	(22)
Total costs, expenses and other	2,557	1,235	6,017	4,413
Other Income				
Gain on sale of marketable equity securities	—	—	1,870	553
Gain on deconsolidation of PBM subsidiary	—	724	—	724
Net loss of equity method investment	(113)	(52)	(494)	(52)
Total other income (loss)	(113)	672	1,376	1,225
Loss before income taxes	(2,470)	(363)	(4,441)	(2,988)
Income tax benefit	569	341	476	634
Net loss	(1,901)	(22)	(3,965)	(2,354)
Less net loss attributable to noncontrolling interest	995	29	2,049	164
Net (loss) income attributable to Solitario shareholders	$(906)	$7	$(1,916)	$(2,190)
(Loss) income per common share attributable to Solitario shareholders:				
Basic and diluted	$(0.03)	$0.00	$(0.06)	$(0.07)
Weighted average shares outstanding:				
Basic and diluted	34,163	29,750	32,336	29,750

See Notes to Unaudited Condensed Consolidated Financial Statements

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SOLITARIO EXPLORATION & ROYALTY CORP.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands of U.S. dollars)	Nine months ended September 30, 2011	2010
Operating activities:		
Net loss	$(1,916)	$(2,190)
Adjustments to reconcile net loss to net cash used in operating activities:		
Unrealized loss (gain) on derivative instruments	122	(52)
Depreciation and amortization	34	56
Loss on equity method investment	494	52
Employee stock option expense	523	851
Asset write down	—	55
Non-controlling interest	(2,049)	(164)
Deferred income tax benefit	(476)	(634)
Amortization of discount on long-term debt	165	—
Gain on asset and equity security sales	(1,870)	(575)
Gain on deconsolidation of PBM subsidiary	—	(724)
Changes in operating assets and liabilities:		
Prepaid expenses and other current assets	(168)	3
Accounts payable and other current liabilities	110	(470)
Net cash used in operating activities	(5,031)	(3,792)
Investing activities:		
Additions to mineral properties	(1,730)	(11)
Additions to other assets	(116)	(7)
Investment in marketable equity securities	—	(178)
Proceeds from sale of marketable equity securities	1,964	730
Sale of (purchase) of derivative instruments	57	(65)
Cash decrease from deconsolidation of PBM subsidiary	—	(1,083)
Proceeds from sale of other assets	—	22
Net cash provided (used) by investing activities	175	(592)
Financing activities:		
Short-term borrowing	1,075	1,500
Repayment of short-term borrowing	(1,926)	—
Repayment of long-term debt	(500)	—
Proceeds from common stock offering, net	8,937	—
Noncontrolling interest contribution	80	1,496

Proceeds on exercise of options	232	—
Payment to noncontrolling investor	(200)	—
Net cash provided by financing activities	7,698	2,996
Net increase (decrease) in cash and cash equivalents	2,842	(1,388)
Cash and cash equivalents, beginning of period	478	1,946
Cash and cash equivalents, end of period	$3,320	$558
Supplemental disclosure of non-cash activities:		
Reclassification of stock option liability to additional paid-in-capital	$1,240	$—
Reclassification of stock option liability to accumulated deficit, net of deferred taxes of $543	$992	$—

See Notes to Unaudited Condensed Consolidated Financial Statements

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Business and Significant Accounting Policies

Business

Solitario Exploration & Royalty Corp. ("Solitario") is an exploration stage company with a focus on the acquisition of precious and base metal properties with exploration potential and the development or purchase of royalty interests. Solitario acquires and holds a portfolio of exploration properties for future sale, joint venture or to create a royalty prior to the establishment of proven and probable reserves. In August 2010, Solitario signed a Letter of Intent to earn up to an 80% interest in the Mt. Hamilton project located in Nevada from Ely Gold & Minerals, Inc. ("Ely"). Solitario has been working on the exploration and potential development of the Mt. Hamilton project. However, Solitario has never developed a mineral property. Solitario is exploring on other mineral properties that may be developed in the future by Solitario or through a joint venture. Solitario has been actively involved in mineral exploration since 1993. At September 30, 2011, Solitario's mineral properties are located in the United States, Mexico, Brazil, Bolivia and Peru. Solitario was incorporated in the state of Colorado on November 15, 1984.

The accompanying interim condensed consolidated financial statements of Solitario for the nine months ended September 30, 2011 and 2010 are unaudited and are prepared in accordance with accounting principles generally accepted in the United States of America. They do not include all disclosures required by generally accepted accounting principles for annual financial statements, but in the opinion of management, include all adjustments, consisting only of normal recurring items, necessary for a fair presentation. Interim results are not necessarily indicative of results, which may be achieved in the future or for the full year ending December 31, 2011.

These financial statements should be read in conjunction with the financial statements and notes thereto which are included in Solitario's Annual Report on Form 10-K for the year ended December 31, 2010. The accounting policies set forth in those annual financial statements are the same as the accounting policies utilized in the preparation of these financial statements, except as modified for appropriate interim financial statement presentation.

Recent developments

Equity financing

On April 13, 2011, Solitario sold 3,400,000 shares of its common stock in an underwritten public offering at a price to the public of $2.50 per share. In connection with the underwritten public offering, on May 9, 2011, the underwriter exercised its option to purchase an additional 510,000 shares at $2.50 per share to cover over-allotments. The total number of shares sold in the public offering and the over-allotment were 3,910,000 shares (the "Offering") for net proceeds of $8,937,000 after underwriter's commission of six percent and offering costs. The Offering was made pursuant to a shelf registration statement on Form S-3 previously filed with the Securities and Exchange Commission (the "SEC") on March 18, 2011, which was declared effective on March 29, 2011. A prospectus supplement relating to the Offering has been filed with the SEC and is available on the SEC's website located at www.sec.gov.

Stock option liability

On January 1, 2011, Solitario changed its accounting for stock options to equity accounting from liability accounting in accordance with the adoption of the Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") No. 2010-13, "Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades" ("ASU 2010-13"). ASU 2010-13 addresses the classification of a share-based payment award with an exercise price denominated in the currency of a market in which the underlying equity security trades. FASB Accounting Standards Codification ("ASC") Topic 718 was amended to clarify that a share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trade shall not be considered to contain a market, performance or service condition. Therefore, such an award is not to be classified as a liability if it otherwise qualifies for equity classification. In accordance with ASU 2010-13, this change has been made on a prospective basis as of January 1, 2011 with a reduction to stock option liability of $2,775,000, an increase to additional paid-in-capital of $1,240,000 and a reduction in accumulated deficit of $992,000, net of deferred taxes of $543,000. See “Employee stock compensation plans” below.

Investment in Ely and the Mt. Hamilton joint venture

On August 26, 2010, Solitario signed a Letter of Intent (“LOI”) with Ely to make certain equity investments into Ely and to joint venture Ely’s Mt. Hamilton gold project, which was wholly-owned by DHI-Minerals (US) Ltd. (“DHI-US”), an indirect wholly-owned subsidiary of Ely. On August 26, 2010 and October 19, 2010, Solitario made private placement investments of Cdn$250,000 each in Ely securities. Solitario received a total of 3,333,333 shares of Ely common stock and warrants to purchase a total of 1,666,667 shares of Ely common stock (the “Ely Warrants”) for an exercise price of Cdn$0.25 per share, which expire two years from the date of purchase. The private placements were pursuant to the LOI. On November 12, 2010 Solitario made an initial contribution of $300,000 for a 10% membership interest in, upon the formation of, Mt. Hamilton LLC (“MH-LLC”) which was formed in December 2010. The terms of the joint venture are set forth in the Limited Liability Company Operating Agreement of MH-LLC between Solitario and DHI-US (the “MH Agreement”). MH-LLC owns 100% of the Mt. Hamilton Gold project. Pursuant to the MH Agreement, Solitario may earn up to an 80% interest in MH-LLC, and indirectly, the Mt. Hamilton project, by completing various staged commitments. See a more complete discussion of Ely and MH-LLC in Note 12 to the consolidated financial statements, “Ely Gold investment and the Mt. Hamilton Joint Venture” in Item 8 “Financial Statements and Supplementary Data” of our Annual Report on Form 10-K for the year ended December 31, 2010. During the three and nine months ended September 30, 2011, Solitario made cash payments of $100,000 and $200,000, respectively, and issued 25,000 and 50,000 shares of common stock, respectively, valued at $50,000 and $140,000, respectively to DHI-US as part of its earn-in to MH-LLC. These payments were recorded as contra-noncontrolling interest account in the equity section of the condensed consolidated balance sheet.

Royalty buy-down

On May 17, 2011, MH-LLC and Solitario entered into an agreement with an underlying royalty holder on its Mt. Hamilton property whereby Solitario delivered, for the benefit of MH-LLC, 344,116 shares of its common stock, with a fair market value of $1,000,000 based upon a 20-day weighted average quoted stock price, and $1,520,000 of cash, to reduce the future net smelter royalty (the “Royalty Buy-down”) from a maximum royalty of 8% to a maximum royalty of 6%. MH-LLC retains its existing right to further reduce the net smelter royalty at Mt. Hamilton by an additional 5%, to an ultimate royalty of 1%, as further discussed in Note 12 to the consolidated financial statements, “Ely Gold investment and the Mt. Hamilton Joint Venture” in Item 8 “Financial Statements and Supplementary Data” of our Annual Report on Form 10-K for the year ended December 31, 2010. As part of the Royalty Buy-down transaction, Solitario agreed to loan to DHI-US, the non-controlling member of MH-LLC, $504,000 for DHI-US’s mutually agreed 20% share of the total purchase price contributed by Solitario to MH-LLC to fund the Royalty Buy-down. This loan is unsecured; bears interest at 6% per annum and the loan and any accrued interest thereon will only be repaid from 80% of DHI-US share of distributions from MH-LLC, if any. Solitario has recorded the loan of $504,000 as an offset to DHI-US’s non-controlling interest in MH-LLC, as the loan represents a claim on DHI-US’s share of the future distributions from MH-LLC. During the three and nine months ended September 30, 2011, Solitario accrued $7,000 and $11,000, respectively, of interest on the $504,000 loan as an offset to DHI-US’s noncontrolling interest in the equity section of the consolidated balance sheet.

Kinross common stock

Solitario has a significant investment in Kinross Gold Corporation ("Kinross") at September 30, 2011, which consists of 855,000 shares of Kinross common stock. As of September 30, 2011, none of these shares are subject to the Kinross Collar, discussed below under "Derivative instruments." Solitario did not sell any shares of Kinross during the three months ended September 30, 2011 or the three months ended September 30, 2010. During nine months ended September 30, 2011 Solitario sold 125,000 shares of Kinross for net proceeds of $1,964,000 and recorded a gain on sale of $1,870,000, respectively. Solitario sold 40,000 shares of Kinross common shares during the nine months ended September 30, 2010 for net proceeds of $730,000 and recorded a gain on sale of $553,000. As of November 1, 2011, we own 855,000 shares of Kinross, which have a value of approximately $12.3 million based upon the market price of $14,36 per Kinross share. Any significant fluctuation in the market value of Kinross common shares could have a material impact on Solitario's liquidity and capital resources.

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Employee stock compensation plans

Solitario accounts for its stock options under the provisions of ASC 718 Compensation – Stock Compensation. Pursuant to ASC 718, as of January 1, 2011, Solitario classifies its stock options as equity options in accordance with ASU 2010-13. Previously, Solitario had classified its stock options as liabilities as they are priced in Canadian dollars and Solitario's functional currency is United States dollars and Solitario's common stock trades on both the NYSE Amex Equities ("NYSE-Amex") and the Toronto Stock Exchange ("TSX"). Prior to January 1, 2011, Solitario recorded a liability for the fair value of the vested portion of outstanding options based upon a Black-Scholes option pricing model.

Solitario's outstanding options on the date of grant have a five year term, and vest 25% on date of grant and 25% on each of the next three anniversary dates. Solitario recognizes stock option compensation expense on the date of grant for 25% of the grant date fair value, and subsequently, based upon a straight line amortization of the unvested grant date fair value of each of its outstanding options. During the three and nine months ended September 30, 2011 Solitario recorded $174,000 and $523,000 of stock option expense for the amortization of grant date fair value with a credit to additional paid-in-capital.

Prior to January 1, 2011, Solitario recorded a stock option liability for the vested fair value of each option grant on the measurement date by multiplying the estimated fair value determined using the Black-Scholes model by the percent vesting of the option on the measurement date. During the three and nine months ended September 30, 2010, Solitario recognized $206,000 and $851,000, respectively, in stock option compensation expense.

On June 27, 2006 Solitario's shareholders approved the 2006 Stock Option Incentive Plan (the "2006 Plan"). Under the terms of the 2006 Plan, the Board of Directors may grant up to 2,800,000 options to Directors, officers and employees with exercise prices equal to the market price of Solitario's common stock at the date of grant.

There were no new options granted during the three and nine months ended September 30, 2011. Solitario granted 2,065,000 options on May 5, 2010, with a grant fair value of $2,449,000 based upon a Black Scholes option pricing model resulting in a weighted average fair value of $1.19 per share. During the three and nine months ended September 30, 2011, options for 32,500 and 140,600 shares, respectively, were exercised at prices between Cdn$1.55 and Cdn$2.40 per share for cash proceeds of $51,000 and $232,000. No options were exercised during the three and nine months ended September 30, 2010.

The following table summarizes the activity for stock options outstanding under the 2006 Plan as of September 30, 2011, with exercise prices equal to the stock price, as defined, on the date of grant and no restrictions on exercisability after vesting:

	Shares issuable on outstanding Options	Weighted average exercise Price (Cdn$)	Weighted average remaining contractual term in years	Aggregate intrinsic value(1)
2006 Plan				
Outstanding, beginning of year	2,584,000	$ 2.23		
Granted	—			
Exercised	(140,600)	$ 1.55		
Forfeited	—			
Outstanding at September 30, 2011	2,443,400	$ 2.27	3.5	$ 71,000
Exercisable at September 30, 2011	1,281,500	$ 2.23	3.4	$ 47,000

(1)The intrinsic value at September 30, 2011 based upon the quoted market price of Cdn$1.79 per share for our common stock on the TSX and an exchange ratio of 0.96818 Canadian dollars per United States dollar.

At December 31, 2010, the fair value of $2,775,000 for Solitario's outstanding options on that date, granted under the 2006 Plan, was determined utilizing the following assumptions and a Canadian dollar to United States dollar exchange rate of 0.99994.

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Fair Value at December 31, 2010

Grant Date	5/5/10	5/19/09
Plan	2006 Plan	2006 Plan
Option price (Cdn$)	$2.40	$1.55
Options outstanding	2,065,000	519,000
Expected Life	4.4 yrs	3.4 yrs
Expected volatility	62 %	66 %
Risk free interest rate	1.6 %	1.1 %
Weighted average fair value	$2.24	$2.54
Portion of vesting at measurement date	41.6 %	64.6 %
Fair value of outstanding vested options	$1,924,000	$851,000

Earnings per share

The calculation of basic and diluted earnings and loss per share is based on the weighted average number of common shares outstanding during the three and nine months ended September 30, 2011 and 2010. Potentially dilutive shares are related to outstanding common stock options of 2,443,400 and 2,584,000 during the three and nine months ended September 30, 2011 and 2010, respectively, were excluded from the calculation of diluted loss per share because the effects were anti-dilutive.

Derivative instruments

Ely Warrants