SOLITARIO ZINC CORP.
Form 10-Q
May 02, 2018

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 **March 31, 2018**

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 ZINC 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 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, smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

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

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

YES NO

There were 58,332,266 shares of $0.01 par value common stock outstanding as of May 01, 2018.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

SOLITARIO ZINC CORP.

CONSOLIDATED BALANCE SHEETS

(in thousands of U.S. dollars, except share and per share amounts)	March 31, 2018 (unaudited)	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 97	$ 214
Short-term investments	11,223	11,642
Investments in marketable equity securities, at fair value	2,202	2,643
Prepaid expenses and other	93	114
Total current assets	13,615	14,613
Mineral properties	15,657	15,657
Other assets	127	125
Total assets	$ 29,399	$ 30,395
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 165	$ 141
Long-term liabilities		
Asset retirement obligation – Lik	125	125
Commitments and contingencies		
Equity:		
Shareholders' equity:		
Preferred stock, $0.01 par value, authorized 10,000,000 shares (none issued and outstanding at March 31, 2018 and December 31, 2017)	—	—
Common stock, $0.01 par value, authorized 100,000,000 shares (58,381,952 and 58,434,566 shares, respectively, issued and outstanding at March 31, 2018 and December 31, 2017)	584	584
Additional paid-in capital	69,296	69,312
Accumulated deficit	(40,771)	(39,767)
Total shareholders' equity	29,109	30,129
Total liabilities and shareholders' equity	$ 29,399	$ 30,395

See Notes to Unaudited Condensed Consolidated Financial Statements

SOLITARIO ZINC CORP.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(in thousands of U.S. dollars, except per share amounts)	Three months ended March 31	
	2018	2017
Costs, expenses and other:		
Exploration expense	$180	$151
Depreciation and amortization	6	1
General and administrative	403	300
Total costs, expenses and other	589	452
Other (loss) income		
Interest income (net)	26	46
Unrealized (loss) gain on marketable equity securities	(441)	128
Gain on derivative instruments	—	172
Total other (loss) income	(415)	346
Net loss	$(1,004)	$(106)
Loss per common share:		
Basic and diluted	$(0.02)	$(0.00)
Weighted average shares outstanding:		
Basic and diluted	58,444	38,692

See Notes to Unaudited Condensed Consolidated Financial Statements

SOLITARIO ZINC CORP.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands of U.S. dollars)	Three months ended March 31, 2018	2017
Operating activities:		
Net loss	$(1,004)	$(106)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	6	1
Unrealized loss (gain) on sale of marketable equity securities	441	(128)
Employee stock option expense	10	—
Unrealized (gain) on derivative instruments	—	(172)
Changes in operating assets and liabilities:		
Prepaid expenses and other current assets	32	32
Accounts payable and other current liabilities	24	(12)
Net cash used in operating activities	(491)	(385)
Investing activities:		
Sale of short-term investments, net	408	246
Purchase of other assets	(8)	—
Proceeds from the sale of marketable equity securities	—	259
Purchase of marketable equity securities	—	(167)
Sale of derivative instruments	—	25
Net cash provided by investing activities	400	363
Financing activities:		
Purchase of common stock for cancellation	(26)	(6)
Net cash used in financing activities	(26)	(6)
Net decrease in cash and cash equivalents	(117)	(28)
Cash and cash equivalents, beginning of period	214	119
Cash and cash equivalents, end of period	$97	$91

See Notes to Unaudited Condensed Consolidated Financial Statements

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Business and Significant Accounting Policies

Business and company formation

Solitario Zinc Corp. (“Solitario,” or the “Company”) is an exploration stage company as defined in Industry Guide 7, as issued by the United States Securities and Exchange Commission (“SEC”). Solitario was incorporated in the state of Colorado on November 15, 1984 as a wholly-owned subsidiary of Crown Resources Corporation ("Crown"). In July 1994, Solitario became a publicly traded company on the Toronto Stock Exchange (the "TSX") through its initial public offering. Solitario has been actively involved in mineral exploration since 1993. Solitario’s primary business is to acquire exploration mineral properties or royalties and/or discover economic deposits on its mineral properties and advance these deposits, either on its own or through joint ventures, up to the development stage. At that point, or sometime prior to that point, Solitario would likely attempt to sell its mineral properties, pursue their development either on its own, or through a joint venture with a partner that has expertise in mining operations, or create a royalty with a third party that continues to advance the property. As a result of the Acquisition (defined below), Solitario is now primarily focused on the acquisition and exploration of zinc-related exploration mineral properties. In addition to focusing on its mineral exploration properties and the evaluation of mineral properties for acquisition or purchase of royalty interests, Solitario also evaluates potential strategic transactions for the acquisition of new precious and base metal properties and assets with exploration potential or business combinations that Solitario determines to be favorable to Solitario.

Solitario has recorded revenue in the past from the sale of mineral property, including the sale in 2015 of its former interest in Mount Hamilton LLC (“MH-LLC”) the owner of its former Mt. Hamilton project (the “Mt. Hamilton Transaction”), and joint venture property payments and the sale of a royalty on its former Mt. Hamilton project. Revenues from the sale or joint venture of properties or assets, although significant when they occur, have not been a consistent annual source of revenue and would only occur in the future, if at all, on an infrequent basis.

Solitario currently considers its carried interest in the Florida Canyon project and its interest in the Lik project to be its core mineral property assets. Solitario’s joint venture partner is expected to continue the development and furtherance of the Florida Canyon project and Solitario will monitor progress at Florida Canyon. Solitario is working with its 50% joint venture partner, Teck American Incorporated, a wholly-owned subsidiary of Teck Resources Limited (both companies referred to as “Teck”), in the Lik deposit to further the exploration and evaluate potential development plans for the Lik project.

As of March 31, 2018, Solitario has significant balances of cash and short-term investments that Solitario anticipates using, in part, to further the development of the Florida Canyon and Lik projects and to potentially acquire additional mineral property assets. The fluctuations in precious metal and other commodity prices contribute to a challenging environment for mineral exploration and development, which has created opportunities as well as challenges for the potential acquisition of early-stage and advanced mineral exploration projects or other related assets at potentially attractive terms.

The accompanying interim condensed consolidated financial statements of Solitario for the three months ended March 31, 2018 are unaudited and are prepared in accordance with accounting principles generally accepted in the United States of America ("generally accepted accounting principles"). 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, 2018.

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, 2017. 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

Purchase of Zazu

On July 12, 2017, Solitario completed the acquisition of Zazu Metals Corp. (“Zazu”) pursuant to a definitive arrangement agreement between Solitario and Zazu whereby Solitario agreed to acquire all of the issued and outstanding common shares of Zazu (the "Zazu Shares") by way of a statutory plan of arrangement (the "Arrangement") under the *Canada Business Corporations Act* (the “Acquisition”). The Arrangement was approved by the Ontario (Canada) Superior Court of Justice on July 7, 2017. Per the Arrangement, Solitario issued 19,788,177 shares of its common stock on July 12, 2017 in exchange for all of the issued and outstanding Zazu Shares, which represented 0.3572 shares of Solitario common stock for each outstanding Zazu Share. Zazu had one primary asset, its interest in the Lik project, and the Acquisition was treated as an asset purchase in accordance with ASU 2017-01 “Business Combinations.” Solitario granted stock options to acquire an aggregate of 1,782,428 shares of Solitario common stock to Zazu option holders the (“Replacement Options”) in connection with the Acquisition. The total purchase price of $16,110,000 was recorded during the year ended December 31, 2017.

Financial reporting

The consolidated financial statements include the accounts of Solitario and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("generally accepted accounting principles") and are expressed in U.S. dollars.

Revenue recognition

Solitario records delay rental payments as revenue in the period received. Any payments received for the sale of property interests 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. There were no delay rentals in the periods presented.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Some of the more significant estimates included in the preparation of Solitario's financial statements pertain to: (i) Solitario’s carrying value of short-term investments; (ii) the recoverability of mineral properties related to its mineral exploration properties and their future exploration potential; (iii) the fair value of stock option grants to employees, to officers and directors and to others; (iv) the ability of Solitario to realize its deferred tax assets; and (v) Solitario's investment in marketable equity securities.

In performing its activities, Solitario has incurred certain costs for mineral properties. The recovery of these costs is ultimately dependent upon the sale of mineral property interests or the development of economically recoverable ore reserves and the ability of Solitario to obtain the necessary permits and financing to successfully place the properties into production, and upon future profitable operations, none of which is assured.

Cash equivalents

Cash equivalents include investments in highly liquid money-market securities with original maturities of three months or less when purchased. As of March 31, 2018, a portion of Solitario’s cash and cash equivalents are held in brokerage accounts and foreign banks, which are not covered under the Federal Deposit Insurance Corporation (“FDIC”) rules for the United States. At March 31, 2018, Solitario holds short-term investments in United States Treasury securities (“USTS”) of $9,976,000.

Short-term investments

As of March 31, 2018, Solitario has $9,976,000 of its current assets in USTS with maturities of 15 days to 21 months. The USTS are recorded at their fair value, based upon quoted market prices. As of March 31, 2018, we have $1,247,000 in separate bank certificates of deposit ("CDs") each with a maximum value of $250,000, and each of which are covered by FDIC insurance to the full-face value of the CDs. At March 31, 2018, the CDs have maturities of between 4 and 15 months. Solitario's short-term investments are recorded at their fair value, based upon quoted market prices. The short-term investments are highly liquid and may be sold in their entirety at any time at their quoted market price and are classified as a current asset.

Mineral properties

Solitario expenses all exploration costs incurred on its mineral properties prior to the establishment of proven and probable reserves through the completion of a feasibility study. Initial acquisition costs of Solitario's mineral properties are capitalized. Solitario capitalizes all of its development expenditures on its projects, subsequent to the completion of a feasibility study. Solitario regularly performs evaluations of its investment in mineral properties to assess the recoverability and/or the residual value of its investments in these assets. All long-lived assets are reviewed for impairment whenever events or circumstances change which indicate the carrying amount of an asset may not be recoverable, utilizing established guidelines based upon undiscounted future net cash flows from the asset or upon the determination that certain exploration properties do not have sufficient potential for economic mineralization.

Derivative instruments

Solitario accounts for its derivative instruments in accordance with ASC 815, "Accounting for Derivative Instruments and Hedging Activities" ("ASC 815"). Solitario has entered into covered calls from time to time on its investment in Kinross Gold Corporation ("Kinross") marketable equity securities. In addition, during 2017 and 2016, Solitario owned warrants exercisable to acquire shares of Vendetta Mining Corp. ("Vendetta") common stock (the "Vendetta Warrants"). Each Vendetta warrant allowed Solitario to purchase one share of Vendetta common stock at a price of Cdn$0.10 per share for a period of two years. Solitario has not designated its covered calls as hedging instruments and any changes in the fair value of the covered calls and its Vendetta Warrants are recognized in the statement of operations in the period of the change as gain or loss on derivative instruments.

Fair value

FASB ASC 820, “Fair Value Measurements and Disclosures” (“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. For certain of Solitario's financial instruments, including cash and cash equivalents and accounts payable, the carrying amounts approximate fair value due to their short-term maturities. Solitario's short-term investments in USTS and CDs, its marketable equity securities and any covered call options against those marketable equity securities are carried at their estimated fair value based on quoted market prices.

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. Solitario records investments in marketable equity securities as available-for-sale for investments in publicly traded marketable equity securities for which it does not exercise significant control and where Solitario has no representation on the board of directors of those companies and exercises no control over the management of those companies. The cost of marketable equity securities sold is determined by the specific identification method. During the first three months of 2018 Solitario adopted ASU 2016-01, “Financial Instruments – Recognition and Measurement of Financial Assets and Financial Liabilities (Topic 825)” (“ASU 2016-01”). In accordance with ASU 2016-01, changes in fair value are recorded in the consolidated statement of operations during the period of the change. During the first three months of 2018 Solitario recorded a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption of ASU 2016-01. See Note 9, “Shareholders’ Equity and Other Comprehensive Income”, below.

Foreign exchange

The United States dollar is the functional currency for all of Solitario's foreign subsidiaries. Although Solitario's South American exploration activities during 2017 and the first quarter of 2018 have been conducted primarily in Peru, a portion of the payments under the land, leasehold and exploration agreements of Solitario are denominated in United States dollars. Realized foreign currency gains and losses are included in the results of operations in the period in which they occur.

Income taxes

Solitario accounts for income taxes in accordance with ASC 740, "Accounting for Income Taxes" ("ASC 740"). 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.

Accounting for uncertainty in income taxes

ASC 740 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements. ASC 740 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. ASC 740 provides that a company's tax position will be considered settled if the taxing authority has completed its examination, the company does not plan to appeal, and it is remote that the taxing authority would reexamine the tax position in the future. The provisions of ASC 740 had no effect on Solitario's financial position or results of operations.

Earnings per share

The calculation of basic and diluted earnings (loss) per share is based on the weighted average number of shares of common stock outstanding during the three months ended March 31, 2018 and 2017. Potentially dilutive shares related to outstanding common stock options of 2,082,428 Solitario common shares for the three months ended March 31, 2018 were excluded from the calculation of diluted earnings (loss) per share because the effects were anti-dilutive. There were no similar potentially dilutive securities outstanding during the three months ended March 31, 2017.

Employee stock compensation and incentive plans

Solitario classifies all of its stock options as equity options in accordance with the provisions of ASC 718, "Compensation – Stock Compensation."

Recent accounting pronouncements

In February 2016, the FASB issued ASU 2016-02, "Leases" ("ASU No. 2016-02"), which will require lessees to recognize a right-of-use asset and a lease liability for all leases that are not short-term in nature. For a lessor, the accounting applied is also largely unchanged from previous guidance. The new rules will be effective for Solitario in the first quarter of 2019. Solitario does not anticipate early adoption. Solitario does not expect the adoption of ASU No. 2016-02 to materially change its current accounting methods and therefore it does not expect the adoption to have a material impact on its consolidated financial position or results of operations.

In January 2016 the FASB issued ASU No 2016-01. ASU No. 2016-01 revises the classification and measurement of investment in certain equity investments and the presentation of certain fair value changes for certain financial liabilities measured at fair value. ASU No. 2016-01 requires the change in fair value of many equity investments to be recognized in net income. ASU No. 2016-01 is effective for interim and annual periods beginning after December 15, 2017, with early adoption permitted. Solitario adopted ASU No. 2016-01 in the first quarter of 2018. Solitario recorded a cumulative-effect adjustment for the change in accounting principle to retained earnings of $576,000 related to the adoption of ASU 2016-01. See Note 9, "Shareholders' Equity and Accumulated Other Comprehensive Income," below.

In February 2018, the FASB issued ASU No. 2018-02, "Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" (ASU 2018-02), which allows for a reclassification from accumulated other comprehensive income or loss to retained earnings or accumulated deficit for stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017 ("TCJA"). ASU 2018-02 also requires certain related disclosures. ASU 2018-02 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018 and should be applied either in the period of adoption or retrospectively to each period in which the effect of the change in the U.S. federal corporate income tax rate in the TCJA is recognized. Early adoption is permitted. Solitario is currently evaluating the impact of ASU 2018-02 but does not believe it will have a material effect on Solitario's financial position or results of operations.

2. Mineral Property

The following table details Solitario's investment in Mineral Property:

(in thousands)	March 31, 2018	2017
Exploration		
Lik project (Alaska – US)	$15,611	$15,611
La Promesa (Peru)	6	6
Montana Royalty property (US)	40	40
Total exploration mineral property	$15,657	$15,657

All exploration costs on our exploration properties, none of which have proven and probable reserves, including any additional costs incurred for subsequent lease payments or exploration activities related to our projects are expensed as incurred.

<u>Exploration expense</u>

The following items comprised exploration expense:

(in thousands)	Three months ended March 31,	
	2018	2017
Geologic and field expenses	$24	$22
Administrative	156	129
Total exploration costs	$180	$151

Asset Retirement Obligation

In connection with the Acquisition, Solitario recorded an asset retirement obligation of $125,000 for Solitario's estimated reclamation cost of the existing disturbance at the Lik project. This disturbance consists of an exploration camp including certain drill sites and access roads at the camp. The estimate was based upon estimated cash costs for reclamation as determined by the permitting bond required by the State of Alaska, for which Solitario has purchased a reclamation bond insurance policy in the event Solitario or its 50% partner, Teck, do not complete required reclamation.

Solitario has not applied a discount rate to the recorded asset retirement obligation as the estimated time frame for reclamation is not currently known, as reclamation is not expected to occur until the end of the Lik project life, which would follow future development and operations, the start of which cannot be estimated or assured at this time. Additionally, no depreciation will be recorded on the related asset for the asset retirement obligation until the Lik project goes into operation, which cannot be assured.

3. 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 the consolidated statement of operations. During the three months ended March 31, 2018, Solitario recorded an unrealized loss on marketable equity securities of $441,000. During the three months ended March 31, 2017, Solitario recorded an unrealized gain on marketable equity securities of $128,000.

On May 2, 2016 Solitario purchased 7,240,000 units of Vendetta for aggregate consideration of $289,000. Each unit included one common share of Vendetta and one Vendetta Warrant. The total purchase price for the units of $289,000 was allocated between the Vendetta common shares and the Vendetta Warrants based upon total fair values on the date of purchase. The Vendetta common shares were allocated a purchase cost of $186,000 and the Vendetta Warrants were allocated a purchase cost of $103,000. During the three months ended March 31, 2017, Solitario sold 1,480,000 common shares of Vendetta for proceeds of $259,000, and a recorded cost of $38,000. In addition, during the three months ended March 31, 2017 Solitario exercised 2,240,000 of the Vendetta Warrants it held and received 2,240,000 Vendetta common shares, by paying $167,000 (Cdn$224,000) to Vendetta. The cost of the common shares received from the exercise of the Vendetta Warrants was recorded based upon the total of the (i) exercise price of the Vendetta Warrants exercised, $167,000, and (ii) the fair value of the Vendetta Warrants on the date of exercise, which equaled their intrinsic value, $309,000, for a total value of $476,000. During 2017, subsequent to March 31, 2017, Solitario exercised its remaining 5,000,000 Vendetta Warrants by paying $441,000 and owns 11,000,000 common shares of Vendetta and no Vendetta Warrants as of March 31, 2018 and December 31, 2017.

The following tables summarize Solitario’s marketable equity securities and adjustments to fair value:

(in thousands)	March 31, 2018	December 31, 2017
Marketable equity at cost	$1,714	$ 1,714
Unrealized gain on marketable equity securities	488	929
Marketable equity securities at fair value	$2,202	$ 2,643

The following table represents changes, including sales, in marketable equity securities during the three months ended March 31, 2018 and 2017:

(in thousands)	Three months ended March 31, 2018	2017
Cost of marketable equity securities sold	$—	$38
Realized gain on marketable equity securities sold	—	221
Proceeds from the sale of marketable equity securities sold	—	(259)
Purchase of marketable equity securities	—	477
Gross unrealized (loss) gain recorded in the statement of operations	(441)	128
Change in marketable equity securities at fair value	$(441)	$346

4. Other Assets

The following items comprised other assets:

(in thousands)	March 31, 2018	December 31 2017
Furniture and fixtures, net of accumulated depreciation	$ 38	$ 31
Lik project equipment, net of accumulated depreciation	85	90
Exploration bonds and other assets	4	4
Total other assets	$ 127	$ 125

5. Derivative Instruments

Vendetta Warrants

During the three months ended March 31, 2017, Solitario exercised 2,240,000 of the Vendetta Warrants it held and received 2,240,000 Vendetta common shares, by paying $167,000 (Cdn$224,000) to Vendetta. As a result, as of March 31, 2017, Solitario owned 5,000,000 Vendetta Warrants, which are carried at fair value, based upon a Black-Scholes model. During the three months ended March 31, 2017, Solitario recorded a gain on derivative instruments of $148,000, related to the Vendetta Warrants. Solitario owned no Vendetta Warrants during the three months ended March 31, 2018; see Note 3, "Marketable equity securities," above.

Covered Call Options

From time to time Solitario has sold covered call options against its holdings of Kinross. The business purpose of selling covered calls is to provide additional liquidity on a limited portion of shares of Kinross that Solitario may sell in the near term, which is generally defined as less than one year. Solitario has not designated its covered calls as hedging instruments and records gains or loss on the covered call in the period of the change.

Solitario recorded the following gain on derivative instruments:

(in thousands)	Three months

	ended March 31,	
	2018	2017
Gain (loss) on Kinross calls	$—	$24
Gain on Vendetta Warrants	—	148
	$—	$172

6. Fair Value

For certain of Solitario's financial instruments, including cash and cash equivalents and payables, the carrying amounts approximate fair value due to their short-term maturities. Solitario's short-term investments in CDs and USTS, Kinross calls and marketable equity securities are carried at their estimated fair value primarily based on quoted market prices.

Solitario accounts for its financial instruments under ASC 820. 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.

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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 months ended March 31, 2018 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 March 31, 2018:

(in thousands)	Level 1	Level 2	Level 3