

SMG Indium Resources Ltd.
Form 10-Q
August 10, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2012

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 000-54391

SMG INDIUM RESOURCES LTD.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

51-0662991

(IRS Employer Identification No.)

100 Park Ave., 16th Floor

New York, New York

10017

(Address of Principal Executive Offices) (Zip Code)

(212) 984 0635

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark 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 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 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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Accelerated filer

Large accelerated filer

Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares of Common Stock, par value \$0.001 per share, outstanding as of August 1, 2012 was 8,832,301.

SMG INDIUM RESOURCES LTD.

Table of Contents

	Page
Part I Financial Information	
Item 1. Financial Statements	
Condensed Balance Sheets as of June 30, 2012 (Unaudited) and December 31, 2011 (Audited)	3
Condensed Statements of Operations for the Three Months and Six Months ended June 30, 2012 and 2011 (Unaudited)	4
Condensed Statement of Changes in Stockholders' Equity for the Six Months Ended June 30, 2012 (Unaudited)	5
Condensed Statements of Cash Flows for the Six Months Ended June 30, 2012 and 2011 (Unaudited)	6
Notes to Condensed Financial Statements (Unaudited)	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	15
Item 3. Qualitative and Quantitative Disclosures about Market Risk	23
Item 4. Controls and Procedures	23
Part II Other Information	
Item 1. Legal Proceedings	24
Item 1A. Risk Factors	24
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	24
Item 3. Defaults upon Senior Securities	24
Item 4. Mine Safety Disclosures	24
Item 5. Other Information	24
Item 6. Exhibits	25
Signatures	26

PART I—FINANCIAL INFORMATION**Item 1. Financial Statements.****SMG INDIUM RESOURCES LTD.****CONDENSED BALANCE SHEETS****ASSETS**

	June 30, 2012 (Unaudited)	December 31, 2011 (Audited)
Current Assets:		
Cash and cash equivalents	\$7,846,185	\$3,536,331
Prepaid expenses and other current assets	66,298	23,704
Total Current Assets	7,912,483	3,560,035
Cash and cash equivalents restricted for indium purchases	-	2,700,781
Inventory - indium	22,216,321	18,998,756
Equipment, net of accumulated depreciation	763	929
Total Assets	\$30,129,567	\$25,260,501

LIABILITIES AND STOCKHOLDERS' EQUITY**Current Liabilities:**

Accounts payable and accrued expenses, including Manager - related party fee of \$154,734 and \$88,228 at June 30, 2012 and December 31, 2011, respectively	\$248,360	\$195,696
Total Current Liabilities	248,360	195,696

Commitments and Contingencies**Stockholders' Equity:**

Preferred stock - \$0.001 par value; 1,000,000 shares authorized; 0 shares issued and outstanding	-	-
Common stock - \$0.001 par value; authorized 40,000,000 shares at June 30, 2012 and December 31, 2011; issued and outstanding 8,832,301 shares and 6,832,301 shares at June 30, 2012 and December 31, 2011, respectively	8,833	6,833
Additional paid-in capital	40,097,528	32,598,678
Accumulated deficit	(10,225,154)	(7,540,706)
Total Stockholders' Equity	29,881,207	25,064,805
Total Liabilities and Stockholders' Equity	\$30,129,567	\$25,260,501

The accompanying notes are an integral part of these unaudited condensed financial statements.

SMG INDIUM RESOURCES LTD.**CONDENSED STATEMENTS OF OPERATIONS****(Unaudited)**

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
Operating Costs:				
Inventory - indium write-down	\$1,496,548	\$-	\$2,004,588	\$-
Operating expenses - Manager - related party	154,734	401,907	319,822	401,907
Officers and directors compensation expense	36,625	186,750	70,850	186,750
Other operating expenses	206,554	136,302	322,995	313,734
Total Operating Costs	1,894,461	724,959	2,718,255	902,391
Other expense (income):				
Interest expense - Manager - related party	-	1,325	-	5,300
Interest income	(5,922)	(9,739)	(13,747)	(9,739)
Other income	-	-	(20,060)	-
Net Loss	(1,888,539)	(716,545)	(2,684,448)	(897,952)
Preferential Dividend to Class A Common Stockholders	-	(2,359,755)	-	(2,359,755)
Net Loss Applicable to Common Stockholders	\$(1,888,539)	\$(3,076,300)	\$(2,684,448)	\$(3,257,707)
Net Loss Applicable to Common Stockholders - Per Basic and Diluted Share	\$(0.21)	\$(0.80)	\$(0.31)	\$(1.62)
Weighted Average Number of Common Shares Outstanding - Basic and Diluted	8,832,301	3,852,840	8,788,345	2,014,135

The accompanying notes are an integral part of these unaudited condensed financial statements.

SMG INDIUM RESOURCES LTD.

CONDENSED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(Unaudited)

	Common Stock		Additional	Accumulated	Total
	Shares	Value	Paid-In	Deficit	Stockholders'
			Capital		Equity
Balance at December 31, 2011	6,832,301	\$6,833	\$32,598,678	\$(7,540,706)	\$25,064,805
Issuance of common stock in a private placement, net	2,000,000	2,000	7,495,500	-	\$7,497,500
Awards of stock options to an officer	-	-	3,350	-	\$3,350
Net loss	-	-	-	\$(2,684,448)	\$(2,684,448)
Balance at June 30, 2012	8,832,301	\$8,833	\$40,097,528	\$(10,225,154)	\$29,881,207

The accompanying notes are an integral part of these unaudited condensed financial statements.

SMG INDIUM RESOURCES LTD.**CONDENSED STATEMENTS OF CASH FLOWS****(Unaudited)**

	For the Six Months Ended June 30,	
	2012	2011
Cash flow from operating activities:		
Net loss	\$(2,684,448)	\$(897,952)
Adjustments to reconcile net loss to net cash used in operating activities:		
Write-down of inventory - indium	2,004,588	-
Non-cash compensation to Manager - related party	-	197,970
Non-cash compensation to officers and directors	3,350	140,250
Accrued interest to Manager - related party	-	5,300
Depreciation	166	-
Changes in operating assets and liabilities:		
Increase in prepaid expenses	(42,594)	(65,491)
Decrease (increase) in cash and cash equivalents restricted for indium purchases	2,700,781	(11,729,466)
Increase in inventory - indium	(5,222,153)	(8,633,926)
Increase in accounts payable and accrued expenses	52,664	57,696
Net cash used in operating activities	(3,187,646)	(20,925,619)
Cash flow from financing activities:		
Proceeds from initial public offering, net	-	24,212,343
Proceeds from private placement of common stock, net	7,497,500	-
Net cash provided by financing activities	7,497,500	24,212,343
Net increase in cash and cash equivalents	4,309,854	3,286,724
Cash and cash equivalents, at beginning of period	3,536,331	693,940
Cash and cash equivalents, at end of period	\$7,846,185	\$3,980,664

The accompanying notes are an integral part of these unaudited condensed financial statements.

SMG INDIUM RESOURCES LTD.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

Note 1 — Organization and Nature of Business and Basis of Presentation

Organization and Nature of Business

SMG Indium Resources Ltd. (the “Company”) is a corporation established pursuant to the laws of the State of Delaware on January 7, 2008. On April 2, 2008, the Company changed its name from Specialty Metals Group Indium Corp. to SMG Indium Resources Ltd. Effective with the quarter ended June 30, 2011, the Company is an operating company and is no longer considered a development-stage company. The Company operates in a single-segment business whose primary business purpose is to purchase and stockpile indium, a specialty metal that is being increasingly used as a raw material in a wide variety of consumer electronics manufacturing applications. The primary commercial application of indium is in coatings for the flat panel display industry and in the liquid crystal display (“LCD”) industry on electronic devices such as television sets, computer monitors, cell phones and digital cameras. Indium is increasingly being used as a raw material in light emitting diodes (“LED”) and in the solar energy industry. Its main use in solar energy applications is for high-efficiency photovoltaic cells in the form of thin-film photovoltaic. Other uses of indium are in electrical components, alloys and solders. At its discretion and based on market conditions, the Company may subsequently lend or sell some, or all, of its indium stockpile to cover annual operating expenses. The Company’s common shares represent an indirect interest in the physical indium it owns.

To assist in the purchase of indium, the Company entered into a Management Services Agreement, as amended and restated on May 10, 2011 (the “MSA”), with a related party, Specialty Metals Group Advisors, LLC (“SMG Advisors” or the “Manager”). The primary responsibilities of the Manager are: (i) purchasing, lending and selling indium; (ii) submitting written reports to the Company’s Board of Directors detailing the delivery and payment particulars regarding each purchase and sale of indium; (iii) arranging for the storage of indium; (iv) preparing a biweekly report on the net market value (“NMV”), as defined below; (v) preparing any regulatory filings or special reports to the Company’s stockholders and Board of Directors; and (vi) managing the general business affairs of the Company. The MSA has an initial term of five years with options to renew upon mutual agreement between the parties. Pursuant to the terms of the MSA, the Company is required to pay the Manager a fee of 2% per annum of the monthly NMV beginning in May 2011 upon the completion of the Company’s Initial Public Offering (“IPO”); see Note 4. Since the Company was not obligated to pay any fees prior to the IPO, no fees were paid or accrued to the Manager prior to May 2011.

The NMV is not a United States generally accepted accounting principles (“U.S. GAAP”) measurement. It is an internally created formula used by the Company to monitor performance and to compute the management fee and the number of IPO units that the Class A stockholders received upon the completion of the IPO. The NMV is determined by multiplying the number of kilograms of indium held by the Company by the last spot price for indium published by Metal Bulletin and posted on Bloomberg L.P. (Bloomberg L.P. is not regulated or government approved) for the month, plus cash and other Company assets, less any liabilities. At June 30, 2012 and December 31, 2011, the Company’s management calculated the NMV of the Company to be approximately \$30.0 million and \$25.7 million, respectively. At June 30, 2012 and December 31, 2011, the excess of the indium spot price as of the respective dates (as published by Metal Bulletin PLC and posted on Bloomberg L.P.) over the historical book value was approximately \$0.1 million and \$0.6 million, respectively.

The Company’s business strategy is to purchase and stockpile indium in order to achieve long-term appreciation in the value of its indium stockpile, and not to actively speculate with regard to short-term fluctuations in indium prices. However, there is no assurance that the price of indium or the value of the Company’s securities will increase over time. The Company was required to use at least 85% of the net proceeds of the IPO to purchase and stockpile already processed and mined indium ingots within 18 months of consummating the IPO. As of June 30, 2012, the Company satisfied its obligation and expended the 85% required by the IPO. The Company’s indium is insured and physically stored in a facility located in New York. In the future, the Company’s indium may be stored in other facilities in the United States, Canada, the Netherlands and/or the United Kingdom.

SMG INDIUM RESOURCES LTD.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

Note 1 — Organization and Nature of Business and Basis of Presentation – (continued)

Basis of Presentation

The accompanying interim unaudited condensed financial statements have been prepared in accordance with U.S. GAAP and with the instructions to Form 10-Q and Article 10 of Regulation S-X as promulgated by the Securities and Exchange Commission (“SEC”). Accordingly, these interim unaudited condensed financial statements do not include all of the disclosures required by U.S. GAAP for complete financial statements. These interim unaudited condensed financial statements should be read in conjunction with the Company’s audited financial statements included in the Company’s 2011 Annual Report on Form 10-K, filed with the SEC. In the opinion of management, the interim unaudited condensed financial statements included herein include all adjustments, all of which are of a normal recurring nature, necessary for a fair statement of the results for the interim periods presented. The condensed balance sheet at December 31, 2011 has been derived from the Company’s 2011 audited financial statements included in the Company’s 2011 Annual Report on Form 10-K, as filed with the SEC. Operating results for the three months and six months ended June 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012 or any interim period.

Note 2 — Summary of Significant Accounting Policies

Use of Estimates

The preparation of the financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statement and the reported amounts of revenue and expenses during the reporting period. The most significant estimates relate to the valuation of indium inventory, share-based compensation, income tax, and revenue recognition. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid instruments with original maturities of 90 days or less at the time of purchase to be cash equivalents.

Inventory of the Metal Indium

The Company's inventory or "stockpile" of the metal indium is recorded at cost, including all associated costs of delivering the indium to the bonded storage warehouse on the date the Company takes delivery of the physical metal. Cost is determined using the specific-identification method. The stockpile of the physical metal indium is classified as noncurrent as the Company does not expect to sell any of the indium during the next twelve months. The stockpile of the physical metal indium is carried at the lower of cost or market with cost being determined on a specific-identification method and market being determined as the net realizable value based on the spot prices obtained from Metal Bulletin as posted on Bloomberg L.P., a real-time financial information services data platform. The Company charges against earnings an inventory write-down on an interim basis the amount by which the spot price of indium is less than cost on a specific-identification basis. Increases in the spot price of the same lots of indium held in inventory in later interim periods within the fiscal year are recognized in the later interim period. Increases in value recognized on an interim basis do not exceed the previously recognized diminution in value within that fiscal year. Further, the Company periodically reviews the indium stockpile to determine if a loss should be recognized where the utility of indium has been impaired on an other-than-temporary basis. Where such impairment is viewed as other-than-temporary, the Company will charge against earnings the amount by which the fair market value is less than the cost. Realized gains (losses) from sale transactions will be determined for income tax and for financial reporting purposes on a specific-identification method when incurred. During the three months and six months ended June 30, 2012, certain lots of indium in inventory were adjusted to reflect a lower of cost or market write-down of approximately \$1.5 million and \$2.0 million, respectively. There was no such write-down during the first half of 2011. The spot price of indium on August 1, 2012 was \$495 per kilogram which is lower than the spot price on June 30, 2012 of \$502.50 per kilogram. If the spot price of indium does not recover to \$502.50 per kilogram by September 30, 2012, the Company will be required to take an additional write-down in the third quarter of 2012.

Basic and Diluted Earnings (Loss) per Share

The Company presents both basic and diluted earnings (loss) per share ("EPS") on the face of the statement of operations. Basic EPS is computed by dividing net loss applicable to common stockholders by the weighted average number of common shares outstanding during the period. Diluted EPS gives effect to all potentially dilutive common shares outstanding during the period including stock options and warrant, using the treasury-stock method and convertible stock using the if-converted method. If antidilutive, the effect of potentially dilutive common shares is ignored. In computing diluted EPS, the average stock price for the period is used in determining the number of shares assumed to be purchased from the exercise of stock option or warrants. For the three months and six months ended June 30, 2012, the number of common shares potentially issuable upon the exercise of certain (1) warrants was 6,998,101, (2) options was 634,999 and (3) unit purchase option ("UPO") was 240,000 for both periods. For the three months and six months ended June 30, 2011, the number of common shares potentially issuable upon the exercise of certain (1) warrants was 6,998,101, (2) options was 624,999 and (3) UPO was 240,000 for both periods. These potentially issuable shares have been excluded from the computation of the diluted EPS for both periods since the

effect would be antidilutive. Also, for the three months and six months ended June 30, 2011, 1,163,600 shares of Class A common stock were excluded from the calculation of dilutive EPS since the effect would be antidilutive.

SMG INDIUM RESOURCES LTD.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

Note 2 — Summary of Significant Accounting Policies – (continued)

Accounting for Direct Sales and Lending Transactions

The stockpile of indium may be used from time to time for “direct sales” and/or “lending” transactions. Under a “direct sale” transaction, the Company would record a gain (loss) equal to the difference between the proceeds received from the sale of indium and the indium carrying value. The Company may also elect to enter into a lending transaction. In indium lending transactions, the Company would exchange a specified tonnage and purity of indium for cash. Title and the risks and rewards of such indium ownership would pass to the purchaser/counterparty in the lending transaction. The Company would simultaneously enter into an agreement with such counterparty in which it would unconditionally commit to purchase and the counterparty would unconditionally commit to sell a specified tonnage and purity of indium that would be delivered to the Company at a fixed price and at a fixed future date in exchange for cash (the Unconditional Sale and Purchase Agreement or “USPA”). The USPA would also contain terms providing the counterparty with substantial disincentives (“penalty fees”) for nonperformance of the return of indium to the Company as a means to assure its future supply of indium. While the Company believes that this risk would be mitigated by the penalty fee features of the USPA, it is nonetheless a risk associated with a transaction of this type.