

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. We currently focus our resources primarily on the development and financing of our San Cristobal Project in Bolivia. At present, none of our properties are in production and, consequently, we have no current operating income or cash flow.

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 income 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, 2001 was \$2.2 million compared to \$5.2 million and \$1.0 million for the years ended December 31, 2000 and 1999, respectively. The 2001 decrease in interest and other income compared to 2000 is primarily the result of lower average cash balances and lower interest rates during 2001. The increase in our interest and other income for 2000 compared to 1999 was due to higher average cash balances during 2000 as the result of the net proceeds of our November 1999 offering of ordinary shares and warrants.

Trading Gains and Losses

Our company currently engages in limited metals trading activities utilizing puts and calls and other

trading instruments in anticipation of potential lender requirements for the San Cristobal project financing. We measured the fair value of open positions at each reporting date during 2001, recording the difference in the carrying value to current earnings, in accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("FAS 133"), which we adopted January 1, 2001. Adoption of FAS 133 had no effect on our results of operations or financial position as previously we had marked open positions to market and included gains or losses in earnings. We recorded a trading loss for the year ended 2001 of approximately \$1.0 million compared to trading gains of approximately \$0.4 million and \$0.1 million for 2000 and 1999, respectively. The 2001 \$1.0 million loss as compared to the \$0.4 million gain in 2000 is primarily the result of marking our long position in zinc, and to a lesser extent, silver to market. The 2000 trading gain increase to \$0.4 million from \$0.1 million in 1999 is primarily the result of the increased size of the program in 2000. Inception to date, we have recorded a loss of approximately \$0.4 million related to the trading program. Of that amount, approximately \$0.1 million represents cash losses and the remaining \$0.3 million represents unrealized losses at December 31, 2001. Under FAS 133, fair value measurements may vary substantially from period to period based on spot prices, forward prices and quoted option volatilities.

Exploration

Our company expenses mineral exploration expenditures on each property as incurred 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, 2001, 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.

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Our exploration expenses, including property holding costs and allocated administrative expenses, were \$3.7 million, including the \$0.9 million value of shares issued to acquire mineral rights, for the year ended December 31, 2001, compared to \$4.4 million and \$6.0 million for the years ended December 31, 2000 and 1999, respectively. The decreases in our exploration expenses for these periods are due primarily to the reduced emphasis on exploration as we concentrated our resources on the development of the San Cristobal Project.

Administrative

Our administrative expenses were \$5.4 million for the year ended December 31, 2001 compared to \$8.4 million and \$2.8 million for the years ended December 31, 2000 and 1999, respectively. The decrease in our administrative expenses for 2001 compared to 2000 is primarily the result of cost savings associated with the reduction of personnel and office facilities as part of our cash conserving policy. In addition, the 2001 expenses include the \$0.5 million value of stock and options issued to consultants in lieu of cash. 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 activities.

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 do not conduct or expect to conduct business that 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 that may subsequently be adopted in the Cayman Islands. Deferred tax assets of approximately \$34 million at December 31, 2001, resulting from operating loss carryforwards of our company's subsidiaries, have been entirely offset by valuation allowances.

Liquidity and Capital Resources

As of December 31, 2001, our company had cash and cash equivalents of \$41.5 million compared to \$61.1 million at December 31, 2000. The decrease in our cash and cash equivalents during 2001 is due to the investment of \$12.7 million in property, plant and equipment related to the development of San Cristobal. We also used cash of \$6.7 million for operations, which is net of interest and other income and is primarily related to administration and exploration, and we made payments of \$0.5 million on outstanding notes. These cash uses were partially offset by \$0.3 million in proceeds from the exercise of stock options.

Our company has a universal shelf registration statement filed with the Securities and Exchange Commission that became effective September 8, 2000. The universal shelf registration statement allows us to raise up to \$200 million by selling any combination of equity or debt securities listed in the statement. Proceeds from offerings 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 and acquire additional mining related properties or businesses, and for general corporate purposes. At December 31, 2001 a total of 203,011 Ordinary Shares valued at \$2.1 million had been issued under the shelf registration statement to pay \$0.8 million under a note, to purchase mineral rights for \$0.9 million and to pay \$0.4 million in consulting fees.

The major pre-financing expenditures related to San Cristobal were completed during 2001. Unless there is an improvement in the metals and capital markets in 2002, we expect to limit project spending during the year to approximately \$2 million for completion of our transportation, port and power arrangements and payment of holding and permitting costs. In addition, in order to maintain our current portfolio of mineral properties, we expect to make lease, patent and option payments during the

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next twelve months of about \$1 million. There also may be some discretionary spending on attractive new exploration opportunities should they arise. Total administrative expenses are not expected to exceed \$6 million during 2002, net of interest and other income. Our company could maintain its current properties and retain key personnel while significantly reducing its expenditures should we deem it strategically desirable to do so. We plan to fund our project and operating expenditures from our existing cash balances or, as in 2001, we may issue limited amounts of stock.

We will be required to raise significant additional debt and equity financing from outside sources to complete development of the San Cristobal Project. Based on estimated revisions made during 2000 to the September 1999 feasibility study for the San Cristobal Project, which assumes contract mining, we forecast capital costs for construction to total approximately \$435 million net of approximately \$60 million in expected tax credits, including approximately \$25 million which will be recovered against our company's future Bolivian income taxes after commencement of production. We have spent approximately \$31 million on construction costs through December 31, 2001 and have invested over \$81 million in total project capital to date. When and if metals markets improve, our company expects to complete detailed engineering and incorporate into our feasibility study any changes deriving from our ultimate infrastructure arrangements, which may result in increases to our forecasted construction capital and working capital requirements. We continue to work with our co-lead arrangers for project financing, Barclays Capital and Deutsche Bank Securities Inc., as well as several multilateral funding agencies, 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 use of capital markets. There can be no assurance that metals or capital markets will improve or 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 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.

To complete the project financing for San Cristobal, our company expects to be required to hedge a portion of its planned production. In addition, when San Cristobal enters production, we may sell forward a portion of our production and use price hedging techniques to mitigate some of the risks associated with fluctuating metals prices. Our company currently engages in limited metals trading activities, utilizing puts and calls and other market instruments in anticipation of potential lender requirements for the San Cristobal project financing. See "Results of Operations".