

# **SILVERMET INC.**

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

**FOR THE THREE MONTHS ENDED  
MARCH 31, 2011**

**Dated June 27, 2011**

# Silvermet Inc.

## Management's Discussion and Analysis For the three months ended March 31, 2011

(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 months ended March 31, 2011. 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 months ended March 31, 2011, which were prepared in accordance with International Financial Reporting Standards ("IFRS"). All amounts referred to in this MD&A are in United States dollars unless otherwise specified. Information contained herein is presented as at June 27, 2011, 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; 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; 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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### Adoption of International Financial Reporting Standards

The Company has prepared its first quarter 2011 consolidated financial statements and other financial information according to IFRS, and restated its 2010 comparative financial statements and other financial information following its IFRS accounting policies. See Adoption of International Financial Reporting Standards section for more information.

### Overview

All amounts are stated in US dollars unless otherwise noted.

In 2009, the Company successfully transitioned from an exploration and development company to an operating company. The Company's Waelz kiln operation in Turkey recovers zinc from zinc-bearing electric arc furnace dust ("EAFD") that is produced as a waste product by local steel mills.

In October 2008, the Company entered into an agreement to acquire the land and equipment of an existing Waelz kiln located in Iskenderun, Turkey. This facility had not been operational since September 2008. The acquisition closed on February 16, 2009 at a purchase price of approximately \$7.7 million. The purchase price was paid by cash of \$727,710, the assumption of certain liabilities and bank debts of the vendor of \$3,669,006, a fixed payment to the vendor over two years of \$960,000, and a contingent payment to the vendor of up to \$2,348,372 over the next five years, dependent on the performance of the operations.

Financing of the Waelz kiln 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 Company's Turkish Waelz kiln business (the "Turkish Operations").

On October 27, 2010, Silvermet and an affiliate of Befesa Medio Ambiente, S.A. ("Befesa"), a Spanish company that operates a number of Waelz kilns throughout Europe, established a new joint venture known as Befesa Silvermet Turkey, S.L. ("BST") 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 BST. Befesa advanced \$4,000,000 to the Company to fund the acquisition of Cooper Island's 41.5% interest and Befesa invested the balance of the \$10 million directly into BST. The Turkish Operations were transferred to BST, which included 100% of the shares of the Turkish operating company and the assumption of certain related liabilities.

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

Upon entering the BST joint venture, the Company adopted the proportionate consolidation method for accounting for its interest in the Turkish Operations, under which the Company includes in its accounts the Company's proportionate share of assets, liabilities, revenues and expenses of the BST joint venture. The Turkish Operations had been consolidated in the Company's accounts at 100% until this time and the Company's operating results therefore include the Turkish operations at 100% for the first 10 months of 2010 and at 49% since November 2010. The balance sheets at March 31, 2011 and December 31, 2010 reflect the impact of proportionate consolidation in which each asset and liability of the Turkish Operations is included on a 49% basis.

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### Highlights

The highlights of the Company's 2011 first quarter results include the following (operational figures expressed at 100%):

- Operations were cash flow positive and profitable in Q1 2011.
- Production in Q1 2011 versus Q1 2010 increased by 43% to 3,144 DMT (Dry Metric Tonnes zinc concentrate containing 68% zinc on average) from 2,195 DMT in 2010 despite a 15 day planned shutdown in March for maintenance.
- Sales volumes increased to 3,626 DMT in Q1 2011 from 3,434 DMT in Q1 2010. (Q1 2010 sales included 1,581 DMT that had been shipped to port in Q3 2009 but were not accounted for as sales until Q1 2010.)
- Revenues increased by 14% to \$5.0 million (at 100%) in Q1 2011 (Silvermet's share - \$2.4 million) from \$4.3 million in Q1 2010.
- Increased production from 731 DMT per month of zinc concentrate in Q1 2010 to an average 1,048 DMT per month in Q1 2011.
- Started refractory lining change project with planned four week shutdown commencing mid-March 2011.
- Repaid the C \$500,000 convertible debenture financing in February 2011.

The following table summarizes comparative quarterly results and reconciles net earnings, a GAAP measure, to EBITDA. The 2010 figures reflect operational results at 100% and 2011 figures reflect operational results at a proportionally consolidated level of 49%.

	For the three months ended March 31,		
	2011 100%	2011 proportional	2010 100%
Gross sales revenues	\$ 4,963,404	\$ 2,432,068	\$ 4,345,210
Direct operating costs	2,311,754	1,084,387	2,512,673
Treatment & transportation	1,366,470	669,570	1,522,362
General and administration	137,671	137,671	212,303
<b>EBITDA<sup>(1)</sup></b>	<b>\$ 1,147,508</b>	<b>\$ 540,440</b>	<b>\$ 97,872</b>
Interest and financing		174,118	81,469
Amortization - Turkey		65,063	110,287
Amortization - Canada		991	2,370
Investment & other gain		(72,081)	(3,241)
Foreign exchange loss		11,859	50,982
Stock option expense		27,357	14,687
Income tax		120,772	-
Future income tax recovery		(31,340)	-
Non-controlling interest in net income of consolidated affiliates		-	92,054
<b>Net income (loss) available to common shareholders</b>		<b>\$ 243,701</b>	<b>\$ (250,736)</b>

- (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

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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.

### Selected Quarterly Financial Information

	Gross Sales Revenue		Net Income (loss)		Net Income (loss) per share
<b>2011</b>					
IFRS - Q1 <sup>(1)</sup>	\$	2,432,068	\$	243,701	\$ 0.002
<b>2010</b>					
IFRS - Q4 <sup>(2)</sup>		3,068,906		1,294,710	0.009
IFRS - Q3		4,753,062		200,675	0.002
IFRS - Q2		2,109,494		(363,362)	(0.003)
IFRS - Q1		4,345,210		(158,682)	(0.002)
<b>2009</b>					
CGAAP - Q4		2,104,903		273,603	0.002
CGAAP - Q3		1,589,329		908,670	0.008
CGAAP - Q2		837,001		(1,105,101)	(0.010)

(1) 2011 Q1 figures reflect Silvermet's 49% proportional interest as a result of the joint venture with Befesa.

(2) 2010 Q4 figures reflect October values at 100% and November, December values at 49% proportional interest as a result of the joint venture with Befesa.

The quarterly results of the Company have not been comparable as the Company began operations in Q2 2009 and only stabilized operations beginning in Q3 2010. Also, Q4 2010 and Q1 2011 are represented on a proportionate consolidation basis. The various trends impacting operations are discussed in greater detail hereafter. However, major items affecting quarterly comparisons can be highlighted as follows:

- Prior to Q2 2009, there were no revenues as operations of the Waelz kiln had not started.
- Q2 2009 results included significant start-up costs.
- Q3 2009 continued to experience operating problems as we became more familiar with the kiln, but these results were offset by the gain on dilution resulting from the sale of an equity position to Cooper Island.
- Although operations improved somewhat in Q4 2009, production was paid for on a provisional basis by a trader but sales were delayed until January 2010, thus increasing Q1 2010 sales.
- Q1 2010 results were negatively affected by a major maintenance shut down during the month of February.
- Q2 2010 results were negatively affected by a combination of reduced zinc prices, maintenance shutdowns and a flood.
- Operations began to stabilize in Q3 2010.
- Operations continued to show significant improvements in Q4 2010. However, the effect on revenues and net income is offset to some degree as a result of the conversion to proportionate consolidation upon the formation of the BST joint venture on October 27, 2010. Additionally, the Company recorded a significant gain on dilution of \$1.6 million on entering the BST joint venture.
- Q1 2011 was the first full quarter with operations proportionally consolidated at 49%.

### Operations

#### **Production**

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

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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; volatized gases are created that contain most of the zinc from the EAFD. The gases are cooled and Waelz oxide is produced. The Waelz oxide is further processed by washing it with soda ash to produce washed Waelz oxide. Prior to December 2009, the Waelz oxide was processed through a second kiln into a zinc clinker. When the Waelz oxide is processed into a zinc clinker, a by-product of lead oxide is produced. The Company's products during 2009 therefore included washed Waelz oxide, zinc clinker and lead oxide. Since mid-December 2009, the Company's production has been exclusively washed Waelz oxide.

### Gross Sales Revenue

	For the three months ended March 31,		
	2011	2011	2010
	100%	proportional	100%
Gross sales revenue	\$ 4,963,404	\$ 2,432,068	\$ 4,345,210

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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 Waelz 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.

Revenues increased by 14% to \$5.0 million (at 100%) in Q1 2011 (Silvermet's share - \$2.4 million) from \$4.3 million in Q1 2010 as a result of the combination of several factors:

#### Inventory

- 1,581 DMT inventory on hand at December 31, 2009 in respect of 2009 production was shipped in Q1 2010 resulting in revenues of \$1.9 million being included in the first quarter of 2010.
- Inventory on hand as of December 31, 2010 was 548 DMT, largely composed of a shipment that took place in the first few days of January 2011.

#### Production

- A three 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 washed Waelz zinc oxide.

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- Until March 2010, most EAFD processed had been the EAFD that was stored on the property when acquired. In March 2010, 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 organized.
- During the first quarter of 2011, a planned shut-down of four weeks commenced in mid-March to replace the refractory lining of the kiln.

### Price

- During the first quarter of 2011, the average price of zinc was \$1.09 per pound (2010 - \$1.04 per pound).
- 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.
- 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 Costs

	For the three months ended March 31,		
	2011	2011	2010
	100%	proportional	100%
Treatment & transportation	\$ 1,366,470	\$ 669,570	\$ 1,522,362

Benchmark smelter treatment charges are determined annually, normally in February. Based on improved demand for zinc, since the second half of 2009, smelter production increased and significant reductions to benchmark treatment charges were established. At the beginning of 2010, the Company entered negotiations with smelters for shipments and treatment charges, with the result that treatment charges declined significantly for some of the March 2010 shipments and all shipments thereafter.

Further declines in treatment charges have been realized in 2011 and will benefit results in Q2 2011 onward.

### Cost of Sales

	For the three months ended March 31,		
	2011	2011	2010
	100%	proportional	100%
Direct operating costs	\$ 2,311,754	\$ 1,084,387	\$ 2,512,673
Amortization - Turkey	132,781	65,063	110,287
	\$ 2,444,536	\$ 1,149,450	\$ 2,622,960

### Direct Operating Costs

The operating costs consist of raw materials (primarily coke, anthracite and lime), labour, utilities (natural gas and electricity), maintenance expenses and plant overhead costs. Direct operating costs in Q1 2011 were 8% lower than the same period in 2010. This is a significant reduction of costs on a per

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unit basis, as the production in Q1 2011 increased by 43% versus the same period last year. The production in Q1 2010 was negatively affected by a major maintenance shut down.

### *Amortization Expense*

Amortization of the assets at the operating facility in Iskenderun, Turkey is recorded as a direct operating cost.

### **Expenses**

	For the three months ended March 31,	
	2011	2010
General and administration	177,878	280,342
Interest and financing	174,118	81,469
Investment and other income	(72,081)	(3,241)
	279,915	358,570

### *General and Administration*

General and administration expenses include corporate costs, foreign exchange loss or gain, and stock option expense.

*Corporate Costs* include general office and management expenses, the costs of maintaining a public listing at TSX-V, professional fees, legal, accounting, tax and consultants' costs, insurance, travel and other miscellaneous office expenses. During the first quarter of 2010 such costs also included amounts paid to the Turkish managing director for services, various consultants' costs and bookkeeping. As a result of cost containment measures taken, during the first quarter of 2011 management fees were lowered; there were no consultant's fees; outsourced bookkeeping was internalized and there was no expatriate management.

*Foreign Exchange Gains and Losses* are incurred due to fluctuations in foreign exchange rates between the US dollar, Turkish Lira and Canadian dollar. While revenues are received in US dollars, there is a significant Turkish Lira exposure since most Turkish operating costs are incurred in Turkish Lira. Additionally, there is Canadian dollar exposure due to corporate transactions and related corporate overhead costs in Canada. The Company is therefore subject to gains and losses due to fluctuations in the US dollar against the two other currencies.

*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. Stock option expense is recorded based on fair value calculations determined using the Black-Scholes valuation method. During the first quarter of 2011 the Company booked \$27,357 stock option expense compared to \$14,687 in the first quarter of 2010. The difference largely reflects the impact of the stock options granted during the third quarter of 2010.

### *Interest and Financing*

During the first quarter of 2011 accretion of liabilities of \$135,715 were booked, of which \$109,255 was in relation to the convertible debenture (see below - Convertible debenture) and the remaining \$26,460 was the accretion of the discount applied to the future obligations which were incurred on acquisition of the Waelz kiln assets. The \$65,672 booked in the first quarter of 2010 was entirely attributable to the future obligations that were incurred on acquisition of the Waelz kiln assets.

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Interest and financing costs for the first quarter of 2011 also include interest on the bank debt of \$0.2 million which was the remaining balance of the \$1.1 million bank debt that was assumed as part of the liabilities on the acquisition of the Turkish Waelz kiln and interest on the convertible debenture that was issued in July 2010

The first quarter of 2010 interest and financing costs include interest on the \$1.1 million bank debt that was assumed as part of the liabilities on the acquisition of the Turkish Waelz kiln.

### *Investment and Other Income*

\$5.3 million of the cash invested by Befesa into the BST joint venture was advanced to Befesa under a credit facility (Silvermet's proportionate share as of March 31, 2011 - \$2.7 million) accruing interest at an annual rate of 8.35%. During the first quarter of 2011 \$0.1 million (at 100%) of interest income was earned.

### **Current and Future Income Taxes**

Provision for current income taxes includes tax liability on income generated in the Turkish entity and future income tax credits related to exchange losses for tax purposes on cash balances at BST.

### **Liquidity and Financial Position**

#### *Working Capital*

The working capital of the Company was in a surplus of approximately \$3.2 million at both March 31, 2011 and at December 31, 2010. The various components of working capital are discussed hereafter.

#### *Credit facility receivable*

The working capital position of the Turkish Operations has been very strong since the fourth quarter of 2010 and no immediate projects existed that would require funding out of the cash in the BST joint venture. Accordingly, a decision was made to advance repay the Silvermet promissory note of \$0.5 million and \$5.3 million of the remaining cash was advanced to Befesa under a credit facility (Silvermet's proportionate share being \$2.6 million). The credit facility provides that Befesa will accrue interest payable to the BST joint venture at an annual rate of 8.35% and calculated on the daily balances advanced under the credit facility. The accrued interest is payable to the BST joint venture at the earlier of its cancellation or the end of the fiscal year. The BST joint venture may cancel the credit facility at any time with no penalty and upon so doing, the principal plus accrued interest must be paid to the BST joint venture by Befesa within two days.

#### *Accounts receivable*

Accounts receivable comprise primarily smelter and tax receivables. Smelter receivables account for \$0.6 million and include residual payments to be received subsequent to period end once final pricing is determined on a number of shipments. As such, the receivable represents amounts to be received based on zinc prices as they existed at March 31, 2011 and is subject to adjustment for future zinc price changes.

Accounts receivable at March 31, 2011 include \$0.4 million for Value Added Taxes ("VAT") in Turkey. VAT is payable at a rate of 18% of most input costs and is subsequently recovered by the Company after product has been exported. However, there is a significant lag between the export date and the date on which the VAT refund is actually received. The balance of receivables is made up of related party receivables, HST and advances.

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### *Inventories*

Inventories were reduced from \$0.5 million at December 31, 2010 to \$0.3 million (Silvermet's proportionate share being \$0.135 million) at March 31, 2011, mainly a reflection of timing of shipments.

### *Prepaid expenses*

Prepaid expenses of approximately \$0.2 million (100%) as at March 31, 2011 mainly consist of anthracite supplier advances of \$0.15 million (at 100%), and liability insurance and directors' and officers' insurance. December 31, 2010 balance of \$0.05 million (at 100%) did not have any anthracite supplier advance.

### *Accounts payable and accrued liabilities*

The main components of the accounts payable and accrued liabilities relate to \$1.3 million (Silvermet's proportionate share being \$0.74 million) operating trade accounts. Accrued liabilities of \$0.1 million (Silvermet's proportionate share being \$0.05 million) comprise accruals related to personnel, social security and tax liabilities, which are held as an offset to the VAT receivables.

### *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 \$1.1 million. 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 \$0.4 million and extended the remaining \$0.7 million 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 March 31, 2011 was \$0.25 million (Silvermet's proportionate share being \$0.1 million).

### *Convertible debenture*

On July 23, 2010, the Company completed a 13.2% convertible debenture financing for \$0.5 million, half of which was placed with one of the Company's directors. The debentures were 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 \$0.3 million, including a \$0.1 million accretion expense booked in 2010 and a further \$0.1 million booked during the first quarter of 2011. The equity component consisted of a value conversion component and a share issue cost of \$0.82 million representing the valuation of 5,000,000 warrants at C \$0.036 per unit. The convertible debenture and accrued interest were paid off completely on February 9, 2011.

### *Tax payable*

The tax payable of \$0.5 million (Silvermet's proportionate share being approximately \$0.25 million) represents mainly current year income tax payable accrued for the Turkish Operations.

### *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 March 31, 2011, the gross payable amount remaining under this fixed payment arrangement was \$0.45 million (Silvermet's proportionate share being \$0.2 million). 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

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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 Silvermet's proportionate share of 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. In view of the actual performance of the Turkish Operations since their acquisition and estimated future operating results, management revised its estimate of the fair value of the contingent consideration on the formation of the BST joint venture to an estimated amount of \$1.5 million. At that date, the accreted balance of the contingent consideration was approximately \$1.95 million. The difference was recorded as a reduction to the carrying cost of fixed assets.

The liabilities under both the loan payable and contingent consideration were assumed by the BST joint venture as of October 27, 2010. The Company does not expect to make any payments of contingent consideration during 2011 and this liability should therefore 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.

### **Capital management**

In managing its capital, the Company's objective is to ensure the Company is able to continue its operations and that it has sufficient ability to satisfy its capital obligations and ongoing operational expenses. The Company considers the components of shareholders' equity, as well as its cash and equivalents, notes receivable, credit facilities and long-term loan obligations as capital. 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.

### **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***

The Company's credit risk is attributed to cash, notes and accounts receivable. The Company has a concentration of credit risk within the international zinc smelting industry which resulted in approximately 74% of sales from one account in the three months ended March 31, 2011 (2010 – 100%). Cash is held with reputable financial institutions, from which management believes the risk of loss to be minimal. The BST joint venture has advanced excess funds to Befesa under a credit facility receivable, which funds can be demanded for payment with two day notice. Management believes the risk of loss to be minimal. Account receivables include expenses paid on behalf of related companies, sales tax receivables from the Turkish and Canadian governments and sales receivables from various smelters. Accounts receivables are in good standing as at March 31, 2011. Management believes that the credit risk concentration with respect to accounts receivable is mitigated by the use of provisional payments made against shipments.

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### ***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's liquidity and operating results may be adversely affected if the Company's access to the capital markets is hindered, whether as a result of a downturn in stock market conditions generally or related to matters specific to the Company. The Company generates cash flow primarily from its financing activities and kiln operations. As at March 31, 2011 the Company had a cash and cash equivalents balance of \$522,038 (December 31, 2010 - \$1,188,247) and a credit facility receivable of \$2,652,322 (December 31, 2010 - \$2,597,324) to settle current liabilities of \$1,462,194 (December 31, 2010 - \$1,985,454). The Company utilizes planning, budgeting and forecasting processes to help ensure that funding requirements for contractual and other obligations are met. The Company regularly evaluates its cash position to ensure preservation and security of capital as well as maintenance of liquidity.

### ***Market risk***

#### (a) Interest rate risk

At March 31, 2011, the Company had a credit facility receivable bearing a fixed interest rate. Debt balances bear interest at either fixed or no rates of interest. Accordingly, the Company was not exposed to any significant interest rate risks at March 31, 2011.

#### (b) Foreign currency risk

The Company's operations are based in Turkey and the majority of expenses are incurred in Turkish lira. Sales are made outside Turkey and are denominated in US dollars. The Turkish Operations are therefore subject to foreign currency risk in the US dollar versus the Turkish lira. Additionally, the Company's head office is located in Canada, so corporate overhead costs expose the Company to changes in the US dollar versus the Canadian dollar. Sensitivity to a plus or minus 5% change in all foreign currencies against the US dollar with all other variables held constant as at March 31, 2011 would have an impact of approximately \$10,000 on the balance sheet values; while the impact on revenues would be \$90,000.

#### (c) Commodity price risk

The Company sells zinc concentrates and is exposed to changes in the price of international zinc prices as quoted on the London Metals Exchange ("LME"). Sales of zinc concentrate are recognized in revenue on a provisional pricing basis when title transfers and the rights and obligations of ownership pass to the customer, which can occur at different times depending on the contract. Final pricing is typically not determined until a subsequent date. Accordingly, revenue in any period is based on current prices for sales occurring in the period and ongoing pricing adjustments from sales that are still subject to final pricing. These pricing adjustments result in additional revenues in a rising price environment and reductions to revenue in a declining price environment. The effect of these adjustments on earnings is mitigated by the effect that changing commodity prices have on treatment charges, taxes and non-controlling interests. For the three months ending March 31, 2011, a plus or minus 10% change in the price of zinc, if all other variables were held constant would affect net and comprehensive income by approximately \$180,000.

### **Related Party Transactions**

During the three months March 31, 2011 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

# Silvermet Inc.

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

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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 \$34,500 to the related companies concerning these expenses for the three months ended March 31, 2011 (2010 - \$21,328). Included in receivables is \$58,899 (\$18,662 at March 31, 2010) related to these amounts which are due on demand.

During the three months ended March 31, 2011 the Company paid key management personnel, including officers, directors, or their related entities for management services. Compensation of key management personnel for services provided during the periods was \$81,000 (2010 - \$116,245). There were no amounts payable or accrued at March 31, 2011 or 2010 related to these amounts. These transactions were in the normal course of operations and recorded at exchange value.

On June 18, 2010, a director of the Company assumed the remaining balance of \$417,565 on the Cooper Island loan (see note 11) 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.

### **Financial Instruments**

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 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 March 31, 2011.

### **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 3 of its interim consolidated financial statements for the three months ended March 31, 2011.

### **Adoption of International Financial Reporting Standards**

The Company has adopted International Financial Reporting Standards ("IFRS") beginning January 1, 2010 and as a result the 2010 comparative information has been adjusted and presented in accordance with IFRS. However, the January 1, 2010 and December 31, 2010 comparative consolidated statements of financial position for the year ending December 31, 2011 may differ from herein if there are future changes to IFRS standards requiring retroactive adjustment.

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

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As stated in Note 2, these are the Company's first interim consolidated financial statements prepared in accordance with IFRS. The accounting policies described in Note 3 have been applied in preparing the comparative consolidated financial statements for the year ended December 31, 2010 and in preparation of the opening IFRS consolidated statement of financial position at January 1, 2010.

### *(a) First time adoption of IFRS*

Under IFRS 1, IFRS has been applied retrospectively at the transition consolidated statement of financial position date with all adjustments to assets and liabilities as stated under Canadian GAAP taken to retained earnings except where certain exemptions and exceptions were applied.

The primary exemptions and exceptions that were applied by the Company are:

#### Functional currency

The Company reset the cumulative translation gains and losses in accumulated other comprehensive income to nil at January 1, 2010 and made the corresponding adjustment to retained earnings.

#### Business combinations

IFRS 1 indicates that a first-time adopter may elect not to apply IFRS 3 Business Combinations ("IFRS 3") retrospectively to business combinations that occurred before the date of transition to IFRS. The Company has taken this election and applied IFRS 3 only to business combinations that occurred on or after January 1, 2010.

#### Share-based payment transactions

IFRS 1 allows first-time adopters to apply IFRS 2 Share-based Payments ("IFRS 2") to equity instruments that were granted on or before November 7, 2002, or equity instruments that were granted subsequent to November 7, 2002 and vested before the later of the date of transition to IFRS and January 1, 2005.

#### Estimates

In accordance with IFRS 1, estimates made under IFRS at the date of transition to IFRS must be consistent with estimates made for the same date under previous GAAP, unless there is objective evidence that those estimates were in error. The Company's estimates as of January 1, 2010 under IFRS are consistent with its Canadian GAAP estimates for the same date.

### *(b) Adjustments recorded on transition and for comparative periods*

IFRS employs a conceptual framework that is similar to Canadian GAAP. However, significant differences exist in certain matters of recognition, measurement and disclosure. While adoption of IFRS has not changed the Company's actual cash flows, it has resulted in changes to the Company's reported financial position and results of operations, which are demonstrated in the notes to the interim consolidated financial statements.

## **Future Changes in Accounting Policies**

The International Accounting Standards Board ("IASB") has issued a new standard, IFRS 9, "Financial Instruments" ("IFRS 9"), which will ultimately replace IAS 39, "Financial Instruments: Recognition and Measurement" ("IAS 39"). IFRS 9 provides guidance on the classification and measurement of financial assets and financial liabilities. This standard becomes effective for the Company's fiscal year-end beginning January 1, 2013. The Company is currently assessing the impact of the new standard on its financial statements.

# Silvermet Inc.

## Management's Discussion and Analysis For the three months ended March 31, 2011

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IFRS 10 "Consolidated Financial Statements" requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 "Consolidation - Special Purpose Entities" and parts of IAS 27 "Consolidated and Separate Financial Statements". This standard is effective for all annual periods beginning on or after January 1, 2013. The Company is currently assessing the impact of the new standard on its financial statements.

IFRS 11, "Joint Arrangements" ("IFRS 11") was issued by the IASB on May 12, 2011 and will replace IAS 31, "Interest in Joint Ventures". The new standard will apply to the accounting for interests in joint arrangements where there is joint control. Under IFRS 11, joint arrangements are classified as either joint ventures or joint operations. The structure of the joint arrangement will no longer be the most significant factor in determining whether a joint arrangement is either a joint venture or a joint operation. Proportionate consolidations will no longer be allowed and will be replaced by equity accounting. IFRS 11 is effective for the Company's fiscal year-end beginning January 1, 2013, with early adoption permitted. The Company is currently assessing the impact of IFRS 11 on its results of operations and financial position.

IFRS 12 "Disclosure of Interests in Other Entities" establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interests in other entities. This standard is effective for all annual periods beginning on or after January 1, 2013. The Company is currently assessing the impact of the new standard on its financial statements.

IFRS 13, "Fair Value Measurement" ("IFRS 13") was also issued by the IASB on May 12, 2011. The new standard creates a single source of guidance for fair value measurements. IFRS 13 is effective for the Company's fiscal year-end beginning January 1, 2013, with early adoption permitted. The Company is assessing the impact of IFRS 13 on its consolidated financial statements.

### **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 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

# Silvermet Inc.

## Management's Discussion and Analysis For the three months ended March 31, 2011

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

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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 some items of cost are U.S. dollars based. Most operating expenses are incurred in Turkish Lira and head office relate costs are incurred in Canadian dollars. Such activities are subject to risks associated with fluctuations in the rate of exchange of these foreign currencies.

*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.

# Silvermet Inc.

## Management's Discussion and Analysis For the three months ended March 31, 2011

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

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### Outstanding Share Data

As at June 27, 2011 the outstanding common shares, share purchase warrants and stock options are:

Common shares outstanding	156,380,216
Share purchase warrants	5,000,000
Options	<u>9,200,000</u>
Fully diluted shares outstanding	<u>170,580,216</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 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.

# Silvermet Inc.

## Management's Discussion and Analysis For the three months ended March 31, 2011

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

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### Outlook

Operating results for the first quarter of 2011 reflect the third consecutive quarter of stable kiln operations. In recent months, various projects have been initiated to improve efficiencies and help ensure continued stability of operations, and these projects are on-going. Combined with stable zinc prices and lower treatment charges, these series of factors have established a base operating level that is expected to show continuing improvement in the coming quarters. Our working capital position has improved significantly in recent quarters and we now have a strong financial base from which to expand.

Both in the Iskenderun region where our existing plant is located and in the other steel-producing regions of Turkey, there is a great need for additional EAFD processing capacity. In October of last year, we entered into a joint venture with Befesa, so that we could benefit from their expertise in both the operation and construction of Waelz kilns. Befesa have now been involved in the Turkish operations for 8 months and have a greater appreciation for the market opportunity. We are actively working to together with Befesa to identify sites on which we can establish additional production facilities in Turkey. It is expected that we will secure such sites in the coming months and begin development of new capacity shortly thereafter.

### 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).

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*"Stephen G. Roman"*

Stephen G. Roman  
Chairman, President & Chief Executive Officer

*"Ian D. Atacan"*

Ian D. Atacan  
Chief Financial Officer

June 27, 2011