

# **SILVERMET INC.**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**FOR THE THREE AND NINE MONTHS ENDED  
SEPTEMBER 30, 2010**

**Dated November 25, 2010**

# Silvermet Inc.

## Management's Discussion and Analysis

For the three and nine months ended September 30, 2010

(All amounts in United States Dollars, unless otherwise stated)

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### Introduction

The following management's discussion and analysis ("MD&A") of the financial condition and results of the operations of Silvermet Inc. (the "Company") constitutes management's review of the factors that affected the Company's financial and operating performance for the three and nine months ended September 30, 2010. This MD&A was written to comply with the requirements of National Instrument 51-102 – Continuous Disclosure Obligations. This discussion should be read in conjunction with the unaudited interim consolidated financial statements of the Company for the three and nine months ended September 30, 2010, together with the notes thereto, which were prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). All amounts referred to in this MD&A are in United States dollars unless otherwise specified. Information contained herein is presented as at November 25, 2010, unless otherwise indicated.

Further information about the Company and its operations can be obtained from the offices of the Company, at [www.silvermet.ca](http://www.silvermet.ca) or from [www.sedar.com](http://www.sedar.com).

### Caution Regarding Forward-looking Statements

Except for statements of historical fact relating to the Company, certain information contained in this MD&A constitutes "forward-looking information" under Canadian securities legislation. Forward-looking information includes, but is not limited to, statements with respect to the potential of the Company's assets; the future prices of zinc, lead and silver; capital expenditure requirements; requirements for additional capital and other statements relating to the financial and business prospects of the Company. Generally, forward-looking information can be identified by the use of forward-looking terminology such as "plans", "expects" or "does not expect", "is expected", "budget", "scheduled", "estimates", "forecasts", "intends", "anticipates" or "does not anticipate", or "believes", or variations of such words and phrases or statements that certain actions, events or results "may", "could", "would", "might" or "will be taken", "occur" or "be achieved". Forward-looking information is based on the reasonable assumptions, estimates, analysis and opinions of management made in light of its experience and its perception of trends, current conditions and expected developments, as well as other factors that management believes to be relevant and reasonable in the circumstances at the date that such statements are made, and are inherently subject to known and unknown risks, uncertainties and other factors that may cause the actual results, level of activity, performance or achievements of the Company to be materially different from those expressed or implied by such forward-looking information, including but not limited to risks related to: unexpected events and delays during permitting; the possibility that future exploration results will not be consistent with the Company's expectations; timing and availability of external financing on acceptable terms and in light of the current decline in global liquidity and credit availability; future prices of zinc, lead and silver; currency exchange rates; government regulation; failure of equipment or processes to operate as anticipated; risks inherent in manufacturing and processing operations, including environmental hazards or industrial accidents; and uncertain political and economic environments. Although management of the Company has attempted to identify important factors that could cause actual results to differ materially from those contained in forward-looking information, there may be other factors that cause results not to be as anticipated, estimated or intended. There can be no assurance that such statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on forward-looking information. The Company does not undertake to update any forward-looking information, except in accordance with applicable securities laws.

The Company is a reporting issuer under applicable securities legislation in the provinces of Alberta, British Columbia and Ontario and its outstanding shares are listed on the TSX Venture Exchange (the "TSX-V") under the symbol "SYI".

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### Overview

All amounts are stated in US dollars unless otherwise noted.

In 2008, the Company entered into an agreement to acquire the Waelz kiln assets of Metoks Madencilik Metalurji Tasimacilik Sanayi ve Ticaret Anonim Sirketi ("Metoks"), the owner of an existing Waelz kiln located in Iskenderun, Turkey. This acquisition closed on February 16, 2009. The purchase price was approximately \$7.7 million. The purchase price was paid by cash of \$727,710, the assumption of certain liabilities and bank debts of Metoks of \$3,669,006, a fixed payment over two years of \$960,000, and a contingent payment of up to \$2,348,372 over the next five years, dependent on the performance of the operations.

In 2009, the Company successfully transitioned from an exploration and development company to an operating company. The Company's Waelz kiln operations in Turkey recover zinc from zinc-bearing Electric Arc Furnace Dust ("EAFD") that is produced as a waste product by local steel mills.

Financing of the Company's acquisition and start-up of operations came from funds on hand, private placements of equity and an investment by Cooper Island Investments, LLC ("Cooper Island"), a company related to a major shareholder of the Company, Greyling Investments Inc. By February 2010, Cooper Island had invested \$3.5 million and had earned a 41.5% interest in the Turkish operations.

On October 27, 2010, Silvermet and an affiliate of Befesa Medio Ambiente, S.A. ("Befesa") established a new joint venture known as Befesa Silvermet Turkey, S.L. ("Befesa Silvermet") to hold the Turkish operations. In conjunction with the formation of the joint venture, Befesa invested \$10 million directly and indirectly. Befesa acquired a 10% shareholding in Silvermet by completing a private placement of 16 million shares at C \$0.125 per share (C \$2 million), which funds were then invested in Befesa Silvermet. Befesa invested the balance of the \$10 million directly into Befesa Silvermet. Befesa Silvermet acquired Cooper Island's 41.5% interest in the Turkish operations for \$4 million and Silvermet transferred its 58.5% interest in the Turkish operations to Befesa Silvermet.

As a result of these transactions, Befesa Silvermet is held 51% by Befesa and 49% by the Company. On closing of the transactions, Befesa Silvermet held 100% of the Turkish operations and assumed the related liabilities. Befesa Silvermet began operations with a cash balance of \$6 million.

### Highlights

The highlights of the Company's 2010 year-to-date results include the following:

- Increased production from 713 DMT (dry metric tonnes) per month of zinc concentrate in the first half of 2010 to an average 1,205 DMT per month in the third quarter of 2010.
- Improved cost structure for coke began toward the end of August.
- Successful conversion from zinc clinker production to double washed Waelz oxide, a more marketable form of zinc concentrate.
- Entered multi-year smelter contracts with two of the largest zinc smelter groups.
- Smelter treatment charges in 2010 are much more favourable than they were in 2009.
- Experienced significant downtime for modifications and maintenance of the kiln, as well as a flood in the first half.
- Since the beginning of July, there have not been any unplanned major shutdowns.
- A number of management changes were made at the Turkish operations throughout the year.

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- Borrowed \$932,000 from Cooper Island in January which was subsequently repaid out of residuals.
- A director took over the remaining \$417,565 owing on the foregoing Cooper Island loan on June 18, 2010 and extended the maturity. The loan was paid out in early October.
- The Company drew down a further \$500,000 on the Cooper Island equity facility on February 23, 2010, increasing the Cooper Island interest in the Turkish operations to 41.5%.
- On July 23, 2010, the Company closed on a convertible debenture financing of C \$500,000, in which a director participated as to C \$250,000.
- In Q2, the Company entered discussions with Befesa Medio Ambiente, S.A. ("Befesa"), a Spanish company that operates a number of Waelz kilns throughout Europe. This culminated in the formation of a joint venture, Befesa Silvermet Turkey, S.L. ("Befesa Silvermet") which transaction closed on October 27, 2010.
- In connection with the Befesa Silvermet joint venture, the Cooper Island interests were acquired, Befesa acquired a 10% interest in Silvermet and the joint venture began operations with \$6 million cash.
- Befesa Silvermet is owned 51% by Befesa and 49% by Silvermet.
- 8,993,000 warrants were exercised on September 20, 2010 for proceeds of C \$899,300. Subsequently, a further 5,725,000 warrants were exercised on November 5, 2010 for proceeds of C \$572,500.

The following table summarizes comparative quarterly and year-to-date results and reconciles net earnings, a GAAP measure to EBITDA:

	For the three months ended September 30,		For the nine months ended September 30,	
Gross sales revenues	\$ 4,753,062	\$ 1,589,329	\$11,207,766	\$ 2,426,330
Direct operating costs	1,667,007	1,044,341	5,557,357	1,777,796
Treatment & transportation	1,282,809	631,693	3,528,950	1,012,364
General & admin - Turkey	215,481	-	814,830	-
General & admin - Canada	341,616	388,844	681,366	705,926
EBITDA <sup>(1)</sup>	\$1,246,149	\$(475,549)	\$625,263	\$(1,069,756)
Interest and financing	44,777	35,848	88,672	125,418
Amortization - Canada	4,916	1,118	8,674	6,045
Amortization - Turkey	98,866	27,289	289,688	73,132
Investment & other (gain) loss	(3,475)	8,874	(206,748)	4,829
Foreign exchange loss	7,149	127,247	154,913	249,922
Stock option expense	267,253	9,860	293,813	183,791
Accretion of liabilities	101,252	133,374	226,326	165,466
Pre-operating costs	-	-	-	542,289
Gain on dilution	-	(1,503,776)	(83,748)	(1,503,776)
Non-controlling interest in net income (loss) of consolidated affiliates	524,736	(224,053)	128,562	(224,053)
Net income (loss) available to common shareholders	200,675	908,670	(274,889)	(692,819)

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- (1) EBITDA is a non-GAAP measure, does not have a standardized meaning prescribed by GAAP and may not be comparable to similar terms and measures presented by other issuers. EBITDA comprises net income (loss) before income taxes, interest and financing expense (including accretion of liabilities), amortization expense, gain on dilution, non-controlling interest and stock option expense. The Company believes it is appropriate to exclude stock option expense, gain on dilution and non-controlling interest from EBITDA as a measure of operating performance that excludes non-recurring items.

### **2010 Third Quarter Operations**

The current year has been one of many changes for Silvermet. The year began with very good zinc prices, averaging \$1.10/pound in January. However, zinc prices deteriorated through the first 6 months and only averaged \$0.79/pound in June. This resulted in significant negative adjustments to shipment values, as final settlement pricing occurs a number of months after shipment.

The negative pricing trend was exacerbated by significant production downtime due to maintenance issues and a flood. The Company experienced cash flow challenges during the first half of the year and various sources of financing were secured.

Production stabilized during the third quarter and at the same time zinc prices improved. The average zinc price during the third quarter was \$0.91/pound. In September, zinc prices averaged \$0.98/pound and increased to \$1.08/pound for the month of October. These factors helped to build cash flow that was used to pay down debt and accounts payable, and this trend has continued since the end of the third quarter. Although zinc prices have declined in November to their recent level of \$0.95/pound, this is a level at which the Company continues to generate positive cash flows and reduce our liabilities.

During the third quarter, the Company produced and sold 3,615 Tonnes zinc concentrate at 68.7% zinc for a total of approximately 5.5 million pounds contained zinc.

### **Operations**

#### ***Waelz Kiln Re-Commissioning***

Upon closing the acquisition of the Turkish Waelz kiln assets, the Company began the process of re-commissioning the plant, which had been closed since September 10, 2008. Until operational, certain repair and maintenance requirements on the plant could not be specifically quantified. The plant operations commenced in late May 2009 and in the subsequent months certain repairs were required on components that could not be identified through visual inspection prior to start up.

In re-commissioning the plant, numerous changes were introduced, including a complete change to the mix of feedstock to the kiln. The result has been a significant improvement in kiln throughput from that achieved by the former owners. However, in making such changes, it also became apparent that bottlenecks existed in the production process after the zinc oxide exits from the kiln and various programs were put in place to improve the production process.

The changes introduced to the process have been substantial. Previous operations had not incorporated process measurement and management tools. These have now been incorporated at the same time as major process changes have been introduced. The plant was able to hire back much of the same work force as had previously been in place; however the multitude of changes introduced has required an on-going need to train the employees on new product mix and operating procedures. Recovery rates have been lower than the rates experienced in other similar Waelz kiln operations and management attributes this to the on-going need for training in new procedures, improving the consistency of feed mix and the addition of new measurement and process monitoring equipment.

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### Operations

The Company's operations currently comprise the Turkish Waelz kiln plant which recovers the zinc content from EAFD.

The Waelz kiln operation processes EAFD obtained from steel mills and targets the recovery of the zinc content of the EAFD. EAFD is readily available from the existing steel mills near the Iskenderun plant. EAFD is a waste product of the steel mills, which they are obligated to dispose of properly in accordance with Turkish regulations and therefore, is available from the steel mills at no cost.

The EAFD is then blended with lime and coke (or anthracite) to produce pellets. The pellets plus additional coke / anthracite are fed into the kiln and with the application of heat, volatilized gases are created that contain most of the zinc from the EAFD. The gases are cooled and zinc oxide is produced. The zinc oxide is further processed by washing it with soda ash to produce Waelz oxide. Prior to December 2009, the Waelz oxide was further processed through a second kiln into a zinc clinker. When the zinc oxide is processed into a zinc clinker, a by-product of lead oxide is produced. The Company's products during 2009 included Waelz oxide, zinc clinker and lead oxide.

During the start-up period, the Company experienced high direct operating costs as a result of low recovery rates and throughput. In December 2009, after reviewing its operating results and the requirements of the market, the Company decided to truncate its production process after the production of a double-washed Waelz oxide. By changing its finished product to a double-washed Waelz oxide from a zinc clinker, the Company have reduced the amount of energy used in the process, and therefore, the unit cost of production.

### Selected Quarterly Financial Information

	Gross Sales Revenue	Net Income (loss)	Net Income (loss) per share
<b>2010</b>			
Q3	\$ 4,753,062	\$ 244,892	\$ 0.002
Q2	2,109,494	(363,362)	(0.003)
Q1	4,345,210	(112,202)	(0.001)
<b>2009</b>			
Q4	2,104,903	273,603	0.002
Q3	1,589,329	908,670	0.008
Q2	837,001	(1,105,101)	(0.010)
Q1	-	(496,388)	(0.006)
<b>2008</b>			
Q4	-	(690,587)	(0.008)

### Revenues

	For the three months ended September 30,		For the nine months ended September 30,	
	2010	2009	2010	2009
<b>Revenue</b>				
Gross sales revenue	\$ 4,753,062	\$ 1,589,329	\$ 11,207,766	\$ 2,426,330
Treatment and transportation costs	(1,282,809)	(631,693)	(3,528,950)	(1,012,364)
<b>Net Revenue</b>	3,470,253	957,636	7,678,816	1,413,966

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Revenues are recognized when title transfers, the rights and obligations of ownership pass to the customer and the price is reasonably determinable. Under the Company's smelter contracts, this occurs when the zinc concentrate has been loaded onto a vessel.

Under smelter payment terms, the Company is paid for a percentage of the zinc metal content in either washed zinc oxide or zinc clinker, referred to as payable zinc. Payment for the payable zinc is then made in two components: a provisional payment and a settlement payment. A partial payment (typically 85%) is received on a provisional pricing basis once the product is either at the port or loaded on vessels, depending on the contract. Final settlement payment is determined based on zinc prices for a period (one to three months) after the month of shipment or receipt at its destination port, depending on the contract terms, and final assay results. Accordingly, a portion of the final revenue is not determinable until sometime after title has passed.

During the three months ended September 30, 2009 the Company's revenues were 1,589,329. The Company recognized its first revenue in June 2009 after shipping 979 tonnes of zinc clinker. As a result, during the nine months ended September 30, 2009, the Company recognized revenues of \$2,426,330.

During the three and nine month periods ended September 30, 2010 revenues of \$4,753,062 and \$11,207,766 were booked, respectively. The revenues for the 2009 periods are not comparable to 2010 revenues as during the first three quarters of 2009 the Company was in start-up phase.

The variance in quarterly revenues since start-up of operations in June 2009 was due to a number of factors:

#### *Inventory*

- 1,581 DMT inventory on hand at December 31, 2009 in respect of 2009 production was shipped in early January resulting in revenues of \$1,925,000 being included in the first quarter of 2010.
- Production in the first three quarters of 2010 was 7,896 DMT and sales were 7,840 DMT, excluding the 1,581 DMT sold out of inventory at the beginning of the year.
- For the first nine months of 2010, most production had been sold, so there was no significant quantity of inventory on hand as of September 30, 2010.

#### *Production*

- A 3 week planned shutdown took place in February 2010 to modify and perform maintenance on the kiln, including expanding the drying capacity to support the production of double washed zinc oxide.
- Until March 2010, most EAFD processed had been the EAFD that was stored on the property when acquired. In March, the Company began receiving its entire EAFD supply from the steel mills. Production was affected over several weeks as the new logistical requirements of direct receipts were arranged.
- In May 2010, the plant experienced a flood, which caused a two week shut down.
- During 2010, the Company experienced problems with the specified carbon content of coke and anthracite used in its production process, causing low recoveries and excessive shutdowns to remove accretions. This supply issue was addressed during the second quarter of 2010 and additional changes were introduced in the third quarter.
- The impact of these factors was that average monthly production was 713 DMT for the first half, well below expectations.
- The Company has been able to address many of the production issues and the benefits were realized in the third quarter, during which the Company has been producing approximately 1,205 DMT per month.

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### Price

- The price of zinc fluctuated significantly during the first three quarters of 2010. While quarterly averages were \$1.04 per pound in the first quarter, \$0.92 in second quarter and \$0.91 per pound in the third quarter, prices as low as \$0.72 per pound and as high as \$1.10 per pound were in effect.
- Shipments are priced on a provisional basis using the London Metal Exchange ("LME") zinc price on the shipment date. A final settlement is made several months later, based on a subsequent monthly average zinc price. The provisional payment is for the 85% of total invoice and a residual receivable is booked for the remaining 15%.
- Because of the lag between shipment date and final settlement pricing, the revenues that are recognized at the time of the shipment will subsequently be adjusted upward or downward, dependent on what has happened to zinc prices in the interim period.

### Treatment and Transportation Charges

The Company did not incur any treatment or transportation charges during the first quarter of 2009. Production and shipments started late in the second quarter of 2009; therefore, three and nine months ending September 30, 2009 treatment and transportation charges were \$631,693 and \$1,012,364 respectively while for the same periods ending September 30, 2010, the Company incurred treatment and transportation charges of \$1,282,809 and \$3,528,950, respectively.

During the nine months ended September 30, 2009, the Company introduced its product to a number of smelters for testing and negotiated treatment charges. During the second quarter of 2009 smelter demand globally was low and as a result the Company incurred unusually high smelter cost relative to its production.

Benchmark smelter treatment charges are determined annually, normally in February. Based on improved demand, during the first quarter of 2010, smelter production had increased and this resulted in significant reductions to benchmark treatment charges. Upon this development, the Company entered negotiations with smelters for shipments and treatment charges, with the result that treatment charges declined significantly for some of the March shipments and all shipments thereafter.

### Direct Operating Costs and Amortization

	For the three months ended September 30,		For the nine months ended September 30,	
	2010	2009	2010	2009
Direct operating costs	\$ 1,667,007	\$ 1,044,341	\$ 5,557,357	\$ 1,777,796
Amortization - Turkey	98,866	27,289	289,688	73,132

### Direct Operating Costs

The operating costs consist mainly of raw materials (primarily coke, anthracite and lime), labour, utilities (natural gas and electricity) and maintenance expenses. Direct operating costs were \$1,667,007 during the third quarter of 2010 and \$5,557,357 during the nine months ending September 30, 2010. The Company incurred operating costs of \$1,044,341 and \$1,777,796 during the three and nine months

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ended September 30, 2009 as it commenced operations in late May 2009 and there were no direct operating costs in the first quarter of 2009. The operating costs booked during the reporting periods in 2010 versus 2009 are not comparable as the nine month information for 2010 relates to nine months of expenses while the 2009 information relates to the period after the commencement of operations in May 2009.

A major component of direct operating costs during the first three quarters of 2010 was maintenance costs. Numerous modifications and maintenance projects were undertaken to improve throughput and operating performance of the plant. In addition to costs that were capitalized, approximately \$540,000 maintenance costs were expensed in the first three quarters of 2010. This level of maintenance expenses is not considered to be recurring.

#### *Amortization Expense*

Amortization of the assets at the operating facility in Iskenderun, Turkey is recorded as a direct operating cost and amounted to \$98,866 for the third quarter of 2010, and \$27,289 for the same period of 2009. For the nine months ending September 2010, \$289,688 was booked as amortization expense while during the nine months ending September 2009 the amortization amount was \$73,132, as no amortization was booked during the first quarter of 2009. The amortization booked during the reporting periods in 2010 versus 2009 are not comparable as the nine month information for 2010 relates to nine months of expenses while the 2009 information relates to the period after the commencement of operations in May 2009.

#### **Expenses**

	For the three months ended		For the nine months ended	
	September 30,		September 30,	
	2010	2009	2010	2009
<b>Expenses</b>				
General and administration - Turkey	\$ 215,481	\$ -	\$ 814,830	\$ -
General and administration - Canada	341,616	388,844	681,366	705,926
Interest and financing	44,777	35,848	88,672	125,418
Amortization - Canada	4,916	1,118	8,674	6,045
Investment and other (gain) loss	(3,475)	8,874	(206,748)	4,829
Foreign exchange loss	7,149	127,247	154,913	249,922
Stock option expense	267,253	9,860	293,813	183,791
Accretion of liabilities	101,252	133,374	226,326	165,466
Pre-operating costs	-	-	-	542,289
Gain on dilution (note 6)	-	(1,503,776)	(83,748)	(1,503,776)
	\$ 978,969	(798,611)	\$ 1,978,098	\$ 479,910

#### *General and Administration (Turkey and Canada)*

General and administration expenses include general office and management expenses in Turkey and Canada, the costs of maintaining a public listing at TSX-V, professional fees, legal, accounting and consultants' costs, and other miscellaneous office expenses. For the three and nine months ended September 30, 2010, such costs were \$978,969 and \$1,978,098 respectively (2009 - \$(798,611) and \$479,910).

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The Company incurred office and general expenses, as well as consulting fees associated with the local Turkish operations during the first three quarters of 2010, and none during the first quarter of 2009. The expenses during the reporting periods in 2010 versus 2009 are not comparable as the nine month information for 2010 relates to nine months of expenses while the 2009 information relates to the period after the commencement of operations in May 2009.

#### *Interest and Financing*

Interest and financing costs for the three and nine months ending September 30, 2010 are comparable to the same periods in 2009, mainly due to the reduction in bank debt during the first quarter of 2010 from \$1,130,800 to \$494,118 as of September 30, 2010, offset by interest expense on the loan from Cooper Island and convertible debenture. In 2009, the Company also incurred interest expense to Cooper Island on its initial investment, which expense did not recur in 2010.

#### *Investment and Other (Gain) Loss*

During the second quarter of 2010 approximately \$200,000 of insurance proceeds were received as compensation for flood damage that Turkish operations suffered. This amount was booked as Other Gain in the income statement.

#### *Foreign Exchange Loss*

Foreign exchange loss is booked to reflect fluctuations in foreign exchange rates between US dollar, Turkish Lira and Canadian dollar. While revenues are received in US dollars and part of the cost of sales are in US dollars, there is a significant Turkish Lira and Canadian dollar exposure due to operations and assumed liabilities in Turkey and corporate transactions being carried out in Canada. The Company is therefore subject to gains and losses due to fluctuations in the US dollar against the two other currencies. The Turkish Lira exchange rates in 2010 are summarized as follows:

<b>Turkish Lira per US \$</b>	<b>Quarter Average</b>	<b>Quarter End</b>
2010 Q1	1.51	1.52
2010 Q2	1.54	1.58
2010 Q3	1.51	1.45

#### *Stock Option Expense*

During the three and nine months ending September 30, 2010, the Company booked \$267,253 and \$293,813 stock option expense, respectively (2009 - \$9,860 and 183,791 respectively). While the nine month period figures were mostly comparable, there were no new stock options issued during the third quarter of 2009. Stock option expense is allocated based on the vesting provisions of the options, where 100% of the expense is recognized for options that vest immediately, and a portion of the expense is recognized each period for options that vest over time.

#### *Accretion of Liabilities*

Accretion of liabilities of \$101,252 and \$226,326 booked during the three and nine months ending September 30, 2010 mainly represent the current year portion of the discount applied to the future obligations which were incurred on acquisition of the Waelz kiln assets. During the third quarter of 2010 a \$44,217 accretion expense was booked in relation to the convertible debenture (see below - Convertible debenture).

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### *Pre-operating Costs*

Pre-operating costs of \$542,289 for the nine months ending September 30, 2009 include legal and due diligence costs required to complete the acquisition plus the initial labour and materials expenses associated with cleaning and repairing the existing plan through to the start up of operations and were incurred in the acquisition and re-commissioning of the Waelz kiln assets. There were no such costs in 2010.

### *Gain on Dilution*

During the first quarter of 2010, the Company drew down its final tranche of \$500,000 on the Cooper Island financing. This transaction was accounted for as a sale of a portion of its interest in a subsidiary to a third party. As a result of the disposition, the Company has recognized a gain of \$83,748 on dilution of its interest in the subsidiary. During the third quarter of 2009, the Company sold a portion of its interest in a subsidiary to Cooper Island. As a result of the disposition, the Company recognized a gain on dilution of its interest in the subsidiary of \$1,503,776.

## **Liquidity and Financial Position**

### *Working Capital*

The working capital of the Company was in a deficit of \$701,206 at September 30, 2010 compared to a deficit of \$2,037,876 at December 31, 2009. The various components of working capital are discussed hereafter.

### *Accounts receivable*

Accounts receivable comprise primarily tax and smelter receivables. At September 30, 2010, an amount of \$1,100,410 was accrued as a receivable of Value Added Taxes ("VAT") in Turkey. VAT is payable at a rate of 18% of most input costs and is subsequently recoverable by the Company after product has been exported. Smelter receivables of \$1,039,674 represent receivable for one shipment that was loaded at the end of September 2010, and residual payments to be received once final pricing is determined on shipments. The balance of receivables is made up of related party receivables, HST and advances.

### *Inventories*

Inventories were reduced from \$1,521,980 at December 31, 2009 to \$509,387 at September 30, 2010. The 2009 year-end inventory was unusually high, as a number of shipments were delayed until the first week of January.

### *Accounts payable and accrued liabilities*

The main components of the accounts payable and accrued liabilities relate to \$1,976,668 operating trade accounts. \$311,060 of accrued liabilities comprise accruals related to personnel social security and tax liabilities, which are held as an offset to the VAT receivables. The purchase price for the Turkish assets included the assumption of certain liabilities owing by the previous owners. The remaining balance of such liabilities at September 30, 2010 was approximately \$247,140 and will be paid out over the next six months.

### *Loan payable*

The loan payable of \$87,658 as of September 30, 2010 was from one of the Company's directors. It was securitized by the residual receivables from sales of zinc concentrate to smelters. On October 8,

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2010, the loan and accrued interest was paid off completely. This loan was the balance of the \$932,000 loan that had originally been advanced by Cooper Island on January 17, 2010 to assist the Company with its working capital needs. On June 18, 2010, the then balance on the loan of \$417,565 was assumed by one of the Company's directors.

### *Bank loan*

Pursuant to the acquisition of its Turkish Operations the Company assumed a term loan from a financial institution in Turkey in the amount of \$1,130,800. The term loan had an interest rate of 10% and matured on February 17, 2010. The term loan called for interest payments every calendar quarter with the principal due at maturity. On April 5, 2010 the Company repaid \$430,800 and extended the remaining \$700,000 for 18 months, payable in equal monthly instalments and bearing interest at 12%. The loan is secured by land, building and equipment of the Turkish Operations. The outstanding balance at September 30, 2010 is \$494,118.

### *Convertible debenture*

On July 23, 2010, the Company closed a 13.2% convertible debenture financing for \$483,700 (C\$ 500,000), C\$ 250,000 of which was placed with one of the Company's directors. The debentures are convertible into common shares of the Company at a price of \$0.10 (C\$) per share any time prior to their maturity of June 30, 2011. In connection with this financing, the Company also issued 5,000,000 warrants to acquire common shares at \$0.10 (C\$) per share at any time prior to June 30, 2011. The convertible debenture was recorded with liability and equity components. The liability component was recorded as debt at its net present fair value of \$334,994 (C \$345,245), including a \$44,217 (C \$45,500) accretion expense booked during the quarter ending September 30, 2010. The equity component consisted of a value conversion component (valued at C \$18,255) and a share issue cost of \$176,868 (C \$ 182,000) representing the valuation of 5,000,000 warrants at C \$0.036 per unit.

### *Current portion of long term liabilities*

The current portion of long term liabilities is the amount due within 12 months to the vendors of the Turkish plant as part of their fixed payment amount. At September 30, 2010, the gross payable amount remaining under this fixed payment arrangement was \$448,000. In connection with its acquisition, the Company had the right to discontinue payments on the loan payable and contingent consideration if the vendors had not resolved certain retained liabilities. As these liabilities were still unresolved, the Company discontinued further payments in April 2010, pending resolution of these retained liabilities. The amount recorded on the balance sheet is the present value of the liability at a discount rate of 12%.

### *Long-term liabilities*

Long-term liabilities consist of the contingent consideration payable to the vendors. The contingent consideration is based on earnings, after the Company has recovered its investment in the Turkish assets plus a return thereon. The Company does not expect to make any payments of contingent consideration during 2010, therefore, this liability should have no impact on the Company's liquidity during this period.

### *Capital resources*

The Company has various capital expenditure projects underway and planned, which will eliminate bottlenecks, improve throughput and plant performance. Additionally, the Company is seeking to build a second kiln, as the market demand exists for such additional capacity. The execution of all such plans will require financing in addition to cash flows generated from operations.

# Silvermet Inc.

## Management's Discussion and Analysis

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### **Capital management**

When managing capital, the Company's objective is to ensure the entity continues as a going concern as well as to achieve optimal returns to shareholders and benefits for other stakeholders. Management adjusts the capital structure as necessary in order to support its business strategy. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management team to sustain the future development of the business. The Company considers its capital to be shareholder's equity (managed capital), which at September 30, 2010 totaled \$2,756,287 (December 31, 2009 - \$1,883,910).

The Company's policy is to invest all capital not required for its immediate needs in short-term, liquid and highly rated financial instruments, such as cash and other short-term guaranteed deposits, all held with major Canadian financial institutions.

At September 30, 2010, the Company is operating, and has achieved positive operating cash flow. In order to carry out the continuing enhancement of the Waelz kiln and pay for administrative costs, the Company will use cash flows from operations and raise additional amounts as needed. The Company will continue to assess new projects and seek to acquire an interest in additional projects if it believes there is economic potential and if it has adequate financial resources to do so.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is appropriate. There were no changes in the Company's approach to capital management during the three and nine months ended September 30, 2010. The Company is not subject to externally imposed capital requirements.

### **Financial risk factors**

The Company's activities expose it to a variety of financial risks: credit risk, liquidity risk and market risk (including interest rate, foreign exchange rate, and commodity and equity price risk).

#### ***Credit risk***

Credit risk is the risk of loss associated with a counter-party's inability to fulfill its payment obligations. The Company's credit risk is primarily attributable to accounts receivable. Accounts receivable include expenses paid on behalf of related companies and sales tax receivables from the Turkish and Canadian governments. Trade receivables comprise amounts outstanding on shipments that have been made. As provisional payments have already been received against such shipments, management does not believe the credit risk associated with such receivables to be significant.

#### ***Liquidity risk***

Liquidity risk is the risk that the Company will not have sufficient cash resources to meet its financial obligations as they come due. The Company has re-commissioned a plant that it acquired in Turkey, which process required expenditures for capital expenditures, repairs and the production of finished goods before revenues were received. First revenues were received in June. The Company expects future equity financings and future cash flows from production at its Waelz kiln will support the current working capital deficit and payments of future operating costs.

#### ***Market risk***

##### **(a) Interest rate risk**

The Company has cash balances and interest-bearing debt. The Company's cash balances are being held for relatively short-term use in operations and are therefore held in non-interest bearing current

# Silvermet Inc.

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(All amounts in United States Dollars, unless otherwise stated)

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accounts with major financial institutions. Interest-bearing debts have fixed interest rates and the Company is therefore not subject to fluctuations in market rates on its debt.

### (b) Foreign currency risk

Currency risk is the risk that the fair value of, or future cash flows from, the Company's financial instruments will fluctuate because of changes in foreign exchange rates. The Company's functional currency is the US dollar. Revenues are received in US dollars and significant purchases are transacted in US dollars. Additionally, a part of operating costs are incurred in Turkish lira and some of the assumed liabilities on the acquisition of the Turkish operations are denominated in Turkish lira. The Company is therefore subject to gains and losses due to fluctuations in the US dollar against the Turkish Lira. Sensitivity to a plus or minus 5% change in the Turkish Lira against the US dollar with all other variables held constant as at September 30, 2010 would have an impact of approximately \$45,000.

### (c) Price risk

The Company is exposed to price risk with respect to commodity prices. Commodity price risk is defined as the potential adverse impact on earnings and economic value due to commodity price movements and volatilities. The Company closely monitors commodity prices, particularly as they relate to zinc, to determine the appropriate course of action to be taken by the Company. To date, the Company has opted not to enter into any hedging or other price risk strategies.

## Related Party Transactions

(a) During the nine months ended September 30, 2010 the Company received reimbursement for rent and other expenses from companies with a director, or directors, in common to Silvermet, as well as reimbursing such other companies for certain expenses incurred on behalf of Silvermet. These transactions were conducted in the normal course of business on terms that approximate market value and measured at the exchange amounts. The Company charged a total of \$28,875 and \$85,231 to the related companies concerning these expenses for the three and nine months ended September 30, 2010 respectively (for the three and nine months ended September 30, 2009 - \$28,615 and \$33,877 respectively). Included in receivables is \$22,030 (\$54,139 at December 31, 2009) related to these amounts which are due on demand.

(b) During the three and nine months ended September 30, 2010 the Company accrued or paid \$114,337 and \$355,142 to related parties or companies controlled by related parties for management services provided to the Company (2009 - \$71,556 and \$195,966). There were no amounts payable or accrued at September 30, 2010 or 2009 related to these amounts. These transactions were in the normal course of operations and recorded at exchange value.

(c) On June 18, 2010, a director of the Company assumed the remaining balance of \$417,565 on the Cooper Island loan (see Note 6) and extended its maturity. On July 23, 2010 this same director participated in C \$250,000 of the C \$500,000 convertible debenture financing.

## Off Balance Sheet Transactions

As of the date of this filing, the Company does not have any off balance sheet arrangements that have, or are reasonably likely to have, a current or future effect on the results of operations or financial condition of the Company, including, and without limitation, such considerations as liquidity and capital resources.

# Silvermet Inc.

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### Financial Instruments

(a) Until its sale on April 16, 2010, the Company held an investment in Logan Resources Ltd. ("Logan"), which trades on the TSX Venture Exchange. The investment had been classified as a held-for-trading instrument. The Company recorded a gain of \$5,017 on its sale.

(b) In connection with its MuskoX exploration work, the Company held an Inuit Owned Lands ("IOL") license, issued by the Kitikmeot Inuit Association ("KIA"). The Company provided a letter of credit for \$50,000 (C\$) to KIA. The KIA may draw upon the letter of credit if certain environmental conditions of the license are breached. The letter of credit has not been drawn upon and no conditions of the license have been breached. The company expects to close out the letter of credit over the next twelve months. The \$46,965 (C\$ 50,000) has been placed on deposit with the financial institution that issued the letter of credit and is recorded as an investment at September 30, 2010.

### Accounting Policies and Critical Accounting Estimates

The Company prepares its consolidated financial statements in conformity with generally accepted accounting principles in Canada. The preparation of the Company's consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. The Company lists its significant accounting policies in Note 2 of its audited consolidated financial statements for the year ended December 31, 2009.

### Changes in Accounting Policies

There have been no changes in accounting policies since December 31, 2009.

### New Accounting Standards Not Yet Adopted

#### Plans for Transition to International Financial Reporting Standards (IFRS)

The Accounting Standards Board confirmed in February 2008 that International Financial Reporting Standards (IFRS) will replace current Canadian GAAP for financial periods beginning on and after January 1, 2011. IFRS is based on a conceptual framework similar to Canadian GAAP, but there are significant differences in recognition, measurement and disclosure.

While the adoption of IFRS will not change the actual cash flows we spend, it will result in changes to our reported financial position and results of operations — which could have material effects.

The Company has commenced the development of an IFRS implementation plan to prepare for this transition, and is currently in the process of analyzing the key areas where changes to current accounting policies may be required. While an analysis will be required for all current accounting policies, the initial key areas of assessment will include:

- Exploration and development expenditures,
- Capital assets (measurement and valuation),
- Provisions, including asset retirement obligations,
- Stock-based compensation,
- Accounting for income taxes, and
- First-time adoption of International Financial Reporting Standards (IFRS 1).

# Silvermet Inc.

## Management's Discussion and Analysis

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As the analysis of each of the key areas progress, other elements of the Company's IFRS implementation plan will also be addressed, including: the implication of changes to the accounting policies and processes; financial statement note disclosures on information technology; internal controls; contractual arrangements; and employee training.

The table below summarizes the expected timing of activities related to the Company's transition to IFRS.

Initial analysis of key areas for which changes to accounting policies may be required.	Completed
Detailed analysis of all relevant IFRS requirements and identification of areas requiring accounting policy changes or those with accounting policy alternatives.	Q4 2010
Assessment of first-time adoption (IFRS 1) requirements and alternatives.	Q4 2010
Final determination of changes to accounting policies and choices to be made with respect to first-time adoption alternatives.	Q4 2010
Resolution of the accounting policy change implications on information technology, internal controls and contractual arrangements.	Q4 2010
Management and employee education and training.	Throughout the transition process
Quantification of the Financial Statement impact of changes in accounting policies.	Throughout 2010

### **Business Combinations, Consolidated Financial Statements and Non-Controlling Interests**

The CICA issued three new accounting standards in January 2009: Section 1582, "Business Combinations", Section 1601, "Consolidated Financial Statements" and Section 1602, "Non- Controlling Interests". These new standards will be effective for fiscal years beginning on or after January 1, 2011. Section 1582 replaces section 1581 and establishes standards for the accounting for a business combination. It provides the Canadian equivalent to IFRS 3 – Business Combinations. Sections 1601 and 1602 together replace section 1600, Consolidated Financial Statements. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of IFRS IAS 27 - Consolidated and Separate Financial Statements. The Company is in the process of evaluating the requirements of the new standards.

### **Risks and Uncertainties**

*Equipment failures:* The Company's equipment is complex and has many components. Equipment failures can occur due the failure of individual components, such as electric motors, causing a temporary halt in operations while repairs are made. Equipment downtime may also be experienced due to over-heating of the kiln, requiring a period of cooling for a few days before re-start. Catastrophic

# Silvermet Inc.

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failures would include failures of the kiln shell, the failure of the kiln's brick lining or the failure in the primary drive gears. Catastrophic failures would result in an extended period of shut down while repairs are made, including the lead time required to order and receive replacement equipment.

*Energy costs:* The major cost components to the Company's process relate to energy – coke, coal, natural gas, diesel fuel and electricity. The costs of natural gas and electricity are out of the Company's control, being largely regulated in Turkey. In the case of coke and coal, costs are driven by global events that impact these commodities and transportation costs. Significant changes to such costs could impact the ability of the Company to operate profitably. The lack of supply of these energy inputs to the Company's plant would result in cessation of operations until such supplies resumed.

*Uncertainty due to foreign legal and political factors:* Risks may include political unrest, corruption, civil disturbances and terrorist actions, arbitrary changes in law or policies, changes to government regulation, foreign taxation, price and currency controls, delays in obtaining, or the inability to obtain necessary governmental permits, limitations on foreign ownership, limitations on the repatriation of earnings and increased financing costs.

*Environmental regulations:* The Company's business is subject to a variety of environmental regulations. Failure to properly process and handle EAFD in accordance with such regulations could expose the Company to liabilities and/or result in a withdrawal of operating permits. The Company has procedures in place to help ensure compliance with environmental regulations. However, new laws and regulations could be passed at any time that could materially affect the Company's operations.

*Raw material supply:* The Company requires a steady supply of EAFD in order to continue operating at an optimum level and to maintain profitable output levels. The Company relies on the continuing operations of the local steel mills at reasonable levels in order to meet its EAFD requirements. The closing of one or more local steel mills would have an adverse impact on the available supply.

*Additional funding:* The Company anticipates the need for additional funding to support capital expenditures to improve the acquired Waelz kiln facility and to support planned expansions at this and other sites in Turkey. Failure to obtain such additional funding at critical times could lead to delay or indefinite postponement of such projects. There is no assurance that such funding will be available or that it will be obtained on favourable terms.

*Dependence on Key Personnel:* The development of the Company's business is and will continue to be dependent on its ability to attract and retain highly qualified management personnel. The Company faces competition for personnel from other employers.

*Price volatility:* Prices of commodities can fluctuate widely and are affected by numerous factors including demand, inflation, strength of various currencies, interest rates, forward sales by producers, global or regional political or financial events, and production and cost levels in major producing regions. In addition, commodities prices are sometimes subject to rapid short-term changes because of speculative activities. The success of the Company's Waelz kiln operations is dependent on market prices for zinc and the related treatment charges from smelters.

*Currency risk:* The Company's activities are primarily carried on in Turkey. All revenues and many of the key items of cost are U.S. dollars based. Additionally, certain costs are incurred in Turkish Lira. Such activities are subject to risks associated with fluctuations in the rate of exchange of these foreign currencies.

# Silvermet Inc.

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*Critical Accounting Estimates:* Critical accounting estimates used in the preparation of the financial statements include the Company's estimate of the value of stock-based compensation. These estimates involve considerable judgment and are, or could be, affected by significant factors that are out of the Company's control. The factors affecting stock-based compensation include estimates of when stock options might be exercised and the stock price volatility. The timing for exercise of options is out of the Company's control and will depend, among other things, upon a variety of factors including the market value of Company's shares and financial objectives of the holders of the options. The Company has used historical data to determine volatility in accordance with Black-Scholes modeling, however the future volatility is inherently uncertain and the model has its limitations. While these estimates can have a material impact on the stock-based compensation and hence results of operations, there is no impact on the Company's financial condition.

### Outstanding Share Data

As at November 25, 2010 the outstanding common shares, share purchase warrants and stock options are:

Common shares outstanding	156,130,216
Share purchase warrants	7,900,000
Options	<u>8,950,000</u>
Fully diluted shares outstanding	<u>172,980,216</u>

### Management's Responsibility for Financial Information

The Company's financial statements are the responsibility of the Company's management, and have been approved by the board of directors. The consolidated financial statements were prepared by the Company's management in accordance with Canadian generally accepted accounting principles. The consolidated financial statements include certain amounts based on the use of estimates and assumptions. Management has established these amounts in a reasonable manner, in order to ensure that the financial statements are presented fairly in all material respects.

### Disclosure of Internal Controls

Management has established processes to provide them sufficient knowledge to support representations that they have exercised reasonable diligence that (i) the unaudited interim consolidated financial statements do not contain any untrue statement of material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it is made, as of the date of and for the periods presented by the unaudited interim consolidated financial statements, and (ii) the unaudited interim consolidated financial statements fairly present in all material respects the financial condition, results of operations and cash flows of the Company, as of the date of and for the periods presented.

In contrast to the certificate required under Multilateral Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings (MI 52-109), the Company utilizes the Venture Issuer Basic Certificate, which does not include representations relating to the establishment and maintenance of disclosure controls and procedures (DC&P) and internal control over financial reporting (ICFR), as defined in MI 52-109. In particular, the certifying officers filing the certificate are not making any representations relating to the establishment and maintenance of:

(i) controls and other procedures designed to provide reasonable assurance that information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted under

# Silvermet Inc.

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securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation; and

(ii) a process to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP. The Company's certifying officers are responsible for ensuring that processes are in place to provide them with sufficient knowledge to support the representations they are making in this certificate.

Investors should be aware that inherent limitations on the ability of certifying officers of a venture issuer to design and implement on a cost effective basis DC&P and ICFR as defined in MI 52-109 may result in additional risks to the quality, reliability, transparency and timeliness of interim and annual filings and other reports provided under securities legislation.

### Outlook

The joint venture with Befesa is the most exciting development in the year. Befesa have expertise in operating and building Waelz kiln plants throughout Europe. With the introduction of their expertise to our Turkish operations, we expect to achieve training of our personnel and improvements to our operating facilities at a rate much faster than we could achieve without such depth of experience. The joint venture also begins with a cash balance of \$6 million, to be used as needed for capital improvements to the existing facility or to progress with a new kiln. We expect the joint venture with Befesa will enable us to achieve our goals of expanding operations in Turkey sooner than we otherwise could.

### Additional Information

Additional information can be accessed at the Company's website [www.silvermet.ca](http://www.silvermet.ca) or through the Company's public filings at [www.sedar.com](http://www.sedar.com).

Silvermet Inc.

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*"Stephen G. Roman"*

Stephen G. Roman  
Chairman & Chief Executive Officer

*"Ian D. Atacan"*

Ian D. Atacan  
Chief Financial Officer

November 25, 2010