

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## General

You should read the following discussion and analysis together with the consolidated financial statements of Apex Silver Mines Limited and the selected financial data and related notes.

Apex Limited is a mining exploration and development company that holds a portfolio of silver exploration and development properties primarily in South America, Mexico and Central America. None of these properties are in production and, consequently, we have no current operating income or cash flow.

We currently focus our resources primarily on the development of our San Cristobal Project in Bolivia and our continued efforts to secure appropriate financing.

Our Company completed an initial public offering of Ordinary Shares on December 1, 1997. We completed a subsequent offering of Ordinary Shares and warrants during November 1999.

## Results of Operations

### *Interest and Other Income*

Our Company does not yet produce silver or any other mineral products and has no revenues from product sales. Our primary source of revenue is interest income. Our policy is to invest all excess cash in liquid, high credit quality, short-term financial instruments. Our interest and other income for the year ended December 31, 2000 was \$5.7 million compared to \$1.1 million and \$2.4 million for the years ended December 31, 1999 and 1998, respectively. The 2000 increase in interest and other income compared to 1999 is primarily the result of interest earned on higher average cash balances during 2000 as the result of the net proceeds of our November 1999 offering of Ordinary Shares and warrants. The decrease in our interest and other

income for 1999 compared to 1998 was due to the reduced average cash balance during 1999, prior to the receipt of the net proceeds of our November 1999 offering.

### *Exploration*

Our Company expenses mineral exploration expenditures as incurred on each property until we determine that mining operations on that property are feasible. Once we have determined that a mineral property has proven and probable ore reserves, we capitalize all development costs. Through December 31, 2000, we have expensed all acquisition and exploration costs as incurred. Since September 1, 1997, we have capitalized development costs associated with the San Cristobal Project and will continue to do so in the future.

Our exploration expenses, including property holding costs and allocated administrative expenses, were \$4.4 million for the year ended December 31, 2000 compared to \$6.0 million and \$10.0 million for the years ended December 31, 1999 and 1998, respectively. The decrease in our exploration expenses for these periods is due primarily to the reduced emphasis on exploration as we concentrate our resources on the development of the San Cristobal Project.

### *Administrative*

Our administrative expenses were \$8.4 million for the year ended December 31, 2000, compared to \$2.8 million and \$3.3 million for the years ended December 31, 1999 and 1998, respectively. The increase in our administrative expenses in 2000 as compared to 1999 is primarily due to costs and fees directly related to our project financing efforts and stock compensation. The decrease in our administrative expenses for 1999 compared to 1998 is primarily the result of the refocusing of our efforts on development activities at the San Cristobal Project.

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## *Income Taxes*

Apex Silver Mines Corporation, our U.S. management services company, is subject to U.S. income taxes. Otherwise our Company pays no income tax in the U.S. since we are incorporated in the Cayman Islands and conduct no business that currently generates U.S. taxable income. The Cayman Islands currently impose no corporate taxation. Our Company has been granted exemption until January 16, 2015 from any form of corporate taxation which may subsequently be adopted in the Cayman Islands.

## Liquidity and Capital Resources

As of December 31, 2000, our Company had cash and cash equivalents of approximately \$61.1 million compared to \$96.3 million at December 31, 1999. The decrease in our cash and cash equivalents during 2000 is due to the investment of approximately \$27.5 million in property, plant and equipment related to the development of San Cristobal, \$7.3 million in cash used in operations, which is net of interest and other income and is primarily related to administration and exploration, and \$0.4 million of payments on outstanding notes.

In September 2000, our Company amended and replaced its registration statement at the Securities and Exchange Commission with a universal shelf registration statement. The universal shelf registration statement became effective September 8, 2000, and allows us to raise up to \$200 million by selling any combination of equity or debt securities listed in the statement. Proceeds from offering(s) under the shelf registration, if any, may be used to construct and develop San Cristobal, continue exploring our other properties, maintain control or ownership of our properties, acquire additional mining related properties or businesses and for general corporate purposes. It is anticipated that project financing will constitute the substantial majority of the overall financing for the San Cristobal Project. At December 31, 2000 no securities had been sold

under the universal shelf registration statement. In February 2001, 65,000 Ordinary Shares were issued under the shelf registration statement as consideration for acquisition of an exploration property.

Based on estimated revisions made during 2000 to the September 1999 feasibility study for the San Cristobal Project, which assumes contract mining, we expect capital costs for construction to total approximately \$435 million, of which approximately \$23 million has been spent through December 31, 2000. The \$435 million is net of approximately \$60 million in expected tax credits, of which approximately \$35 million is expected to be recovered during the Project's construction phase, and the remaining \$25 million is expected to be recovered against our future Bolivian income taxes. We estimate project spending for the year 2001 to range from approximately \$10 million to \$25 million, depending upon when fabrication of major capital items commences. We plan to fund project expenditures from our existing cash balances. These expenditures may be significantly reduced if our Company decides to delay the construction schedule while waiting for an improvement in financial and metals markets. We have this financial flexibility due to our existing cash balances and low debt.

In order to maintain our mineral properties, we must make certain payments including government mineral patent fees and commissions, work commitments, lease and option payments and advance royalties. In order to maintain our current portfolio of mineral properties, we will be required to make payments during the next twelve months of approximately \$0.2 million for San Cristobal, \$0.9 million for Platosa and \$0.8 million for our other exploration properties. In addition, we expect to make expenditures for other continuing exploration, property acquisition, property evaluation and general corporate expenses. Total exploration and administrative expense is not anticipated to increase significantly during the next twelve months. We expect to fund these obligations from existing cash balances.

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We will be required to raise significant additional debt and equity financing from outside sources to complete development of the San Cristobal Project. In May 2000, two key multilateral funding agencies, International Finance Corporation and Corporacion Andina de Fomento, joined our co-lead arrangers for project financing, Barclays and Deutsche Bank, to develop multilateral financing options for San Cristobal as part of a total financing package that may incorporate support from other official agencies as well as debt financing from banks and the capital markets. There can be no assurance that we will be able to obtain the required financing on terms that we find attractive, or at all.

## Environmental Compliance

Our current and future exploration and development activities, as well as our future mining and processing operations, are subject to various federal, state and local laws and regulations in the countries in which we conduct our activities. These laws and regulations govern the protection of the environment, prospecting, development, production, taxes, labor standards, occupational health, mine safety, toxic substances and other matters. Our management expects to be able to comply with those laws and does not believe that compliance will have a material adverse effect on our competitive position. We intend to obtain all licenses and permits required by all applicable regulatory agencies in connection with our mining operations and exploration activities. We intend to maintain standards of environmental compliance consistent with best contemporary industry practice.

## Quantitative and Qualitative Disclosures About Market Risk

Currently, our major principal cash balances are held in U.S. dollars. We maintain minimum cash balances in foreign currencies and therefore have a relative low exposure to currency fluctuations. Because we conduct our activities largely in several foreign countries, we may in the future engage in hedging activities to minimize the risk of exposure to currency and interest rate fluctuations.

We expect that we will be required to hedge some portion of our planned production in advance in order to complete the financing necessary to develop San Cristobal. In addition, as we bring San Cristobal into production and begin to derive revenue from the production, sale and exchange of metals, we may utilize various price-hedging techniques to lock in forward delivery prices on a portion of our production. We would expect to balance the use of price-hedging techniques to mitigate some of the risks associated with fluctuations in the prices of the metals we produce while allowing us to take advantage of rising metal prices should they occur.

Our Company has engaged in limited metals trading activities utilizing puts and calls in a manner similar to anticipated lender requirements. At December 31, 2000, we recorded a year-to-date mark to market gain of approximately \$446,000 from these activities. There can be no assurance that we will always benefit from the use of these techniques.