SOLITARIO EXPLORATION & ROYALTY CORP.
Form 10-Q
November 09, 2012

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended **September 30, 2012**

OR

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

For the transition period from ________ to ________

Commission File Number. **001-39278**

SOLITARIO EXPLORATION & ROYALTY CORP.

(Exact name of registrant as specified in its charter)

Colorado	
(State or other jurisdiction of incorporation or organization)	**84-1285791**
4251 Kipling St. Suite 390, Wheat Ridge, CO	**(I.R.S. Employer Identification No.)**
(Address of principal executive offices)	**80033**
(303) 534-1030	**(Zip Code)**
(Registrant's telephone number, including area code)	

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

YES S NO £

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

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

YES S NO £

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

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

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

YES £ NO S

There were 34,479,958 shares of $0.01 par value common stock outstanding as of November 5, 2012.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

SOLITARIO EXPLORATION & ROYALTY CORP.

CONSOLIDATED BALANCE SHEETS

(in thousands of U.S. dollars, except share and per share amounts)	September 30, 2012 (unaudited)	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	$ 2,025	$ 432
Investments in marketable equity securities, at fair value	1,710	4,361
Royalty sale receivable	4,000	—
Prepaid expenses and other	140	488
Total current assets	7,875	5,281
Mineral properties, net	8,433	8,901
Investments in marketable equity securities, at fair value	5,938	6,000
Equity method investment	1,315	1,653
Other assets	838	219
Total assets	$ 24,399	$ 22,054
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 759	$ 482
Short-term margin loan	394	2,000
Current portion long-term debt, net of discount	714	727
Deferred income taxes	663	1,627
Other	168	100
Total current liabilities	2,698	4,936
Long-term debt, net of discount	2,354	2,075
Deferred income taxes	719	1,170
Deferred gain on sale of mineral property royalty	7,000	—
Warrant liability	1,379	—
Commitments and contingencies		
Equity:		
Solitario shareholders' equity:		
Preferred stock, $0.01 par value, authorized 10,000,000 shares (none issued and outstanding at September 30, 2012 and December 31, 2011)	—	—
	345	342

Common stock, $0.01 par value, authorized 100,000,000 shares (34,479,958 and 34,204,958, respectively, shares issued and outstanding at September 30, 2012 and December 31, 2011)		
Additional paid-in capital	46,898	49,015
Accumulated deficit	(41,795)	(39,381)
Accumulated other comprehensive income	4,256	5,877
Total Solitario shareholders' equity	9,704	15,853
Noncontrolling interest	545	(1,640)
Contra-noncontrolling interest	—	(340)
Total shareholders' equity	10,249	13,873
Total liabilities and shareholders' equity	$ 24,399	$ 22,054

See Notes to Unaudited Condensed Consolidated Financial Statements

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SOLITARIO EXPLORATION & ROYALTY CORP.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(in thousands of U.S dollars except per share amounts)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Property and joint venture revenue	$200	$200	$200	$200
Costs, expenses and other:				
Exploration expense	507	1,724	1,585	3,486
Depreciation and amortization	15	13	42	34
General and administrative	571	625	1,863	2,270
Loss on derivative instruments	22	193	76	122
Interest expense (net)	105	63	246	223
Property abandonment and impairment	24	—	24	—
Interest and dividend income	(53)	(61)	(100)	(118)
(Loss) gain on sale of assets	1	—	(8)	—
Total costs, expenses and other	1,192	2,557	3,728	6,017
Other Income (expense)				
Gain on sale of marketable equity securities	—	—	1,464	1,870
Loss on warrant liability	(729)	—	(729)	—
Net loss of equity method investment	(93)	(113)	(339)	(494)
Total other income (expense)	(822)	(113)	396	1,376
Loss before income taxes	(1,814)	(2,470)	(3,132)	(4,441)
Income tax benefit	436	569	432	476
Net loss	(1,378)	(1,901)	(2,700)	(3,965)
Less net loss attributable to non-controlling interest	19	995	286	2,049
Net loss attributable to Solitario shareholders	$(1,359)	$(906)	$(2,414)	$(1,916)
Loss per common share attributable to Solitario shareholders:				
Basic and diluted	$(0.04)	$(0.03)	$(0.07)	$(0.06)
Weighted average shares outstanding:				
Basic and diluted	34,466	34,163	34,308	32,336

See Notes to Unaudited Condensed Consolidated Financial Statements

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SOLITARIO EXPLORATION & ROYALTY CORP.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(in thousands of U.S. dollars)	Three months ended September 30		Nine months ended September 30	
	2012	2011	2012	2011
Net loss for the period, before comprehensive loss	$(1,378)	$(1,901)	$(2,700)	$(3,965)
Unrealized gain (loss) on marketable equity securities, net of deferred taxes	968	(869)	(1,621)	(4,028)
Comprehensive loss	$(410)	$(2,770)	$(4,321)	$(7,993)
Comprehensive loss attributable to Solitario shareholders	$(391)	$(1,775)	$(4,035)	$(5,944)
Comprehensive loss attributable to noncontrolling interests	(19)	(995)	(286)	(2,049)
Comprehensive loss	$(410)	$(2,770)	$(4,321)	$(7,993)

See Notes to Unaudited Condensed Consolidated Financial Statements

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SOLITARIO EXPLORATION & ROYALTY CORP.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands of U.S. dollars)	Nine months ended September 30, 2012	2011
Operating activities:		
Net loss	$(2,700)	$(3,965)
Adjustments to reconcile net loss to net cash used in operating activities:		
Loss on derivative instruments	76	122
Depreciation and amortization	42	34
Loss on equity method investment	339	494
Employee stock option expense	523	523
Property abandonment and impairment	24	—
Warrant liability	729	—
Deferred income tax expense	(432)	(476)
Amortization of discounts and deferred offering cost on long-term debt	187	165
Gain on asset and equity security sales	(1,472)	(1,870)
Changes in operating assets and liabilities:		
Prepaid expenses and other current assets	272	(168)
Accounts payable and other current liabilities	277	110
Net cash used in operating activities	(2,135)	(5,031)
Investing activities:		
Additions to mineral properties	(2,557)	(1,730)
Additions to other assets	(86)	(116)
Proceeds from sale of mineral property	6,000	—
Proceeds from sale of marketable equity securities	1,591	1,964
Sale of derivative instruments	68	57
Net cash provided by investing activities	5,016	175
Financing activities:		
Short-term borrowing	1,565	1,075
Repayment of short-term borrowing	(3,171)	(1,926)
Repayment of long-term debt	(750)	(500)
Proceeds from issuance of debt	1,500	—
Deferred offering costs	(588)	—
Proceeds from sale of common stock, net	275	8,937
Non-controlling interest contribution	50	80
Proceeds from exercise of options	—	232
Payment to noncontrolling investor, net	(169)	(200)
Net cash provided by financing activities	(1,288)	7,698
Net increase in cash and cash equivalents	1,593	2,842
Cash and cash equivalents, beginning of period	432	478

Cash and cash equivalents, end of period	$2,025	$3,320
Supplemental disclosure of non-cash activities:		
Warrant liability	$650	$—
Repayment of loan by noncontrolling interest, net	$373	$—
Issuance of stock to noncontrolling interest	$71	$—
Transfer of contra-noncontrolling interest to noncontrolling interest upon earn-in	$531	$—
Disproportionate share entry from noncontrolling interest to additional paid-in capital upon earn-in	$2,983	$—
Royalty sale receivable	$4,000	$—
Reclassification of stock option liability to additional paid-in capital	$—	$1,240
Reclassification of stock option liability to accumulated deficit, net of deferred taxes of $543	$—	$992

See Notes to Unaudited Condensed Consolidated Financial Statements

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Business and significant accounting policies

Business

Solitario Exploration & Royalty Corp. ("Solitario") is a development stage company which is developing its Mt. Hamilton project located in Nevada. See "Recent Developments" below. In addition Solitario has a focus on the acquisition of precious and base metal properties with exploration potential and the development or purchase of royalty interests. In addition to its Mt. Hamilton project, Solitario acquires and holds a portfolio of exploration properties for future sale, joint venture or to create a royalty prior to the establishment of proven and probable reserves. Although Solitario intends to develop the Mt. Hamilton project, Solitario has never developed a mineral property. At September 30, 2012, Solitario's mineral properties are located in the United States, Mexico, Brazil and Peru.

The accompanying interim condensed consolidated financial statements of Solitario for the three and nine months ended September 30, 2012 and 2011 are unaudited and are prepared in accordance with accounting principles generally accepted in the United States of America. They do not include all disclosures required by generally accepted accounting principles for annual financial statements, but in the opinion of management, include all adjustments, consisting only of normal recurring items, necessary for a fair presentation. Interim results are not necessarily indicative of results, which may be achieved in the future or for the full year ending December 31, 2012.

These financial statements should be read in conjunction with the financial statements and notes thereto which are included in Solitario's Annual Report on Form 10-K for the year ended December 31, 2011. The accounting policies set forth in those annual financial statements are the same as the accounting policies utilized in the preparation of these financial statements, except as modified for appropriate interim financial statement presentation.

Recent developments

Mt. Hamilton feasibility study

In December 2010 Solitario signed the Limited Liability Company Operating Agreement of Mt. Hamilton LLC, (the "MH Agreement"), and formed Mt. Hamilton LLC ("MH-LLC"), the owner of the Mt. Hamilton project. Solitario announced on February 22, 2012 the completion of a feasibility study on its Mt. Hamilton project (the “Feasibility Study”), prepared by SRK Consulting (US), Inc. of Lakewood, Colorado (“SRK”). As a result of the completion of the Feasibility Study, pursuant to the MH Agreement, Solitario earned an 80% interest in MH-LLC, became a development stage company (but not a company in the “Development Stage”) and reported mineral reserves at its Mt. Hamilton project. See Note 7, “Mineral Properties,” below.

RMB loan

As explained in more detail in Note 4, Long term debt, Solitario entered into a Facility Agreement (the “Facility Agreement”) with RMB Australia Holdings Limited, an Australian corporation (“RMBAH”), and RMB Resources Inc., a Delaware corporation (“RMBR”) whereby Solitario may borrow up to $5,000,000 from RMBAH (with any amounts outstanding collectively being the “RMB Loan”). Solitario borrowed $1,500,000 on August 21, 2012. Solitario paid an arrangement fee of $250,000 upon initial funding. The RMB Loan matures on the earlier to occur of (i) 36 months from the date of initial funding or (ii) the date on which financing is made available to MH-LLC for purposes of placing the Mt. Hamilton project into commercial production. The RMB Loan amounts will bear interest at LIBOR plus 5%, payable in arrears on the last day of each quarterly interest period. The RMB Loan may be repaid at any time without penalty. Any amounts repaid may not be redrawn under the Facility Agreement. The RMB Loan is secured by a lien on Solitario’s 80% interest in MH-LLC as well as a general security interest in Solitario’s remaining assets.

RMB warrants

Pursuant to the Facility Agreement, Solitario issued 1,624,748 warrants (the “RMB Warrants”) to RMBAH as partial consideration for financing services provided in connection with the Facility Agreement. Each RMB Warrant entitles the holder

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to purchase one common share (the "Warrant Shares") of Solitario pursuant to the terms and conditions of the RMB Warrants. The RMB Warrants expire 36 months from their date of issuance and have an exercise price of $1.5387 per Warrant Share, subject to customary anti-dilution adjustments. During the three months ended September 30, 2012, Solitario registered the resale of the Warrant Shares with the U.S. Securities and Exchange Commission.

Sandstorm royalty sale

On June 11, 2012, MH-LLC completed the sale of a 2.4% net smelter returns royalty ("NSR") on the Mt. Hamilton project to Sandstorm Gold, Ltd ("Sandstorm") for US$10.0 million. MH-LLC received an upfront payment of US$6.0 million upon signing the agreement and will receive US$4.0 million on January 15, 2013, which Solitario has recorded as a current asset as of September 30, 2012. As part of the agreement, MH-LLC will have the option, for a period of 30 months from June 11, 2012 to repurchase up to 100% of the NSR for US$12 million, provided that MH-LLC enters into a gold stream agreement with Sandstorm that has an upfront deposit of greater than US$30 million. In addition, MH-LLC has provided Sandstorm with a right of first refusal on any future royalty or gold stream financing for the Mt. Hamilton project. Pursuant to the Agreement, Solitario is jointly and severally liable for all obligations of MH-LLC to Sandstorm. See Note 7, "Mineral Properties," below for further discussion of the Sandstorm royalty sale.

Private placement to related parties

On June 26, 2012, Christopher Herald, President and Chief Executive Officer of Solitario, and James Maronick, Chief Financial Officer of Solitario, agreed to purchase shares of the Company's common stock at a price of $1.22 per share, with Mr. Herald agreeing to purchase 180,000 shares and Mr. Maronick agreeing to purchase 45,000 shares. The purchase of the shares was unanimously approved by Solitario's Board of Directors and was also unanimously approved by Solitario's Audit Committee of the Board of Directors. The price of the shares was the last closing price of Solitario's common shares as quoted on the NYSE MKT (formerly NYSE Amex) on June 25, 2012. Solitario received total proceeds of $274,500.

Investment in Kinross

Solitario has a significant investment in Kinross Gold Corporation ("Kinross"), which consisted of the following at September 30, 2012 and December 31, 2011:

(in thousands)	9/30/2012	12/31/2011
Shares	670	850
Fair value		
Current assets	$1,710	$4,361

Long term assets	$5,131	$5,329

Solitario did not sell any shares of Kinross during the three months ended September 30, 2012 and 2011. During the nine months ended September 30, 2012 and 2011, Solitario sold the following shares of Kinross:

(in thousands)	Nine months ended September 30	
	2012	2011
Shares sold	180	125
Proceeds	$1,591	$1,964
Gain on sale	$1,464	$1,870

As of September 30, 2012, Solitario has borrowed $394,000 in short-term margin loans, which are primarily secured by its investment in Kinross. The short-term margin loans are discussed below under “Short-term debt.” As of November 5, 2012, Solitario owns 670,000 shares of Kinross common stock which have a value of approximately $6.2 million based upon the market price of $9.22 per Kinross share. Solitario’s investment in Kinross common stock represents a significant concentration of assets, with the inherent risk that entails. Any significant fluctuation in the market value of Kinross common shares could have a material impact on Solitario’s liquidity and capital resources.

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Employee stock compensation plans

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

Solitario's outstanding options on the date of grant have a five-year term, and vest 25% on date of grant and 25% on each of the next three anniversary dates. Solitario recognizes stock option compensation expense on the date of grant for 25% of the grant date fair value, and subsequently, based upon a straight line amortization of the unvested grant date fair value of each of its outstanding options. During the three and nine months ended September 30, 2012, Solitario recorded $174,000 and $523,000, respectively, of stock option expense for the amortization of grant date fair value with a credit to additional paid-in capital. Solitario recorded the same stock option expense during the three and nine months ended September 30, 2011.

There were no new options granted during the three and nine months ended September 30, 2012 and 2011. During the three and nine months ended September 30, 2012 no options were exercised. During the three and nine months ended September 30, 2011, options for 32,500 and 140,600 shares, respectively, were exercised at prices between Cdn$1.55 and Cdn$2.40 per share for cash proceeds of $51,000 and $232,000, respectively.

Earnings per share

The calculation of basic and diluted earnings and loss per share is based on the weighted average number of common shares outstanding during the three and nine months ended September 30, 2012 and 2011. Potentially dilutive shares related to (i) outstanding common stock options of 2,433,400 shares and (ii) the RMB warrants of 1,624,748 shares during the three and nine months ended September 30, 2012 and common stock options of 2,433,400 shares during the three and nine months ended September 31, 2011 were excluded from the calculation of diluted loss per share because the effects were anti-dilutive.

Derivative instruments

The following table provides a detail of the location and amount of the fair values of Solitario's derivative instruments presented in the condensed consolidated balance sheets as of September 30, 2012 and December 31, 2011:

(in thousands)	Derivative Instruments		
	Balance Sheet Location	September 30, 2012	December 31, 2011
Derivatives not designated as hedging instruments under ASC 815			
Kinross February 2013 call option	Other current liabilities	$ 68	$ —
Ely investment warrants	Other current assets	—	74
International Lithium Corp warrants	Other current assets	1	4
Warrant derivative liability	Warrant liability	1,379	—

The following amounts are included in (loss) gain on derivative instruments in the condensed consolidated statement of operations for the three and nine months ended September 30, 2012 and 2011:

(in thousands)	Three months ended September 30, 2012	September 30, 2011	Nine months ended September 30, 2012	September 30, 2011
Derivatives not designated as hedging instruments under ASC 815	Gain(loss)	Gain(loss)	Gain(loss)	Gain(loss)
Kinross February 2012 call option	$—	$ 33	$—	$ 33
Ely investment warrants	(23)	(229)	(74)	(156)
International Lithium Corp warrants	1	3	(2)	3
Kinross collar	—	—	—	(2)
Total derivatives	$(22)	$ (193)	$(76)	$ (122)

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Fair value

For certain of Solitario's financial instruments, including cash and cash equivalents, payables and short-term debt, the carrying amounts approximate fair value due to their short-term maturities. Solitario's marketable equity securities are carried at their estimated fair value primarily based on quoted market prices. The long-term debt associated with MH-LLC is carried at its estimated fair value based upon the discounted present value of the payments using an estimated discount rate, the RMB warrants and the ILC Warrants are carried at their estimated fair value based on a Black-Scholes option pricing model. The RMB Loan is carried at its estimated fair value based upon the loan balance, net of discounts, and any accrued interest payable.

Solitario accounts for its financial instruments under ASC 820, "Fair Value Measurements." ASC 820 establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. ASC 820 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. ASC 820 also requires disclosure about how fair value is determined for assets and liabilities and establishes a hierarchy for which these assets and liabilities must be grouped, based on significant levels of inputs as follows:

- **Level 1**: quoted prices in active markets for identical assets or liabilities;
- **Level 2**: quoted prices in active markets for similar assets and liabilities and inputs that are observable for the asset or liability; or
- **Level 3**: Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

The determination of where assets and liabilities fall within this hierarchy is based upon the lowest level of input that is significant to the fair value measurement. During the three and nine months ended September 30, 2012, there were no reclassifications in financial assets or liabilities between Level 1, 2 or 3 categories.

The following is a listing of Solitario's financial assets and liabilities required to be measured at fair value on a recurring basis and where they are classified within the hierarchy as of September 30, 2012:

(in thousands)	Level 1	Level 2	Level 3	Total
Assets				
Marketable equity securities	$7,648	$—	$—	$7,648
ILC warrants - other current assets	—	1	—	1
Liabilities				
RMB warrants – long term liabilities	—	1,379	—	1,379
Kinross call	68	—	—	68

Solitario has recorded a liability for the fair value of its outstanding warrants issued to RMB in connection with the RMB secured credit facility. The warrants have been recorded at their fair value at September 30, 2012 based upon a Black-Scholes model. Solitario recorded, as a component of other expense, a loss on warrant liability of $729,000 during the three and nine months ended September 30, 2012.

Solitario recorded a royalty sale receivable of $4,000,000 in current assets in connection with the Sandstorm royalty sale discussed above. The determination of the initial fair value of $4,000,000 was categorized as Level 3, as there was no market data available and Solitario determined the fair value based upon its assumptions of the likelihood of payment of the receivable by Sandstorm as discussed below in Note 7, “Mineral Properties.”

The following is a listing of Solitario’s financial assets and liabilities required to be measured at fair value on a recurring basis and where they are classified within the hierarchy as of December 31, 2011:

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(in thousands)	Level 1	Level 2	Level 3	Total
Assets				
Marketable equity securities	$10,361	$—	$—	$10,361
Other current assets - Ely warrants	—	74	—	74
Other current assets - ILC warrants	—	4	—	4

Marketable equity securities

Solitario's investments in marketable equity securities are classified as available-for-sale and are carried at fair value, which is based upon quoted prices of the securities owned. The cost of marketable equity securities sold is determined by the specific identification method. Changes in market value are recorded in accumulated other comprehensive income within shareholders' equity, unless a decline in market value is considered other than temporary, in which case the decline is recognized as a loss in the consolidated statements of operations. The following tables summarize Solitario's marketable equity securities and accumulated other comprehensive income related to its marketable equity securities:

(in thousands)	September 30, 2012	December 31, 2011
Marketable equity securities at fair value	$7,648	$10,361
Cost	860	988
Accumulated other comprehensive income for unrealized holding gains	6,788	9,373
Deferred taxes on accumulated other comprehensive income for unrealized holding gains	2,532	3,496
Accumulated other comprehensive income	$4,256	$5,877

Solitario has classified $1,710,000 and $4,361,000, respectively, of marketable equity securities as current, as of September 30, 2012 and December 31, 2011, which represents Solitario's estimate of the portion of marketable equity securities that will be liquidated within one year.

The following table represents changes in marketable equity securities:

(in thousands)	Three months ended September 30, 2012	2011	Nine months ended September 30, 2012	2011
Gross cash proceeds	$—	$—	$1,591	$1,964
Cost	—	—	127	94
Gross gain on sale included in earnings during the period	—	—	1,464	1,870
Deferred taxes on gross gain on sale included in earnings	—	—	(546)	(698)
Reclassification adjustment to unrealized gain in other comprehensive income for net gains included in earnings	—	—	(918)	(1,172)
Gross unrealized holding gain (loss) arising during the period included in other comprehensive loss.	1,544	(1,385)	(1,121)	(4,555)
Deferred taxes on unrealized holdings (gain) loss included in other comprehensive loss	(576)	516	418	1,699
Net unrealized holding gain (loss)	968	(869)	(703)	(2,856)
Other comprehensive income (loss) from marketable equity securities	$968	$(869)	(1,621)	$(4,028)

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Revenue recognition

Solitario records delay rental payments as revenue in the period received. Solitario received $200,000 in delay rental payments on its Bongará property during the three and nine months ended September 30, 2012 and 2011, respectively. Any payments received for the sale of property interests without reserves are recorded as a reduction of the related property's capitalized cost. Proceeds which exceed the capitalized cost of the property without reserves are recognized as revenue. Payments received on the sale of properties with reserves are recognized as revenue to the extent the proceeds exceed the proportionate basis in the assets sold. Gain on the sale of a mineral property revenue stream is deferred to the extent there is a guarantee for the future revenue stream until such time as the potential funding obligation for the guarantee is reduced or released.

Variable interest entity

Pursuant to the terms of the MH Agreement, Solitario determined that prior to earning an 80% interest in MH-LLC as a result of the completion of the Feasibility Study, MH-LLC was a variable interest entity as of December 31, 2011, of which Solitario was the primary beneficiary in accordance with ASC 810. Accordingly, Solitario consolidated MH-LLC in its consolidated financial statements at December 31, 2011 in accordance with ASC 810. Solitario has determined no separate presentation of assets or liabilities was necessary per ASC 810 at December 31, 2011, as MH-LLC does not have any assets that can only be used to settle specific obligations or liabilities for which creditors do not have recourse to Solitario. As discussed in Note 1, as a result of the completion of the Feasibility Study, Solitario earned an 80% interest in MH-LLC on February 22, 2012. MH-LLC will no longer be accounted for as a variable interest entity, but will be subject to the consolidation method of accounting.

2. Exploration expense

The following items comprised exploration expense:

(in thousands)	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Geologic and field expenses	$432	$623	$1,003	$1,231
Administrative	81	76	274	210
Mt. Hamilton exploration	(6)	1,025	308	2,045
Total exploration costs	$507	$1,724	$1,585	$3,486

3. Short-term debt

Solitario entered into a secured credit line agreement between Solitario and UBS Bank. At September 30, 2012, the credit line is secured by all of Solitario's assets held in its UBS brokerage account, consisting primarily of 460,000 of Solitario's Kinross shares. The UBS Bank credit line carries an interest rate which floats, based upon a base rate of 2.25% plus the one-month London Interbank Offered Rate ("LIBOR"), which is 0.23% as of September 30, 2012. The average base rate was approximately 2.49% and 2.50% for the three and nine months ended September 30, 2012. UBS Bank may change the base rate at any time. The UBS Bank credit line provides that Solitario may borrow up to $2 million and that Solitario maintain a minimum equity value percentage in its UBS brokerage account above 40%, based upon the value of its Kinross shares and any other assets held in Solitario's UBS brokerage account, less the value of its UBS Bank credit line and any other balances owed to UBS Bank. UBS Bank may modify the minimum equity value percentage of the loan at any time. In addition, if the equity value in Solitario's UBS brokerage account falls below the minimum equity value, UBS Bank may sell enough Kinross shares held in Solitario's UBS brokerage account or liquidate any other assets to restore the minimum equity value. At September 30, 2012, the equity value in Solitario's UBS brokerage account was 92%. As of November 5, 2012, the outstanding balance under the UBS credit line was $795,000.

Solitario also maintains a short-term margin account with RBC Capital Markets, LLC ("RBC"). At September 30, 2012, the credit line is secured by all of Solitario's assets held in its RBC brokerage account, consisting primarily of 210,000 of Solitario's Kinross shares. Solitario has utilized short-term margin loans from RBC, using Solitario's investment in Kinross held at RBC as collateral for the short-term margin loans. During the three and nine months ended September 30, 2012, the loans carried interest at a margin loan rate of 4.25% per annum, which floats based upon the London Interbank Offered Rate. The margin loan rate can be modified by RBC at any time. The margin loans are callable by RBC at any time. Per the terms of the

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margin loans, Solitario is required to maintain a minimum equity value in the account of 35%, based upon the value of its Kinross shares and any other assets held at RBC, less any short-term margin loan balance and any other balances owed to RBC. The equity value percentage may be modified by RBC at any time. If the equity value in Solitario's account at RBC falls below the minimum, RBC may call the loan, or may sell enough Kinross shares held in Solitario's brokerage account or liquidate any other assets to restore the minimum equity value. At September 30, 2012, Solitario had no outstanding borrowing on the RBC margin account and the equity balance in Solitario's account at RBC was 100%. Solitario had no outstanding balance under the RBC short-term margin account as of November x, 2012.

The following tables summarize Solitario’s short-term debt:

(in thousands)	September 30, 2012	December 31, 2011
Outstanding UBS short-term credit line	$394	$2,000
Outstanding RBC short term margin loan	—	—
Total short-term margin loans	$394	$2,000

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Interest expense UBS short-term credit line	$5	$13	$24	$36
Interest expense RBC short-term margin loan	7	—	15	21
Total interest expense, short term margin loans	$12	$13	$39	$57

4. Long-term debt

Augusta debt

The following is the schedule of debt payments due Augusta Resources Corporation ("Augusta") as of September 30, 2012 and December 31, 2011:

(in thousands) Payment date	September 30, 2012	December 31, 2011
June 1, 2012	$—	$750
June 1, 2013	750	750
June 1, 2014	750	750

June 1, 2015	1,000	1,000
Unamortized discount	(305)	(448)
Total	2,195	2,802
Current portion	714	727
Long-term debt	$1,481	$2,075

The following interest expense from the accretion of the debt discount related to MH-LLC long-term debt due to Augusta:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Interest expense Augusta loan	$41	$51	$143	$165

During the nine months ended September 30, 2012 and 2011 Solitario made payments of $750,000 and $500,000 of principal on the long-term debt to DHI-US, which in turn was paid to Augusta.

RMB Loan

On August 10, 2012, Solitario entered into a Facility Agreement (the “Facility Agreement”) with RMB Australia Holdings Limited, an Australian corporation (“RMBAH”), and RMB Resources Inc., a Delaware corporation (“RMBR”). Under the Facility Agreement, Solitario may borrow up to $5,000,000 from RMBAH (with any amounts outstanding collectively being the “RMB Loan”) at any time during the 24 month period commencing on August 21, 2012, the date of initial funding (the

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"Availability Period"), after which time any undrawn portion of the $5,000,000 commitment will be cancelled and will no longer be available for drawdown. Solitario borrowed $1,500,000 on August 21, 2012 from which it received net proceeds of $912,000 after deducting deferred offering costs of $588,000, which included an arrangement fee of $250,000, legal costs of $328,000 and other costs of $10,000. The deferred offering costs are recorded in other long-term assets and are being amortized on a straight-line basis to interest expense over 36 months, the term of the Facility Agreement. Solitario has recorded deferred offering costs of $567,000 as of September 30, 2012 in other long-term assets. The proceeds from the initial funding were used to pay the balance due on the facility arrangement fee of $175,000, to pay certain legal expenses related to the Facility Agreement, and to reduce outstanding short-term margin loans.

The Facility Agreement was subject to a $250,000 arrangement fee, of which $75,000 had been paid prior to initial funding. The RMB Loan matures on the earlier to occur of (i) 36 months from the date of initial funding or (ii) the date on which financing is made available to MH-LLC for purposes of placing the Mt. Hamilton project into commercial production. The RMB Loan amounts bear interest at LIBOR plus 5%, payable in arrears on the last day of each quarterly interest period. All proceeds from the RMB Loan are to be deposited in a proceeds account (the "Proceeds Account") and are recorded as restricted cash until disbursed in accordance with the Facility Agreement. Pursuant to the Facility Agreement, funds may only be disbursed from the Proceeds Account for approved expenditures, including (i) exploration and development activities at the Mt. Hamilton project, ongoing earn-in payments at MH-LLC, general corporate purposes as set forth in a project and corporate budget approved by RMBAH and (iv) any other purpose approved by RMBAH. As of September 30, 2012 there was no cash balance in the Proceeds Account. The RMB Loan may be repaid at any time without penalty. Any amounts repaid may not be redrawn under the Facility Agreement. The RMB Loan is secured by a lien on Solitario's 80% interest in MH-LLC as well as a general security interest in Solitario's remaining assets.

As of September 30, 2012, the outstanding balance under the RMB Loan was $1,500,000. During the three and nine months ended September 30 Solitario recorded the following interest expense related to the RMB Loan:

(in thousands)	Three and nine months ended September 30, 2012
Interest expense RMB Loan	$ 8
Amortization of the RMB Warrants discount	23
Amortization of RMB deferred offering costs	21
Total interest expense related to the RMB Loan	$ 52

RMB Warrants

Pursuant to the Facility Agreement, the Company issued 1,624,748 warrants to RMBAH as partial consideration for financing services provided in connection with the Facility Agreement. Each RMB Warrant entitles the holder to purchase one common Share of Solitario pursuant to the terms and conditions of the RMB Warrants. The RMB Warrants expire 36 months from their date of issuance and have an exercise price of $1.5387 per Warrant Share, subject to customary anti-dilution adjustments. During the three months ended September 30, 2012, Solitario registered the resale of the Warrant Shares with the U.S. Securities and Exchange Commission following the execution of the Facility Agreement. Solitario recorded a discount to the RMB Loan for the fair value of the RMB Warrants of $650,000 as of August 21, 2012, based upon a Black-Scholes model using a 36-month life, volatility of 62%, and a risk-free interest rate of 0.39%. Solitario is amortizing this discount on a straight-line basis to interest expense over the three-year term of the RMB Loan and as of September 30, 2012 the remaining unamortized warrant discount was $627,000.

As a result of certain registration rights requirements, Solitario has classified its RMB Warrants as a liability in accordance with ASC 815-40, “Derivatives and Hedging, Contracts in Entity’s Own Equity.” Under ASC 815-40, Solitario adjusts the fair value of the warrants at each balance sheet date, with changes in value recorded in other income/expense in the statement of operations. Solitario recorded a loss on the RMB Warrants of $729,000 for the three months ended September 30, 2012, based upon a Black-Scholes model using a 35 month-life, a volatility of 62% a stock price of $1.85 per share and a risk free interest rate of 0.40%

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5. Income taxes

Solitario accounts for income taxes in accordance with ASC 740, "Accounting for Income Taxes." Under ASC 740, income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes related to certain income and expenses recognized in different periods for financial and income tax reporting purposes. Deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred taxes are also recognized for operating losses and tax credits that are available to offset future taxable income and income taxes, respectively. A valuation allowance is provided if it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Primarily as a result of the built-in gain in the value of Solitario's holdings of Kinross common stock recognized as other comprehensive income, Solitario estimated that its deferred tax liabilities exceeded its realizable deferred tax assets by $1,382,000 and $2,797,000 at September 30, 2012 and December 31, 2011.

The following table summarizes the changes in income taxes during the three and nine months ended September 30, 2012 and 2011:

(thousands)	Three months ended September 30		Nine months ended September 30	
	2012	2011	2012	2011
Income tax benefit	$436	$569	$432	$476
Deferred tax benefit (expense) on unrealized losses on marketable equity securities in other comprehensive income	$(576)	$516	$964	$2,397

6. Shareholders' equity, comprehensive loss and non-controlling interest

As a result of the completion of the Feasibility Study discussed above under "Recent developments," Solitario recorded the earn-in of its 80% interest in MH-LLC by reducing noncontrolling interest by $531,000 for Solitario's accumulated earn-in payments made to DHI-US recorded in its contra noncontrolling interest account as of February 22, 2012. In addition Solitario recorded a reduction in additional paid-in-capital of $2,983,000 for DHI-US' proportionate share of its 20% interest in the equity of MH-LLC as of February 22, 2012. The following provides a reconciliation of the beginning and ending balances of Solitario Shareholders' equity, comprehensive loss and non-controlling interest for the three and nine months ended September 30, 2012.

For the nine months ended September 30, 2012

(in thousands, except Share amounts)	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Solitario Shareholders' Equity	Non-Controlling Interest	Contra Non-Controlling Interest	Total Shareholders' Equity
Balance at December 31, 2011	34,204,958	$342	$49,015	$(39,381)	$5,877	$15,853	$(1, 640)	$(340)	$13,873
Issuance of shares and $150 cash to noncontrolling shareholder for future earn-in	25,000	-	41	-	-	41	-	(191)	(150)
Noncontrolling interest contribution	-	-	-	-	-	-	99	-	99
Loan to noncontrolling interest	-	-	-	-	-	-	(49)	-	(49)
Record reversal of contra noncontrolling interest on earn-in	-	-	-	-	-	-	(531)	531	-
Record interest on advance to noncontrolling interest (net)	-	-	-	-	-	-	(8)	-	(8)
Disproportionate share entry on earn-in	-	-	(2,983)	-	-	(2,983)	2,983	-	-
Stock option expense	-	-	174	-	-	174	-	-	174
Comprehensive income:									
Net loss	-	-	-	(670)	-	(670)	(192)	-	(862)
Net unrealized loss on marketable equity securities (net of tax of $529)	-	-	-	-	(889)	(889)	-	-	(889)

Comprehensive loss	-	-	-	-	-	(1,559)	(192)	-	(1,751)
Balance at March 31, 2012	34,229,958	342	46,247	(40,051)	4,988	11,526	662	-	12,188

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Issuance of common stock	225,000	3	272			275			275
Record forgiveness of interest on advance to noncontrolling interest	-	-	-	-	-	-	26	-	26
Stock option expense	-	-	175	-	-	175	-	-	175
Comprehensive income:									
Net loss	-	-	-	(385)	-	(385)	(75)	-	(460)