

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

General

The following discussion and analysis should be read together with the consolidated financial statements of Apex Silver Mines Limited and the selected financial data and related notes thereto included elsewhere in this report.

Apex Silver is a mining exploration and development company that holds a portfolio of silver exploration and development properties primarily in South America 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 is in production and, consequently, we have no current operating income or cash flow.

Overview

During 2004, we completed two share offerings resulting in net proceeds of approximately \$208.6 million, after commissions and fees. In March and April of 2004, we completed the issuance of \$200 million principal amount of 2⁷/₈% Convertible Senior Subordinated Notes due 2024 and in October and December of 2004 we completed the issuance of an additional \$140 million principal amount of 4.0% Convertible Senior Subordinated Notes due 2024. The Convertible Notes offerings resulted in aggregate net proceeds of \$328.1 million after commissions. The net proceeds from the share offerings and the Convertible Notes will be used to finance a portion of the construction and development of our San Cristobal project, advance evaluation of exploration properties and for other general corporate purposes.

We continue to work with Barclays and BNP Paribas to secure commercial bank debt financing and develop other financing options for San Cristobal as part of a total financing package that may incorporate support from export credit agencies, multilateral agencies and other public lenders. During 2004, we also filed a universal shelf registration statement on Form S-3 with the Securities and Exchange Commission ("SEC"). The registration statement became effective in August 2004, and allows us to sell up to \$200 million in any combination of equity or

debt securities as described in the registration statement in one or more offerings.

We have completed updating the San Cristobal Development Plan, and, in October 2004, we released an updated estimate of capital costs. The capital cost estimate is approximately \$560 million, \$65 million or 13% more than estimated in the 2000 updated feasibility study. The increase in the estimated capital cost was due to changes in the infrastructure scope (including the decision to haul concentrates by rail rather than by truck), higher energy and raw material costs and other normal cost escalations. The capital cost estimate includes pre-stripping, engineering, procurement, construction, and freight necessary to commence production, as well as appropriate taxes, duties and levies under Bolivian law. The estimate excludes working capital, advances to the companies constructing the power line and port, escalation from the original constant dollar estimate and certain production enhancements which were added subsequent to the October 2004 estimate. Total project funding from January 1, 2004 going forward, including all additional amounts described above that were not included in the October 2004 estimate, is approximately \$650 million. Of this amount, approximately \$26 million in capital costs were spent at the San Cristobal project during 2004 and approximately \$27 million of the costs relate to amounts that may be paid using ordinary shares rather than cash.

In November 2004, we entered into an agreement with an engineering and construction firm that will manage the engineering, procurement and construction for the San Cristobal project. In January 2005, we entered into an Open-Pit Contract Mining Services Agreement with a contract mining firm that will provide services including construction and maintenance of site access and haul roads, open-pit preproduction stripping, mining of ore and waste, construction and management of waste dumps and ore stockpiles, and various other contract mining services.

During 2004, we adopted the fair-value-based method of accounting for stock options as presented in Statement of Financial Accounting Standards No. 123 ("FAS No. 123"), *Accounting for Stock-Based Compensation*, as amended by FAS No. 148, *Accounting*

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

for Stock-Based Compensation—Transition and Disclosure, effective as of the beginning of the year. We used the “modified prospective method” of transition, as defined in FAS No. 123, where employee stock-based compensation cost was recognized from January 1, 2004 as if the fair value based accounting method in FAS No. 123 had been used to account for all employee awards granted, modified, or settled in fiscal years beginning after December 15, 1994. As a result, compensation costs of \$10.1 million were recognized including \$1.4 million capitalized and \$8.7 million charged to expense for the year ended December 31, 2004. The costs include a charge of approximately \$4.1 million relating to the modification of stock awards previously granted to the retiring Apex Silver Chairman, another retiring director and a retiring employee.

Results of Operations

Exploration

Our exploration expenses, including property holding costs and allocated administrative expenses, were \$5.3 million for the year ended December 31, 2004, as compared to \$2.7 million and \$3.9 million for the years ending December 31, 2003 and 2002, respectively. The 2003 and 2002 amounts include the \$0.3 million and \$0.9 million value of Ordinary Shares issued to consultants and to acquire mineral rights for the respective years. The increase in exploration costs during 2004, as compared to the previous two years, is primarily the result of our increased exploration activities in Bolivia and Peru.

Administrative

Administrative expense was \$18.2 million for the year ended December 31, 2004, compared to \$4.6 million and \$5.5 million for the years ended December 31, 2003 and 2002, respectively. The increase in administrative expense during 2004 is primarily the result of non-cash stock compensation expense of \$8.7 million following the adoption of FAS No. 123, which includes expense of approximately \$4.1 million relating to the modification of stock awards previously granted to the retiring Chairman of Apex Silver, another retiring director

and a retiring employee. In addition, the 2004 administrative expense includes the \$2.5 million value of shares granted to the retiring Chairman of Apex Silver as well as a one time \$1.5 million payment made to a consultant for financial advisory and consulting services associated with the equity and Convertible Notes offerings completed during 2004. During 2004, the company also spent approximately \$1.0 million related to the documentation and testing of its internal controls as required by the Sarbanes-Oxley Act. Administrative costs during 2004 also increased as the result of the addition of personnel and the related support costs in anticipation of the development of our San Cristobal project.

The decrease in administrative expenses from \$4.6 million for the year ended December 31, 2003 compared to \$5.5 million for the same period of 2002 is primarily the result of cost savings associated with the reduction of personnel and office facilities as part of a cash conservation policy that was in effect during that period.

Interest and Other Income

Our interest and other income for the year ended December 31, 2004 was \$6.1 million compared to \$0.6 million and \$0.9 million for the years ended December 31, 2003 and 2002, respectively. The 2004 increase is the result of interest earned on the higher cash balances we held as a result of the Ordinary Share and convertible debt offerings completed during 2004. The decrease in interest and other income for the year ended December 31, 2003 compared to the same period of 2002 is primarily the result of lower interest rates during 2003.

Gains and Losses—Commodity Derivatives

We recorded a trading gain for the year ended December 31, 2004 of approximately \$0.8 million compared to a gain of approximately \$0.7 million and a trading loss of \$0.1 million for the comparable period in 2003 and 2002, respectively. The improvement in 2004 and 2003 as compared to 2002 is primarily the result of rising silver, zinc and lead prices. From inception until December 31, 2004, we have recorded a gain of approximately \$1.0 million related to the metals trading program. That amount

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

represents approximately \$1.5 million of cash gains partially offset by \$0.5 million of unrealized losses at December 31, 2004. Under Statement of Financial Accounting Standards No. 133 ("FAS No. 133"), *Accounting for Derivative Instruments and Hedging Activities*, fair value measurements may vary substantially from period to period based on spot prices, forward prices and quoted option volatilities.

Gains—Foreign Currency Derivatives

During 2004, we placed an order for certain long lead equipment related to the San Cristobal project. The purchase price of the equipment was denominated in euros. To partially offset the potential deterioration of the U.S. dollar relative to the euro, we entered into a foreign currency collar transaction utilizing puts and calls. For the year ended December 31, 2004 the company recognized a gain related to the transaction of approximately \$1.4 million based on the fair market value of the puts and calls at that date. We had no similar foreign currency transactions in place during 2003 or 2002 and, therefore, had no gains or losses related to foreign currency derivatives. Under FAS No. 133, fair value measurements may vary substantially from period to period based on spot prices, forward prices and quoted option volatilities.

Interest and Other Borrowing Costs

For the year ended December 31, 2004, we recorded \$3.6 million of expense for interest and amortized borrowing cost compared to no interest or borrowing costs for the years ended December 31, 2003 and 2002. The 2004 expense is entirely related to the 2⁷/₈% Convertible Senior Subordinated Notes due 2024 and the 4.0% Convertible Senior Subordinated Notes due 2024, each of which was issued during 2004.

Income Taxes

Apex Silver Mines Corporation, our U.S. management services company, is subject to U.S. income taxes. Other than amounts payable by Apex Silver Mines Corporation, we pay no income tax in the U.S. since we are incorporated in the Cayman Islands and do not conduct or expect to conduct business in the U.S. that would generate U.S. taxable income.

The Cayman Islands currently impose no corporate taxation. We have been granted an 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 \$12.9 million at December 31, 2004, resulting from operating loss carry-forwards of our subsidiaries, have been entirely offset by valuation allowances.

Liquidity and Capital Resources

At December 31, 2004, our aggregate cash, short-term investments and long-term investments amounted to \$525.4 million compared to an aggregate of \$40.3 million in cash, short-term investments and long-term investments at December 31, 2003. The amounts held at December 31, 2004 include \$27.7 million in cash and cash equivalents, \$419.6 million in short-term investments and \$78.0 million in long-term investments. In addition to these amounts, at December 31, 2004, we had \$3.1 million of cash that has been restricted to collateralize outstanding letters of credit and \$15.3 million of investments that have been restricted and at maturity will provide the amounts necessary to pay the first three years interest payments on the 4.0% Convertible Senior Subordinated Notes due 2024.

The increase in our cash balance at December 31, 2004 is the result of net proceeds of \$208.6 million received from the sale of Ordinary Shares, net proceeds of \$328.1 million from the issuance of the Notes (net of \$11.9 million of deferred financing costs) and \$1.8 million received from the exercise of stock options by employees and a director. The increase was partially offset by approximately \$26.6 million invested in property, plant and equipment primarily related to the development of the San Cristobal project and \$9.2 million used to fund operations, property holding costs and administrative costs, net of interest and other income and a \$0.1 million payment on debt. In addition, as noted above, we have invested \$497.6 million in short and long-term investments and \$15.3 million in restricted investments to cover the payment of the first three years of interest on the 4.0% Convertible Senior

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

Subordinated Notes due 2024 pursuant to a Pledge and Security Agreement entered into with the initial purchasers of the Notes.

During 2004, we completed updating the San Cristobal Development Plan, resulting in estimated capital costs of approximately \$560 million. This capital cost estimate, which we publicly disclosed in October 2004, includes pre-stripping, engineering, procurement, construction, and freight necessary to commence production, as well as appropriate taxes, duties and levies under Bolivian law. The estimate excludes approximately \$27 million of working capital, \$22 million expected to be advanced to the company constructing the power line, \$6 million expected to be advanced to the company constructing the port facilities, and \$20 million for escalation from the original constant dollar estimate. Advances for the power line and port facility providers are expected to be recouped through credits applied against payments for the contracted services. The estimate also excludes approximately \$12 million in capital costs related to production enhancements added subsequent to the October 2004 estimate. Total project funding from January 1, 2004 going forward, including the additional amounts described above, is approximately \$650 million. Of this amount, approximately \$26 million in capital costs were spent at the San Cristobal project during 2004 and approximately \$27 million of the costs relate to amounts that may be paid using Ordinary Shares rather than cash.

We continue to work with Barclays and BNP Paribas to secure commercial bank debt financing

and develop other financing options for San Cristobal as part of a total financing package that may incorporate support from export credit agencies, multilateral agencies and other public lenders. During 2004, we also filed a universal shelf registration statement, on Form S-3, with the Securities and Exchange Commission. The registration became effective in August 2004, and allows us to sell up to \$200 million in any combination of equity or debt securities as described in the registration statement in one or more offerings. There can be no assurance we will be able to obtain the required remaining financing on terms that we find attractive, or at all.

During 2005, we expect to spend up to approximately \$250 million on equipment procurement, plant construction, infrastructure development, engineering and other costs related to our San Cristobal project. In addition, in order to maintain our current portfolio of exploration properties, we expect to make lease, patent and option payments during the next 12 months of about \$0.5 million. We expect up to \$5 million of discretionary spending on attractive exploration opportunities. Total administrative expenses are expected to be approximately \$16 million during 2005. Interest earned from short-term investments and other income should approximate \$12 million. We plan to fund our project and operating expenditures for the next 12 months from our existing cash balances.

Off Balance Sheet Arrangements

We have no off balance sheet arrangements.

Table of Contractual Obligations

The following table summarizes our contractual obligations at December 31, 2004:

Contractual Obligations (<i>in thousands</i>)	Total	Less Than 1 Year	1-3 Years	3-5 Years	Thereafter
Debt	\$340,586	\$ 599	\$ —	\$ —	\$339,987
Interest Payments Due on Debt	107,776	11,349	22,699	22,699	51,029
Capital Leases	—	—	—	—	—
Operating Leases	1,520	300	612	608	—
San Cristobal Property Leases	6,120	360	720	720	4,320
Purchase Obligations	30,922	30,697	225	—	—
Other GAAP Liabilities	—	—	—	—	—

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

All of the debt except the current portion is related to the 2 $\frac{7}{8}$ % and 4.0% Convertible Senior Subordinated Notes due 2024. The interest payments due are also related to the 2 $\frac{7}{8}$ % and 4.0% Convertible Senior Subordinated Notes due 2024. Total interest payments due on debt includes only those payments expected to be made through 2014 based on our expectation that the notes may be put by the holders in 2014. The operating lease obligations are related to the office facilities at our corporate headquarters. The San Cristobal property lease payments are all related to payments the company must make to the Bolivian government to maintain its rights to the San Cristobal mining concessions. The purchase obligations are all related to orders placed for long lead time equipment being purchased for the San Cristobal project.

From time to time we enter into lease option agreements related to exploration properties that are of interest to us. These agreements normally contain escalating lease payments required to maintain our exploration rights to the property. Such agreements are not included in the above table because exploration success is historically low and the agreements can be terminated by us at any time.

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. We expect to be able to comply with those laws and do 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 regulatory requirements.

Critical Accounting Policies

The selection and application of accounting policies is an important process that has developed as our business activities have evolved and as the accounting rules have changed. Accounting rules generally do not involve a selection among alternatives, but involve an implementation and interpretation of existing rules, and the use of judgment, to the specific set of circumstances existing in our business. We comply with all applicable rules on or before their adoption, and we believe the proper implementation and consistent application of the accounting rules is critical. Our critical accounting policies are discussed below. You should also read Note 2 of the accompanying Notes to the Consolidated Financial Statements included elsewhere in this report.

Our financial condition and results of operations as reflected in our financial statements are affected by estimates that we, or experts that we have retained, have made as to our proven and probable reserves. Reserve estimates involve subjective judgment and are based on numerous assumptions that may later prove to be inaccurate. These estimates include engineering evaluations of assay values derived from samplings of drill holes and other openings. Additionally, changes in the market prices of metals may render certain reserves containing relatively lower grades of mineralization uneconomic to mine. Further, availability of permits, changes in operating and capital costs, and other factors could materially and adversely affect ore reserves. Our current proven and probable reserve estimates at San Cristobal total approximately 219 million tonnes of ore grading 64.69 grams per tonne of silver, 1.60% zinc and 0.59% lead, containing approximately 456 million ounces of silver, 7.7 billion pounds of zinc and 2.8 billion pounds of lead. The reserves are based on a \$5.37 per ounce silver, \$0.40 per pound zinc and \$0.28 per pound lead. These prices represent the three year average prices for each of the metals as per guidelines established by the Securities and Exchange Commission.

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

To complete the project financing on San Cristobal, we may be required to hedge a portion of our 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. We currently engage 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. We measure the fair value of open positions at each reporting period and record the difference in the carrying value to current earnings, in accordance with FAS No. 133. Under FAS No. 133, fair-value measurements may vary substantially from period to period based on spot prices, forward prices and quoted option volatilities.

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 relatively low exposure to currency fluctuations. During 2004, we placed an order for certain long lead equipment related to the San Cristobal project. The purchase price of the equipment was denominated in euros. To partially offset the potential deterioration of the U.S. dollar relative to the euro, we entered into a foreign currency collar transaction utilizing puts and calls. For the year ended December 31, 2004 we recognized a gain related to the transaction of approximately \$1.4 million based on the fair market value of the puts and calls at that date. Because we conduct our activities in several foreign countries, we may in the future engage in additional hedging activities to minimize the risk of exposure to currency and interest rate fluctuations.

To complete the project financing for San Cristobal, we expect to be required to hedge a portion of our 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. We currently engage 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. We recorded a trading gain for the year ended December 31, 2004 of approximately \$0.8 million. From our inception until December 31, 2004, we have recorded a gain of approximately \$1.0 million related to the metals trading program. This amount represents approximately \$1.5 million of cash gains partially offset by \$0.5 million of unrealized losses at December 31, 2004. See *Results of Operations* under "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to Apex Silver's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required financial disclosure.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our Disclosure Committee and management, including the Chief

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

Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(b) under the Securities Exchange Act of 1934. Based upon, and as of the date of this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective because of the material weakness discussed below. In light of the material weakness described below, we performed additional analysis and other post-closing procedures to ensure our consolidated financial statements are prepared in accordance with generally accepted accounting principles. Accordingly, management believes that the financial statements included in this report fairly present in all material respects our financial condition, results of operations and cash flows for the periods presented.

Management's Report on Internal Control Over Financial Reporting

Apex Silver's management is responsible for establishing and maintaining effective internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has assessed the effectiveness of our internal control over financial reporting as of December 31, 2004. In making its assessment of internal control over financial reporting, management used the criteria described in "Internal

Control—Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. As of December 31, 2004, we did not maintain effective controls over the financial reporting process because we lacked a sufficient complement of personnel with a level of accounting expertise that is commensurate with our financial reporting requirements. This control deficiency resulted in the following adjustments to our financial statements:

- In January 2005, it was determined that the accounting for capitalized interest relating to our San Cristobal development project asset was incorrect. Generally accepted accounting principles require the capitalization of a portion of the interest incurred on debt borrowed for the construction of certain qualifying assets (such as our San Cristobal project). We began capitalizing interest based on only development capital expenditures made related to the San Cristobal project prospectively from the date that our 2⁷/₈% Convertible Senior Subordinated Notes due 2024 were issued. However, the amount of interest capitalized should have been based on all capital expenditures incurred, including the cost to acquire the San Cristobal property. We restated our consolidated financial statements for the first, second and third quarters of 2004 to capitalize additional interest and to reduce interest expense.
- In addition, the control deficiency resulted in a material adjustment to reclassify cash and cash equivalents to short- and long-term investments prior to filing our second quarter 2004 financial statements and an adjustment to stock compensation expense and related disclosures associated with our adoption of FAS No. 123, *Accounting for Stock-Based Compensation* prior to filing our third quarter 2004 financial statements.

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

- The control deficiency also resulted in an audit adjustment to the 2004 financial statements to increase costs capitalized related to our San Cristobal development project asset and to reduce administration expense.

Additionally, the ineffective controls over the financial reporting process are a control deficiency that could result in a material misstatement of annual or interim financial statements that would not be prevented or detected.

Management determined that the ineffective controls over the financial reporting process are a control deficiency that constitutes a material weakness. Because of this material weakness, management has concluded that Apex Silver did not maintain effective internal control over financial reporting as of December 31, 2004, based on the criteria in the "Internal Control—Integrated Framework."

Management's assessment of the effectiveness of Apex Silver's internal control over financial reporting as of December 31, 2004, has been audited by PricewaterhouseCoopers LLP, our independent registered public accounting firm, as stated in their report which appears herein.

Remediation of Material Weakness

As discussed in Management's Report on Internal Control Over Financial Reporting, we identified a material weakness in internal control over financial reporting. As of the end of the period covered by this report, we have not fully remediated the material weakness in our internal control over financial reporting. In order to address the material weakness, we have taken the following remedial actions:

- We have expanded our accounting staff to include, among other individuals, an experienced corporate controller and an experienced site controller for our Bolivian operation to provide additional review over our presentation and disclosure in financial statements. Additionally, these individuals are expected to

provide Apex Silver with further technical accounting expertise in applying generally accepted accounting principles;

- We have created a corporate treasury function to manage cash and investments and to assist in the proper presentation and disclosure of these items;
- We will continue to hire additional accounting staff, including an internal audit manager; and
- We have also engaged an outside accounting firm to support our Sarbanes-Oxley Section 404 compliance activities and to assist in preparing our financial statements and providing technical expertise in the proper application of generally accepted accounting principles to various transactions and other financial statement matters.

Changes in Internal Control Over Financial Reporting

Except as otherwise discussed herein, there have been no changes in our internal control over financial reporting during the most recently completed fiscal quarter that have materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Attestation Report of the Registered Public Accounting Firm

The attestation report of our registered public accounting firm, PricewaterhouseCoopers LLP, is included beginning on page 28 of this Annual Report.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Apex Silver Mines Limited

We have completed an integrated audit of Apex Silver Mines Limited's 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2004 and audits of its 2003 and 2002 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated Financial Statements

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations and comprehensive loss, changes in shareholders' equity and cash flows present fairly, in all material respects, the financial position of Apex Silver Mines Limited and its subsidiaries (a development stage enterprise) at December 31, 2004 and December 31, 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 and, cumulatively, for the period from December 22, 1994 (date of inception) to December 31, 2004 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial state-

ments includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Internal Control Over Financial Reporting

Also, we have audited management's assessment, included in Management's Report on Internal Control Over Financial Reporting, that Apex Silver Mines Limited did not maintain effective internal control over financial reporting as of December 31, 2004, because the company did not maintain effective controls over the financial reporting process because it lacked a sufficient complement of personnel with a level of accounting expertise that is commensurate with the company's financial reporting requirements, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable

Report of Independent Registered Public Accounting Firm

assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material

misstatement of the annual or interim financial statements will not be prevented or detected. The following material weakness has been identified and included in management's assessment. As of December 31, 2004, the company did not maintain effective controls over the financial reporting process because it lacked a sufficient complement of personnel with a level of accounting expertise that is commensurate with the company's financial reporting requirements. This control deficiency resulted in the following adjustments to the company's financial statements:

- In January 2005, it was determined that the accounting for capitalized interest relating to the company's San Cristobal development project was incorrect. Generally accepted accounting principles require the capitalization of a portion of the interest incurred on debt borrowed for the construction of certain qualifying assets (such as the company's San Cristobal project). The company began capitalizing interest based on only development capital expenditures made related to the San Cristobal project prospectively from the date that its 2 $\frac{7}{8}$ % Convertible Senior Subordinated Notes due 2024 were issued. However, the amount of interest capitalized should have been based on all capital expenditures incurred, including the cost to acquire the San Cristobal property. The company restated its consolidated financial statements for the first, second and third quarters of 2004 to capitalize additional interest and to reduce interest expense.
- In addition, the control deficiency resulted in a material adjustment to reclassify cash and cash equivalents to short- and long-term investments prior to filing the company's second quarter 2004 financial statements and an adjustment to stock compensation expense and related disclosures associated with the company's adoption of FAS 123 *Accounting for Stock-Based Compensation* prior to filing the company's third quarter 2004 financial statements.

Report of Independent Registered Public Accounting Firm

- The control deficiency also resulted in an audit adjustment to the 2004 financial statements to increase costs capitalized related to the company's San Cristobal development project asset and to reduce administration expense.

Additionally, the ineffective controls over the financial reporting process are a control deficiency that could result in a material misstatement of annual or interim financial statements that would not be prevented or detected.

Management determined that the ineffective controls over the financial reporting process are a control deficiency that constitutes a material weakness.

This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2004 consolidated financial statements, and our opinion regarding the effectiveness of the company's internal control over financial reporting does not affect our opinion on those consolidated financial statements.

In our opinion, management's assessment that Apex Silver Mines Limited did not maintain effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on criteria established in Internal Control—Integrated Framework issued by the COSO. Also, in our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, Apex Silver Mines Limited has not maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control—Integrated Framework issued by the COSO.



PricewaterhouseCoopers LLP

Denver, Colorado
March 16, 2005

Consolidated Balance Sheets

(Expressed in United States dollars)

December 31,	2004	2003
	<i>(in thousands except share data)</i>	
Assets		
Current assets		
Cash and cash equivalents	\$ 27,740	\$ 17,514
Restricted cash	397	800
Short-term investments	419,625	22,769
Restricted investments	4,628	—
Accrued interest receivable	1,102	28
Prepaid expenses and other assets	3,699	1,823
Current assets	457,191	42,934
Property, plant and equipment (net)	127,582	97,979
Long-term investments	77,995	—
Deferred financing costs	11,262	—
Value-added tax recoverable (net)	6,396	5,239
Restricted cash	2,711	—
Restricted investments	10,657	—
Other	24	15
Total assets	\$ 693,818	\$ 146,167
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable	\$ 4,068	\$ 1,453
Accrued salaries, wages and benefits	158	38
Accrued interest payable	2,890	—
Current portion of notes payable	599	91
Current liabilities	7,715	1,582
Notes payable	339,987	599
Total liabilities	347,702	2,181
Commitments and contingencies (Note 12)		
Shareholders' equity		
Ordinary Shares, \$.01 par value, 75,000,000 shares authorized; 47,679,797 and 36,874,640 shares issued and outstanding, respectively	477	369
Additional paid-in capital	443,229	222,430
Accumulated other comprehensive income	68	—
Accumulated deficit during development stage	(97,658)	(78,813)
Total shareholders' equity	346,116	143,986
Total liabilities and shareholders' equity	\$ 693,818	\$ 146,167

The accompanying notes form an integral part of these consolidated financial statements.

Consolidated Statements of Operations and Comprehensive Loss

(Expressed in United States dollars)

	Years ended December 31,			For the period
	2004	2003	2002	December 22, 1994 (inception) through December 31, 2004
	<i>(in thousands except shares and per share data)</i>			
Operating expenses:				
Exploration	\$ (5,306)	\$ (2,733)	\$ (3,852)	\$ (68,196)
Amortization and depreciation	(55)	(36)	(67)	(1,186)
Total operating expenses	(5,361)	(2,769)	(3,919)	(69,382)
Other income and expenses:				
Interest and other income	6,108	550	870	20,377
Gains (losses)—commodity derivatives	751	728	(71)	967
Gains—foreign currency derivatives	1,406	—	—	1,406
Administrative	(18,162)	(4,553)	(5,534)	(51,998)
Interest expense and other borrowing costs (net of \$2,478 capitalized during 2004 and none capitalized during 2003, 2002 and prior)	(3,587)	—	—	(3,587)
Total other income and expenses	(13,484)	(3,275)	(4,735)	(32,835)
Loss before minority interest	(18,845)	(6,044)	(8,654)	(102,217)
Minority interest in loss of consolidated subsidiary	—	—	—	4,559
Net loss	\$ (18,845)	\$ (6,044)	\$ (8,654)	\$ (97,658)
Other comprehensive income	68	—	—	68
Comprehensive loss	\$ (18,777)	\$ (6,044)	\$ (8,654)	\$ (97,590)
Net loss per Ordinary Share— basic and diluted ⁽¹⁾	\$ (0.41)	\$ (0.17)	\$ (0.24)	
Weighted average Ordinary Shares outstanding	46,528,341	36,576,367	35,677,844	

⁽¹⁾Potential dilutive Ordinary Shares were antidilutive for all periods presented.

The accompanying notes form an integral part of these consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity

(Expressed in United States dollars)

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Shareholders' Equity
	Shares	Amount				
<i>(in thousands except share data)</i>						
Issuance of shares upon incorporation, December 22, 1994 (\$0.85 per share)	8,822,546	\$ 88.2	\$ 5,571	\$ —	\$ —	\$ 5,660
Net loss and comprehensive loss	—	—	—	(213)	—	(213)
Balance, December 31, 1994	8,822,546	88.2	5,571	(213)	—	5,446
Net loss and comprehensive loss	—	—	—	(1,861)	—	(1,861)
Balance, December 31, 1995	8,822,546	88.2	5,571	(2,074)	—	3,585
Issuance of shares in private placement (\$8.00 per share)	4,256,700	42.6	32,407	—	—	32,449
Net loss and comprehensive loss	—	—	—	(11,723)	—	(11,723)
Balance, December 31, 1996	13,079,246	130.8	37,978	(13,798)	—	24,311
Purchase of minority interest in ASC Bolivia (\$11.00 per share)	268,496	2.7	2,951	—	—	2,953
Issuance of shares to associates (\$11.00 per share)	138,595	1.4	1,523	—	—	1,525
Issuance of shares for services (\$1.49 per share)	115,207	1.2	232	—	—	233
Stock option compensation expense	—	—	417	—	—	417
Issuance of shares upon Initial Public Offering (\$11.00 per share)	5,523,372	55.2	54,720	—	—	54,775
Net loss and comprehensive loss	—	—	—	(14,985)	—	(14,985)
Balance, December 31, 1997	19,124,916	191.2	97,820	(28,783)	—	69,229
Exchange of Apex LDC shares	7,079,006	70.8	(71)	—	—	—
Stock options exercised (\$7.91 per share)	25,001	0.3	197	—	—	198
Stock awards (\$8.50 per share)	21,838	0.2	185	—	—	186
Unearned compensation	—	—	(186)	—	—	(186)
Net loss and comprehensive loss	—	—	—	(11,030)	—	(11,030)
Balance, December 31, 1998	26,250,761	262.5	97,946	(39,812)	—	58,397

The accompanying notes form an integral part of these consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity

(Expressed in United States dollars)

	Common Stock		Additional	Accumulated	Accumulated	Total
	Shares	Amount	Paid-in	Deficit	Other	Shareholders'
			Capital		Comprehensive	Equity
					Income	
	<i>(in thousands except share data)</i>					
Balance, December 31, 1998	26,250,761	\$ 262.5	\$97,946	\$(39,812)	\$ —	\$ 58,397
Stock options exercised (\$8.77 per share)	25,549	0.3	224	—	—	224
Sale of Ordinary Share units (\$12.00 per unit)	8,090,132	80.9	94,005	—	—	94,086
Commissions paid in stock (\$12.00 per share)	84,184	0.8	(1)	—	—	—
Stock awards (\$12.06 per share)	15,542	0.2	187	—	—	188
Unearned compensation (net)	—	—	(87)	—	—	(87)
Net loss and comprehensive loss	—	—	—	(7,979)	—	(7,979)
Balance, December 31, 1999	34,466,168	344.7	192,275	(47,791)	—	144,828
Stock compensation (\$10.88 per share)	5,100	0.1	55	—	—	55
Stock awards (\$9.13 per share)	15,361	0.2	140	—	—	140
Unearned compensation	—	—	273	—	—	273
Net loss and comprehensive loss	—	—	—	(7,740)	—	(7,740)
Balance, December 31, 2000	34,486,629	344.9	192,743	(55,531)	—	137,557
Stock to acquire mineral rights (\$9.43 per share)	96,136	1.0	906	—	—	907
Stock options exercised (\$10.36 per share)	39,119	0.4	405	—	—	405
Stock issued as note payment (\$10.95 per share)	70,875	0.7	775	—	—	776
Stock (\$11.04 per share) and options to consultants	36,000	0.4	525	—	—	525
Stock awards (net) (\$9.27 per share)	73,638	0.7	678	—	—	679
Net loss and comprehensive loss	—	—	—	(8,584)	—	(8,584)
Balance, December 31, 2001	34,802,397	348.0	196,032	(64,115)	—	132,266

The accompanying notes form an integral part of these consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity

(Expressed in United States dollars)

	Common Stock		Additional	Accumulated	Accumulated	Total
	Shares	Amount	Paid-in	Deficit	Other	Shareholders'
			Capital		Comprehensive	Equity
	<i>(in thousands except share data)</i>					
Balance, December 31, 2001	34,802,397	\$ 348.0	\$196,032	\$(64,115)	\$ —	\$ 132,266
Sale of Ordinary Shares (\$13.10 per unit)	500,000	5.0	6,545	—	—	6,550
Stock to acquire mineral rights (\$15.37 per share)	58,307	0.6	892	—	—	892
Stock options exercised (\$9.12 per share)	555,244	5.6	5,057	—	—	5,063
Stock issued as note payment (\$16.19 per share)	58,895	0.6	953	—	—	954
Stock (\$13.34 per share) and options to consultants	204,655	2.0	3,561	—	—	3,563
Stock awards (net) (\$12.95 per share)	88,819	0.9	1,149	—	—	1,150
Offering costs	—	—	(53)	—	—	(53)
Net loss and comprehensive loss	—	—	—	(8,654)	—	(8,654)
Balance, December 31, 2002	36,268,317	362.7	214,137	(72,769)	—	141,731
Stock options exercised (\$9.77 per share)	317,220	3.2	3,096	—	—	3,099
Stock Warrants exercised (\$12.92 per share)	60,000	0.6	775	—	—	775
Stock (\$15.13 per share) and warrants to consultants	137,987	1.4	2,911	—	—	2,912
Stock awards (net) (\$16.90 per share)	79,829	0.8	1,348	—	—	1,349
Stock issued as note payment (\$14.53 per share)	11,287	0.1	164	—	—	164
Net loss and comprehensive loss	—	—	—	(6,044)	—	(6,044)
Balance, December 31, 2003	36,874,640	368.7	222,430	(78,813)	—	143,986
Stock options exercised (\$11.03 per share)	159,700	1.6	1,760	—	—	1,762
Stock awards granted (\$17.48 per share)	228,500	2.3	2,718	—	—	2,720
Stock to consultants (\$19.64 per share)	23,681	0.2	465	—	—	465
Sale of Ordinary Shares (net) (\$21.02 per share)	10,393,276	103.9	208,508	—	—	208,612
Fair value of stock options granted	—	—	3,220	—	—	3,220
Stock option modification costs associated with retirement of Chairman, Board member and employee	—	—	4,128	—	—	4,128
Unrealized gain on marketable equity securities	—	—	—	—	68	68
Net loss	—	—	—	(18,845)	—	(18,845)
Balance, December 31, 2004	47,679,797	\$ 476.7	\$443,229	\$(97,658)	\$ 68	\$ 346,116

The accompanying notes form an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows

(Expressed in United States dollars)

	Years ended December 31,			For the period
	2004	2003	2002	December 22, 1994 (inception) through December 31, 2004
	<i>(in thousands)</i>			
Cash flows from operating activities:				
Net cash used in operating activities (Note 10)	\$ (9,218)	\$ (3,199)	\$ (3,692)	\$ (82,539)
Cash flows from investing activities:				
Purchase of available-for-sale investments	(459,534)	(3,349)	(21,900)	(557,242)
Sale of available-for-sale investments	175,989	1,398	24,625	251,962
Purchase of held-to-maturity investments	(226,295)	(4,245)	(3,202)	(233,741)
Sale of held-to-maturity investments	35,069	6,400	—	41,469
Purchase of restricted investments to provide for interest payments	(15,285)	—	—	(15,285)
Additions to property, plant and equipment	(26,562)	(3,923)	(4,975)	(118,193)
Net cash used in investing activities	(516,618)	(3,719)	(5,452)	(631,030)
Cash flows from financing activities:				
Proceeds from the issuance of Ordinary Shares (net of issuance costs of \$9,803 for 2004 and \$0 for 2003 and 2002)	208,612	—	6,550	406,923
Proceeds from the issuance of Convertible Notes (net of issuance costs of \$11,900 for 2004 and \$0 for 2003 and 2002)	328,087	—	—	328,087
Payment of notes	(91)	—	(336)	(2,040)
Proceeds from exercise of stock options and warrants	1,762	3,875	5,063	11,447
Restricted cash to collateralize letters of credit	(2,308)	(800)	—	(3,108)
Net cash provided by financing activities	536,062	3,075	11,277	741,309
Net increase (decrease) in cash and cash equivalents	10,226	(3,843)	2,133	27,740
Cash and cash equivalents, beginning of period	17,514	21,357	19,224	—
Cash and cash equivalents, end of period	\$ 27,740	\$ 17,514	\$ 21,357	\$ 27,740
Supplemental information:				
Interest paid	\$ 2,859	\$ —	\$ —	\$ 2,859
Supplemental non-cash transactions: (See Note 10)				

The accompanying notes form an integral part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

(Expressed in United States dollars)

1. Incorporation, Recapitalization and Operations

Apex Silver Mines Limited (“Apex Limited” or the “company”) was formed under the laws of the Cayman Islands in March 1996 for the sole purpose of serving as a holding company for certain ownership interests in Apex Silver Mines LDC (“Apex LDC”). On April 15, 1996, holders of approximately 55% of the then-outstanding shares of Apex LDC elected to participate, effective as of the completion of a proposed private placement of shares of Apex Limited which was completed as of August 6, 1996, in a recapitalization effected by an exchange, on a one-for-one basis, of their shares in Apex LDC for identical equity instruments of Apex Limited (the “Recapitalization”). The balance of shareholders retained a direct ownership interest in Apex LDC. As a result of this recapitalization, Apex LDC became a majority-owned subsidiary of Apex Limited. The accompanying financial statements reflect the historical accounts of the company’s predecessor, Apex LDC. For purposes of the accompanying consolidated financial statements of Apex Limited, the recapitalization has been given retroactive effect to the date of incorporation of Apex LDC, with the results of operations and equity attributable to the other ownership interests in Apex LDC being

reflected in “minority interest in consolidated subsidiary”. During subsequent years Apex Limited acquired the remaining interest in Apex LDC through equity transactions. Consequently, for purposes of these financial statements, Apex Limited is considered the successor to Apex LDC.

The company’s principal activities are the exploration and development of mineral properties. The company is currently an “exploration and development stage company” as it has not yet realized revenues from planned operations. Activities since inception have included acquisition of mineral interests, raising capital through debt and equity transactions and commencement of exploration and development activities. The company is in the process of developing its San Cristobal property and evaluating certain of its other properties to determine the economic feasibility of bringing one or more of the properties into production.

The company, through indirect subsidiaries, conducts exploration activities in Central America and South America and currently holds interests in non-producing mineral properties in Bolivia, Mexico and Peru.

2. Summary of Significant Accounting Policies

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results could differ from those estimates. The policies adopted, considered by management to be significant, are summarized as follows:

a. Basis of consolidation

These consolidated financial statements include the accounts of the company and its wholly-owned

subsidiaries. All inter-company transactions and balances have been eliminated.

b. Translation of foreign currencies

Substantially all expenditures are made in United States dollars. Accordingly, the company uses the United States dollar as its functional and reporting currency.

c. Cash and cash equivalents

The company considers all highly-liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Notes to the Consolidated Financial Statements

(Expressed in United States dollars)

d. Restricted cash

The company has certain commitments in the form of letters of credit that are collateralized by cash and/or highly-liquid investments with maturities of three months or less when purchased. Such cash and investments are recorded to restricted cash until the letters of credit are released by the holder at which time they are reclassified to cash and cash equivalents. (See Note 12 with respect to letters of credit issued.)

e. Investments

Available for Sale—Available for sale securities are recorded at market, with unrealized gains or losses recorded as a component of equity, unless the value of the security is considered impaired. Realized gains and losses and non-temporary impairments in value are recorded in the statement of operations.

Held to Maturity—Held to maturity investments are debt securities which the company intends to hold until maturity and are recorded at unamortized cost. Income is recorded based upon the current yield of the security. Any non-temporary impairment in value will be recorded in the statement of operations at the date of the impairment. No impairments have been recorded at December 31, 2004.

Restricted—Restricted investments are held to maturity securities held in an escrow account for the purpose of paying the semi-annual interest on the company's 4.0% Convertible Senior Subordinated Notes through 2007 pursuant to the terms of the related arrangements.

f. Mining properties, exploration and development costs

The company expenses general prospecting costs and the costs of acquiring and exploring unevaluated mineral properties. When a mineral property is determined to have proven and probable reserves, subsequent development costs are capitalized to mineral properties. Mineral properties include acquisition costs and property development costs. When mineral properties are developed and operations commence, capitalized costs will be charged to operations using the units-of-production method over proven

and probable reserves. Upon abandonment or sale of a mineral property, all capitalized costs relating to the specific property are written off in the period abandoned or sold and a gain or loss is recognized.

Beginning September 1, 1997, all costs associated with the company's San Cristobal project have been capitalized. As of December 31, 2004 and 2003, capitalized property and development costs related to the San Cristobal project amounted to approximately \$122.1 million and \$95.0 million, respectively. Capitalized costs at San Cristobal include all direct costs associated with the project, certain interest, depreciation on assets being used to construct the project and other internally allocated costs directly associated with the advancement of the project.

No amounts related to other mineral properties have been capitalized.

g. Property, plant and equipment

Buildings are stated at cost and are depreciated using the straight-line method over useful lives of 30 to 40 years or the life of the mine whichever is shorter. Mining equipment and machinery are stated at cost and are depreciated using the straight-line method over useful lives of three to eight years. Other furniture and equipment are stated at cost and are depreciated using the straight-line method over estimated useful lives of three to five years.

h. Asset impairment

The company evaluates its long-lived assets for impairment when events or changes in circumstances indicate that the related carrying amount may not be recoverable. If the sum of estimated future net cash flows on an undiscounted basis is less than the carrying amount of the related asset grouping, an asset impairment is considered to exist. The related impairment loss is measured by comparing estimated future net cash flows on a discounted basis to the carrying amount of the asset. Changes in significant assumptions underlying future cash flow estimates may have a material effect on the company's financial position and results of operations. To date no such impairments have been identified.

Notes to the Consolidated Financial Statements

(Expressed in United States dollars)

i. Deferred financing costs

Costs incurred in connection with the issuance of the company's Senior Subordinated Convertible Notes are deferred and amortized over ten years which corresponds to the call provision of the notes. During 2004, the company amortized approximately \$0.6 million of the deferred costs leaving an unamortized balance at December 31, 2004 of approximately \$11.3 million.

j. Stock compensation

Prior to 2004, the company accounted for stock-based employee compensation using the intrinsic value method in accordance with APB No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. No stock-based employee compensation related to stock options was reflected in net loss for periods prior to 2004, as all options granted had an exercise price equal to the market value of the underlying common stock on the date of the grant. Other stock-based compensation reflected in net loss for periods prior to 2004 was recorded in accordance with APB No. 25.

Effective January 1, 2004, the company adopted the fair-value-based method of accounting for stock options as presented in Statement of Financial Accounting Standards No. 123 ("FAS No. 123"),

Accounting for Stock-Based Compensation, as amended by FAS No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure*. The company used the "modified prospective method" of transition, as defined in FAS No. 123 and FAS No. 148, under which employee stock-based compensation cost was recognized from January 1, 2004 as if the fair-value-based accounting method in FAS No. 123 had been used to account for all employee awards granted, modified, or settled in fiscal years beginning after December 15, 1994. As a result of the adoption of FAS No. 123, the company recognized compensation costs of \$10.1 million for the year ended December 31, 2004. These costs include a charge of approximately \$4.1 million relating to the modification of stock awards previously granted to the retiring company Chairman, a retiring director and a retiring employee (see Note 9). Approximately \$1.4 million of the costs were related to compensation paid to employees directly working on the San Cristobal project and as such were capitalized, while the remaining \$8.7 million was charged to expense.

As provided for under FAS No. 148, the following tables illustrate the effect on net loss and loss per share as if the company had applied the fair value recognition provisions of FAS No. 123 to stock-based employee compensation for 2004, 2003 and 2002.

Years ended December 31,	2004	2003	2002
		<i>(in thousands except per share)</i>	
Net loss as reported	\$ (18,845)	\$ (6,044)	\$ (8,654)
Add back: Stock-based compensation recognized in net loss reported, net of tax effect	8,651	1,038	955
Total stock-based compensation expense determined under fair-value-based method for all awards, net of tax effect	(8,651)	(3,866)	(3,569)
Pro forma net loss	\$ (18,845)	\$ (8,872)	\$ (11,268)
Net loss per Ordinary Share basic and diluted:			
As reported	\$ (0.41)	\$ (0.17)	\$ (0.24)
Pro forma	\$ (0.41)	\$ (0.24)	\$ (0.32)

Notes to the Consolidated Financial Statements

(Expressed in United States dollars)

For purposes of calculating the fair value of options, volatility for the three years presented is based on the historical volatility of the company's Ordinary Shares over its public trading life. The company currently does not foresee the payment of dividends in the near term. The fair value for these options was estimated at the date of grant using the Black-Scholes option-pricing model with the following assumptions:

Years ended December 31,	2004	2003	2002
Weighted average risk-free interest rate	2.95%	2.50%	3.10%
Weighted average volatility	44.90%	42.80%	42.50%
Expected dividend yield	—	—	—
Weighted average expected life (in years)	3.89	2.93	2.91

k. Net loss per Ordinary Share

Basic loss per share is computed by dividing net earnings available to ordinary shareholders by the weighted average number of shares outstanding for the period. Diluted earnings per share reflect the potential dilution that would occur if securities or other contracts to issue Ordinary Shares were exercised or converted into Ordinary Shares.

Outstanding options to purchase 2,437,071, 2,151,926, and 1,963,891 Ordinary Shares were not included in the computation of diluted earnings per share at December 31, 2004, 2003 and 2002, respectively, because to do so would have been antidilutive. Also, warrants to purchase 450,000 Ordinary Shares and Convertible Notes to purchase 11,879,350 Ordinary Shares were not included in the computation of diluted earnings per share at December 31, 2004, because to do so would have been antidilutive. Therefore, basic loss per share is the same as dilutive loss per share.

l. Derivative financial instruments

The company has adopted Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("FAS No. 133"). FAS No. 133, as amended by Statement of Financial Accounting Standards No. 137, *Deferral of the Effective Date of FAS Statement*

No. 133. FAS No. 133 requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. Through December 31, 2004 the company had not engaged in transactions which would be accounted for as a hedge under FAS No. 133. Therefore, all derivative financial instruments have been adjusted to market value at the end of each reporting period with the related change in value recorded to earnings.

To complete the project financing on San Cristobal, the company may be required to hedge a portion of its planned production. In addition, when San Cristobal enters production, the company may sell forward a portion of its production and use price hedging techniques to mitigate some of the risks associated with fluctuating metals prices. For fair-value hedge transactions, in which the company is hedging changes in the fair value of an asset, liability, or firm commitment, changes in the fair value of the derivative instrument will generally be offset by changes in the hedged item's fair value. For cash flow hedge transactions, in which the company is hedging the variability of cash flows related to a variable-rate asset, liability or forecasted transaction, changes in the fair value of the derivative instrument will be reported in other comprehensive income. The gains and losses on the derivative instrument that are reported in other comprehensive income will be reclassified as earnings in the periods in which earnings are impacted by the variability of cash flows of the hedged item. The ineffective portion of all hedges will be recognized in current period earnings.

The company currently engages in limited metals trading activities utilizing puts and calls and other market instruments. The company measured the fair value of open positions at each reporting period and recorded the difference in the carrying value to current earnings, in accordance with FAS No. 133.

During 2004, 2003 and 2002 the company recorded mark-to-market gains (losses) of approximately \$751,000, \$728,000, and (\$71,000) respec-

Notes to the Consolidated Financial Statements

(Expressed in United States dollars)

tively. Since inception, the company has recorded gains of approximately \$1.0 million related to the metals trading program. Of that amount, approximately \$1.5 million represents a cash gain partially offset by approximately \$0.5 million of unrealized loss at December 31, 2004.

During 2004, the company placed an order for certain long lead equipment related to the San Cristobal project that was denominated in euros. To partially offset the potential deterioration of the U.S. dollar relative to the euro, the company entered into a foreign currency collar transaction utilizing puts and calls. At December 31, 2004, the company recognized a mark-to-market gain related to the transaction of approximately \$1.4 million. The company may enter into foreign currency transactions from time to time such as when making purchases of long lead material and equipment that will be settled in a currency other than U.S. dollars.

Under FAS No. 133, fair value measurements may vary substantially from period to period based on spot prices, forward prices and quoted option volatilities.

m. Comprehensive income (loss)

Comprehensive income (loss) is defined as all changes in stockholders' equity, exclusive of transactions with stockholders, such as capital investments. Comprehensive income (loss) includes net income (loss) and changes in certain assets and liabilities that are reported directly in equity. For 2004 comprehensive loss included the increase in the market value of available for sales securities and is reported on the Statements of Consolidated Operations and Comprehensive Loss. For 2003 and 2002, comprehensive loss equaled net loss.

n. Revisions in classification

Certain revisions in classification have been made to the 2003 and 2002 financial information to conform to the 2004 financial statements to ensure comparability. The company revised the classification of funds held in auction rate securities from cash equivalents to available for sale short-term investments for the balance sheet as of December 31, 2003 and the cash flows statement periods ended December 31,

2003 and 2002 to conform to December 31, 2004 classifications. Such revisions had no effect on net loss or cash used in operations. (See Note 3)

o. New accounting standards

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 123R, *Share-Based Payment* ("FAS No. 123R"), which revised FAS No. 123 *Accounting for Stock-Based Compensation*. FAS No. 123R requires measurement and recognition of the costs of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award, recognized over the period during which an employee is required to provide service in exchange for such award. Implementation is required as of the first interim or annual reporting period that begins after June 15, 2005, although early adoption is encouraged. As the company adopted FAS No 123 effective January 1, 2004 (Note 2 (j)), it does not anticipate that the new Standard will have a material impact on its results of operations or financial position.

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, *Inventory Costs—an amendment of ARB No. 43, Chapter 4* ("FAS No. 151") which clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and waste material as current period costs. It also requires that allocations of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The Statement applies to inventory costs incurred in the first fiscal year beginning after June 15, 2005. Until the company enters production, FAS No. 151 is not expected to impact the company's financial position or results from operations.

The Emerging Issues Task Force ("EITF") formed a committee to evaluate certain mining industry accounting issues, including issues arising from the application of Statement of Financial Accounting Standards No. 141, *Business Combinations* ("FAS No. 141"), and Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* ("FAS No. 142"), to business combi-

Notes to the Consolidated Financial Statements

(Expressed in United States dollars)

nations within the mining industry, accounting for goodwill and other intangibles and the capitalization of costs after the commencement of production, including deferred stripping. The issues discussed included whether mineral interests conveyed by leases represent tangible or intangible assets and the amortization of such assets. In March 2004, the EITF reached consensus that the mineral rights should be considered tangible assets. The EITF also reached consensus on other mining related issues involving impairment and business combinations. On April 28, 2004, the FASB ratified the consensus of the EITF that mineral rights should be considered tangible assets. The Task Force also considered the recommendation that stripping costs incurred during production are a mine development cost that should be capitalized as an investment in the mine and attributed to the proven and probable reserves benefited in a systematic and rational manner. However, the Task Force directed the FASB staff to develop additional guidance about what constitutes a systematic and rational manner of attributing the capitalized costs to proven and probable reserves benefited. At this stage these developments do not affect the company, but the company will continue to monitor the progress of the EITF on these mining industry accounting issues.

p. Income taxes

The company accounts for income taxes in accordance with the provisions of Statement of Financial Accounting Standard No. 109, *Accounting for Income Taxes* ("FAS 109"). Under this standard, future income tax assets and liabilities are computed based on differences between the carrying amount of assets and liabilities on the balance sheet and their corresponding tax values using the enacted income tax rates at each balance sheet date. Future income tax assets also result from unused loss carryforwards and other deductions that are not allowed in the current tax period. The valuation of future income tax assets is reviewed annually and adjusted, if necessary, by use of a valuation allowance to reflect the estimated realizable amount. Although the company has tax loss carryforward (see Note 8), there is uncertainty as to utilization. Accordingly, the future income tax assets amounts have been fully offset by an uncertainty provision.

Notes to the Consolidated Financial Statements

(Expressed in United States dollars)

3. Investments

The company invests only in government and corporate securities rated “investment grade” or better. The following table summarizes the company’s investments at December 31, 2004 and 2003:

	Cost	Market	Balance	Holding Losses
<i>(in thousands)</i>				
December 31, 2004				
Short-term:				
Available for sale				
Common stock	\$ 184	\$ 374	\$ 374	
Bond funds	3,381	3,259	3,259	
Auction rate securities	301,715	301,715	301,715	
Total available for sale	305,280	305,348	305,348	
Held to maturity				
Government bonds	\$ 95,152	\$ 94,894	\$ 95,152	\$ (263)
Municipal bonds	3,036	3,034	3,036	(3)
Corporate notes	12,186	12,155	12,186	(31)
Euro bonds	3,903	3,913	3,903	(2)
Total held to maturity	114,277	113,996	114,277	(299)
Total short-term	\$ 419,557	\$ 419,344	\$ 419,625	\$ (299)
Long-term:				
Held to maturity				
Government bonds	\$ 73,938	\$ 73,705	\$ 73,938	\$ (233)
Municipal bonds	1,503	1,503	1,503	—
Corporate notes	2,554	2,540	2,554	(15)
Total long-term	\$ 77,995	\$ 77,748	\$ 77,995	\$ (248)
Restricted investments:				
Short-term				
Government bonds	\$ 4,628	\$ 4,622	\$ 4,628	\$ (7)
Long-term				
Government bonds	\$ 10,657	\$ 10,588	\$ 10,657	\$ (70)
December 31, 2003				
Short-term				
Available for sale				
Common stock	\$ 184	\$ 452	\$ 184	
Corporate notes	197	204	197	
Auction rate securities	21,350	21,350	21,350	
Total available for sale	21,731	22,006	21,731	
Held to maturity				
Corporate notes	\$ 1,038	\$ 1,026	\$ 1,038	\$ (12)
Total held to maturity	1,038	1,026	1,038	(12)
Total short-term	\$ 22,769	\$ 23,032	\$ 22,769	\$ (12)

Notes to the Consolidated Financial Statements

(Expressed in United States dollars)

The company has concluded that it is appropriate to classify auction rate securities as short-term investments. Previously, such investments had been classified as cash and cash equivalents. Accordingly, the company has revised the classification to report these securities as current investments in the Consolidated Balance Sheets as of December 31, 2004. The company also made corresponding adjustments to its Consolidated Balance Sheet in the amount of \$21.4 million at December 31, 2002 and its Consolidated Statement of Cash Flows for the period ended December 31, 2003, December 31, 2002 and for the period December 22, 1994 (inception) through December 31, 2004 to reflect the gross purchases and sales of these securities as investing activities rather than as a component of cash and cash equivalents. This change in classification does not affect previously reported cash flows from operations

or from financing activities in previously reported Consolidated Statement of Cash Flows, or previously reported Consolidated Statement of Operations for any period.

The following table sets forth the affect of the revised classification of auction rate securities to the company's Consolidated Statements of Cash Flows:

December 31,	2003	2002
<i>(in thousands)</i>		
Net cash used in investing activities:		
As originally presented	\$(3,923)	\$(4,975)
Revised classification of auction rate securities	204	(477)
As currently presented	\$(3,719)	\$(5,452)

Quoted market prices at December 31, 2004 were used to determine the market values of the above investments.

4. Prepaid Expenses and Other Assets

Prepaid expense and other assets consist of the following:

December 31,	2004	2003
<i>(in thousands)</i>		
Prepaid insurance	\$ 469	\$ 488
Prepaid consulting and contractor fees	1,932	1,317
Receivables, travel advances and other	283	362
Withholding taxes receivable	99	—
Unrealized derivative gains (losses)	916	(344)
	\$ 3,699	\$ 1,823

The prepaid consulting and contractor fees at December 31, 2004 consist primarily of advance payments made to contractors for work being performed at the San Cristobal project. The prepaid consulting and contractor fees at December 31, 2003, consist primarily of the value of Ordinary Shares issued to two contractors to provide exploration services related to certain of the company's properties in Bolivia, Peru and Uzbekistan, which were completed in 2004.

Unrealized trading gains and losses are the result of hedging transactions that have been marked to market at year-end. Amounts actually realized will differ from the above amounts based on market values at the date the hedge instruments are settled.

Notes to the Consolidated Financial Statements

(Expressed in United States dollars)

5. Value-Added Tax Recoverable

The company has recorded Value-Added Tax ("VAT") paid in Bolivia as a recoverable asset. Bolivian law states that VAT paid prior to production is recoverable as a credit against Bolivian taxes arising from production, including income tax. The VAT paid in Bolivia is expected to be recovered through production from the proven and probable reserves at the San Cristobal project that the company has begun to develop. At December 31, 2004, and 2003 the recoverable VAT recorded for Bolivia was \$6.4 million and \$5.1 million, respectively.

The VAT paid in Mexico is related to exploration activities and according to Mexican law is recoverable upon application to the tax authorities. During 2004, the company received a VAT refund from the Mexican tax authorities and at December 31, 2004 there was no further recoverable VAT for Mexico. At December 31, 2003, the company had recorded recoverable VAT for Mexico of \$0.2 million.

Because of the uncertainty of the recoverability of VAT paid in Peru, VAT costs incurred in Peru are charged to expense as incurred.

6. Property, Plant and Equipment

The components of property, plant and equipment were as follows:

December 31,	2004	2003
	<i>(in thousands)</i>	
Mineral properties (San Cristobal)	\$ 122,141	\$ 95,041
Buildings	1,408	1,408
Mining equipment and machinery	5,524	2,972
Other furniture and equipment	1,263	845
	130,336	100,266
Less: Accumulated depreciation	(2,754)	(2,287)
	\$127,582	\$ 97,979

Depreciation expense for the periods ended December 31, 2004, 2003 and 2002 totaled \$55,000, \$36,000, and \$67,000 respectively. For the periods December 31, 2004, 2003 and 2002, depreciation associated with the San Cristobal project was capitalized in the amounts of \$412,000, \$469,000, and \$508,000, respectively.

During 2004, the company capitalized \$2.5 million of interest related to its Convertible Senior Subordinated Notes to the San Cristobal mineral property. No interest was capitalized in prior years.

7. Notes Payable

During 2004, the company completed several private placements of 2⁷/₈% and 4.0% Convertible Senior Subordinated Notes due 2024. The placements of notes resulted in gross proceeds of \$340.0 million and net proceeds, after commissions, of \$328.1 million. All of the notes were issued at a price of \$1,000 and are convertible into the company's Ordinary Shares at a conversion rate of 34.9406 shares per \$1,000 principal amount of notes (equal to an initial conversion price of approximately

\$28.62 per share), subject to adjustment in certain circumstances. Holders of the notes may convert their notes only if: (i) the price of Apex Silver Ordinary Shares reaches a specified threshold; (ii) the trading price for the notes falls below certain thresholds; (iii) the notes have been called for redemption; or (iv) specified corporate transactions occur. Full conversion of the notes would result in the issuance of approximately 11.9 million of the company's Ordinary Shares (see Note 9).

Notes to the Consolidated Financial Statements

(Expressed in United States dollars)

During 2004, the company recorded interest expense and other borrowing costs of \$3.6 million, net of \$2.5 million capitalized, related to the Convertible Senior Subordinated Notes due 2024. At December 31, 2004, the company recognized interest payable to the note-holders of \$2.9 million. The company recorded no interest expense or interest payable for the years ending December 31, 2003 and 2002.

In 1999, the company executed a non-interest bearing note agreement with the San Cristobal Foundation for \$2.0 million payable by the end of 2005. During 2004, the company made payments on the note totaling \$90,000. Prior to 2004, the company had made payments on the note totaling \$1.3 million, including a stock grant valued at \$0.8 million. The note is being carried on the company's books for \$599,000 at December 31, 2004.

The company's notes payable consist of the following:

December 31,	2004	2003
	<i>(in thousands)</i>	
2 $\frac{7}{8}$ % Convertible Senior Subordinated Notes due 2024	\$ 200,000	\$ —
4.0% Convertible Senior Subordinated Notes due 2024	139,987	—
San Cristobal Foundation	599	690
Total	340,586	690
Less: Current portion	(599)	(91)
Total non-current portion	\$ 339,987	\$ 599

The remaining \$599,000 due on the San Cristobal note will be paid in 2005 and the \$340 million of convertible debt is due in 2024.

Pursuant to the agreement related to the 4.0% notes, the company is required to maintain restricted investments to cover the payment of interest on the notes for the first three years (see Note 3). The amount invested will at maturity equal the interest payments due. As of December 31, 2004, \$4.6 million of the investments are classified as current, representing interest payments due in 2005, and the \$10.7 million balance will be used to make interest payments in 2006 and 2007.

Notes to the Consolidated Financial Statements

(Expressed in United States dollars)

8. Income Taxes

The company did not record a provision or benefit for income taxes for periods ended December 31, 2004, 2003 and 2002, due to the availability of current period losses, net operating loss carryforwards, and the uncertainty of their future realization. Further, the Cayman Islands currently does not impose any form of taxation. Accordingly, the company has no current or deferred U.S. or foreign tax expense.

The loss before income taxes consists of the following for the years ended December 31, 2004, 2003 and 2002:

December 31,	2004	2003	2002
	<i>(in thousands)</i>		
Loss Before Income Taxes:			
U.S.	\$ (1,685)	\$ (143)	\$ (267)
Foreign	(17,160)	(5,901)	(8,387)
	<u>\$ (18,845)</u>	<u>\$ (6,044)</u>	<u>\$ (8,654)</u>

The company is incorporated in the Cayman Islands which currently does not impose income taxes. The company paid no income taxes during the year ended December 31, 2004.

The tax effects of temporary differences that give rise to significant components of the deferred tax assets and deferred tax liabilities are as follows as of December 31, 2004 and 2003:

December 31,	2004	2003
	<i>(in thousands)</i>	
Deferred Tax Assets:		
Tax loss carryforwards	\$ 8,302	\$ 7,505
Stock-based compensation	3,768	—
Property, plant and equipment	920	188
Other	7	—
Total deferred tax assets	<u>12,997</u>	<u>7,693</u>
Deferred Tax Liabilities:		
Other	109	128
Total deferred tax liabilities	<u>109</u>	<u>128</u>
Net deferred tax asset before valuation allowance	\$ 12,888	\$ 7,565
Valuation allowance	\$ (12,888)	\$ (7,565)
Net deferred tax asset	<u>\$ —</u>	<u>\$ —</u>

In the U.S., there are approximately \$4.9 million of federal and state net operating loss carryforwards at December 31, 2004, which will expire in future years through 2023.

At December 31, 2004, the company's foreign subsidiaries had net operating loss carryforwards in certain non-U.S. jurisdictions of \$24.8 million. Of these, \$19.8 million have no expiration, and the remaining \$5.0 million will expire in future years through 2014.

The valuation allowance for deferred tax assets of \$12.9 million and \$7.6 million at December 31, 2004 and 2003, respectively, relates principally to the uncertainty of the utilization of certain deferred tax assets, primarily tax loss carryforwards in various jurisdictions. FAS No. 109 requires that the company continually assess both positive and negative evidence to determine whether it is more likely than not that deferred tax assets can be realized prior to their expiration. The company will reassess the likelihood that the company's net operating loss carryforwards and other deferred tax attributes will be utilized prior to their expiration.

See Note 12 for a discussion regarding income tax contingencies.

Notes to the Consolidated Financial Statements

(Expressed in United States dollars)

9. Stockholders' Equity

Stock Option Plans

The company has established a plan to issue share options and other awards of the company's shares for officers, employees, consultants and agents of the company and its subsidiaries (the "Plan"). Under the Plan, the total number of options and other awards granted cannot exceed two million Ordinary Shares. Options granted and other awards under the Plan are not transferable unless otherwise provided for in a specific award agreement. Options exist for a term, not to exceed ten years, as fixed by the Compensation Committee of the Board of Directors of the company. Options typically vest ratably over periods of up to four years with the first tranche vesting on the date of grant or the anniversary of the date of grant. Unexercised options expire ten years after the date of grant.

The company has established a share option plan for its non-employee directors (the "Director Plan"). Under the Director Plan, the total number of options granted cannot exceed five percent of the company's outstanding shares. Pursuant to the Director Plan,

non-employee directors receive (i) at the effective date of their initial election to the company's Board of Directors, an option to purchase the number of Ordinary Shares equal to \$50,000 divided by the closing price of the Ordinary Shares on the American Stock Exchange (the "AMEX") on such date, (ii) at the close of business of each annual meeting of the company's shareholders, an option to purchase the number of Ordinary Shares equal to \$50,000 divided by the closing price of the Ordinary Shares on the AMEX on such date, and (iii) at the close of business of each meeting of the company's Board of Directors, an option valued at \$3,000 calculated using the Black-Scholes option-pricing model to purchase Ordinary Shares with an exercise price equal to the closing price of the Ordinary Shares on the AMEX on such date. Options granted to a non-employee director vest on the date of the grant and expire ten years after the date of the grant or three years after the date that such non-employee director ceases to be a director of the company. Options granted under the Director Plan are transferable only in limited circumstances.

A summary of the company's stock options at December 31, 2004, 2003 and 2002 and changes during those years is presented in the following table:

Options	2004		2003		2002	
	Number of Shares	Average Price Per Share	Number of Shares	Average Price Per Share	Number of Shares	Average Price Per Share
Outstanding at beginning of period	2,151,926	\$12.75	1,963,891	\$11.01	1,895,150	\$ 9.69
Granted during period	444,845	\$18.48	592,005	\$16.69	635,235	\$13.11
Forfeited or expired during period	—	\$ —	(86,750)	\$11.08	(11,250)	\$ 9.03
Exercised during period	(159,700)	\$11.03	(317,220)	\$ 9.84	(555,244)	\$ 9.12
Outstanding at end of period	2,437,071	\$13.88	2,151,926	\$12.75	1,963,891	\$11.01
Exercisable at end of period	1,511,735	\$12.32	1,097,081	\$11.22	971,116	\$10.14
Weighted average fair value of options outstanding		\$ 5.32		\$ 3.37		\$ 3.02
Weighted average remaining contractual life	7.7 years		7.8 years		7.9 years	

Outstanding options at December 31, 2004 ranged in exercise price from \$16.68 to \$22.54. Options granted during 2004, 2003 and 2002 ranged in exer-

cise price from \$16.68 to \$22.54, \$13.83 to \$16.95 and \$7.00 to \$15.76, respectively. The weighted average fair value of options granted in 2004, 2003

Notes to the Consolidated Financial Statements

(Expressed in United States dollars)

and 2002 was \$7.11, \$4.78 and \$4.12 respectively. All options have been granted at market value.

Of the outstanding options at December 31, 2004, 309,982 of the options, with an average exercise price of \$10.18, will expire during the five year period ending December 31, 2009. The remaining 2,127,089 outstanding options, with an average exercise price of \$14.41, will expire by December 9, 2014.

In connection with the retirement of the company Chairman as an executive on September 30, 2004 and the retirement of an employee effective November 15, 2004, the stock awards and stock options previously granted to the Chairman and employee were modified as follows: (i) share awards and share option agreements were modified to permit unvested restricted stock and options to vest in accordance with their original terms, rather than terminating upon termination of employment and; (ii) vested stock options previously granted will expire in accordance with their original terms, rather than terminating within 180 days following termination of employment. The effect of these modifications was a non-cash charge of \$3.9 million and \$89,000 recorded to administrative expense for the Chairman and employee, respectively.

On September 30, 2004, the company amended the Director Plan to extend the expiration date of options granted pursuant to the Director Plan from one year after the director ceases to serve as a director of the company to three years after such date, unless the Board elects otherwise, provided that the term of the option may in no event exceed ten years after the date of the grant. The effect of the modification to the Director Plan was a non-cash charge of \$49,000 to administrative expense for the year ended December 31, 2004.

Warrants

At December 31, 2004, 450,000 warrants to purchase Ordinary Shares were outstanding. The warrants are at strike prices ranging between \$12.92 and \$20.79 with a weighted average strike price of \$19.29 and expiration dates ranging from April 1, 2008 to September 27, 2009.

Convertible Debt

In connection with the Convertible Senior Subordinated Notes, the company may be required to issue up to 11,879,350 of its Ordinary Shares should the note-holders convert, per the terms of the Notes, at a conversion rate of 34.9406 shares per \$1,000 principle amount of notes (equal to an initial conversion price of \$28.62 per Ordinary Share). The Notes are due in 2024 (see Note 7).

Common Stock Issuances

During January and February 2004, the company completed two offerings of its Ordinary Shares for a total of 10,393,276 shares at an average offering price of \$21.02 per share, realizing total gross proceeds of \$218.4 million and net proceeds of \$208.6 million after commissions and fees. These offerings were made pursuant to two universal shelf registration statements previously filed with the Securities and Exchange Commission, and substantially exhausted the securities available under those registration statements.

On December 13, 2004, December 4, 2003 and December 13, 2002, the company issued 10,500 and 48,142 and 61,396 Ordinary Shares under the Plan respectively to employees as performance bonuses for past services. All of these bonus shares vest two years from the date of grant. Costs of \$175,000, \$725,000 and \$911,000 were recorded in 2004, 2003 and 2002 respectively related to these issuances.

On December 13, 2004, the company granted a retiring Director and former Chairman 150,000 shares and recorded compensation expense in the amount of \$2.5 million.

During 2004 the company also issued 68,000 shares to two employees as a retention incentive under the plan. The shares vest over a four year period at an annual rate of 10%, 15%, 25% and 50% for years one through four respectively. The company will recognize compensation costs over the vesting period of the shares. During 2004 the company recorded \$44,000 to compensation costs related to these share grants.

Notes to the Consolidated Financial Statements

(Expressed in United States dollars)

In addition, during 2004, 2003 and 2002 the company issued 23,681, 137,987 and 204,655 Ordinary Shares to consultants and recorded costs of \$0.5 million, \$2.9 million and \$3.6 million, respectively.

Total compensation costs recognized for stock-based employee compensation awards were \$10.1

million, \$1.3 million and \$1.2 million for the years ended December 31, 2004, 2003 and 2002, respectively. The 2004 costs include \$4.1 million associated with the extension of the expiration dates of stock options previously granted to the retiring Chairman and a retiring employee.

10. Cash Flow Information

The following is a reconciliation of net loss to cash from operations:

	Years ended December 31,			For the period
	2004	2003	2002	December 22, 1994 (inception) through December 31, 2004
	<i>(in thousands)</i>			
Cash flows from operating activities:				
Net loss	\$(18,845)	\$(6,044)	\$(8,654)	\$(97,658)
Adjustments to reconcile net loss to net cash used in operating activities:				
Amortization and depreciation	55	36	67	1,186
Amortization of deferred financing costs	638	—	—	638
Minority interest in loss of consolidated subsidiary	—	—	—	(4,559)
Stock compensation	8,651	1,038	955	12,388
Shares issued in consideration for services	60	2,912	3,563	8,585
Shares issued to purchase mineral rights	—	—	892	1,799
Changes in operating assets and liabilities:				
(Increase) decrease in accrued interest receivable	(1,074)	109	(57)	(1,102)
(Increase) decrease in prepaid expenses and other assets	(1,876)	(1,633)	(367)	(3,699)
Increase in value-added tax recoverable	(1,157)	(34)	(134)	(6,396)
Increase (decrease) in accrued salaries, wages and benefits	120	6	8	158
Increase in accrued interest payable net of amounts capitalized	1,604	—	—	1,604
Increase (decrease) in accounts payable	2,615	359	147	4,068
Other increase (decrease)	(9)	52	(112)	449
Net cash used in operating activities	\$ (9,218)	\$(3,199)	\$(3,692)	\$(82,539)

Notes to the Consolidated Financial Statements

(Expressed in United States dollars)

The following table details supplemental non-cash transactions:

	Years ended December 31,		
	2004	2003	2002
	<i>(in thousands except per share)</i>		
Stock-based compensation (expensed)	\$ 8,651	\$ 1,038	\$ 955
Stock-based compensation costs (capitalized)	\$ 1,417	\$ 311	\$ 196
Acquisition of mineral rights for Ordinary Shares at an average of \$0.00, \$0.00 and \$15.37 per share respectively	\$ —	\$ —	\$ 892
Payment of debt with Ordinary Shares at an average of \$0.00, \$14.53 and \$16.19 per share respectively	\$ —	\$ 164	\$ 954
Payment of consulting services with Ordinary Shares, options and warrants at an average of \$19.64, \$15.13 and \$13.34 per share respectively	\$ 465	\$ 2,912	\$ 3,563
Accrued interest expense capitalized	\$ 1,286	\$ —	\$ —
Depreciation expense capitalized	\$ 412	\$ 469	\$ 508
Offering costs incurred	\$ 21,703	\$ —	\$ —
Unrealized gains on available for sale investments	\$ 68	\$ —	\$ —
Purchase of euro call option	\$ (500)	\$ —	\$ —
Sale of euro put option	\$ 500	\$ —	\$ —

11. Asset Retirement Obligations

No asset retirement liabilities have been recorded by the company at December 31, 2004, as there has been no disturbance that would require reclamation or remediation at San Cristobal or at any of the company's other projects. Exploration and development costs incurred in 2004 and prior years consist primarily of building roads and other infrastructure, which

will not be reclaimed. Beginning in 2005, activity is expected to commence which will require the recognition of an asset retirement obligation based upon estimated costs to reclaim the property. The costs will be capitalized as part of development costs and the obligation will be recorded based upon the estimated present value of the costs expected to be incurred.

12. Commitments and Contingencies

Leases

The company has lease commitments as follows:

	2005	2006	2007	2008	2009
San Cristobal holding costs	\$360,000	\$360,000	\$360,000	\$360,000	\$360,000
Corporate headquarters office lease	\$300,000	\$306,000	\$306,000	\$306,000	\$102,000

The company is required to make mining patent lease payments to the Bolivian government to maintain its rights to the San Cristobal mining concessions. The company has made such payments totaling approximately \$360,000 per year for the years ending December 31, 2004, 2003 and 2002 and the payments were recorded to the mining property.

A lease associated with the corporate headquarters office space expires in 2009. Payments associated with this lease were recorded to rent expense by the company in the amounts of \$271,000, \$215,000 and \$215,000 for the years ended December 31, 2004, 2003 and 2002, respectively.

Notes to the Consolidated Financial Statements

(Expressed in United States dollars)

Letters of Credit

At December 31, 2004, the company had outstanding irrevocable Letters of Credit in the aggregate amount of \$2.7 million associated with the construction management contractor, the planned port facilities and other contractors for the San Cristobal project. The company has deposited \$3.0 million to collateralize the Letters of Credit, which is recorded as restricted cash.

Capital Commitments

The company has placed orders and entered into agreements for certain long lead equipment for its San Cristobal project totaling approximately \$30.7 million, including the foreign currency value of an order to be settled for 12.8 million euros. Should the company cancel any of the orders, it would incur

varying cancellation fees that would have totaled approximately \$557,000 at December 31, 2004.

The company has also entered into certain contracts with respect to its San Cristobal operations including construction management and contract mining agreements (see Note 16).

Income Taxes

The company and its subsidiaries' income tax returns are periodically examined by various tax authorities. In connection with such an examination, Bolivian tax authorities have raised issues and proposed tax deficiencies. The company has reviewed the issues raised by the Bolivian tax authorities and believes it has a reasonable basis for contesting the full amount of this proposed tax deficiency. The company believes the likelihood was remote that a liability existed for this issue at December 31, 2004.

13. Fair Value of Financial Instruments

The company's financial instruments consist of cash and cash equivalents, receivables, value-added tax recoverable, accounts payable, other current liabilities and long-term debt. Except for the value-added tax and long-term debt, the carrying amounts

of these financial instruments approximate fair value due to their short maturities. The estimated fair values of the company's long-term financial instruments as measured on December 31, 2004 and 2003 are as follows:

	2004		2003	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	<i>(in thousands)</i>			
Value-added tax recoverable	\$ 6,396	\$ 5,451	\$ 5,239	\$ 3,807
Investments held to maturity	192,272	191,744	1,038	1,026
2 $\frac{7}{8}$ % Convertible Senior Subordinated Notes due 2024	200,000	188,000	—	—
4.0% Convertible Senior Subordinated Notes due 2024	139,987	138,587	—	—
Notes payable	599	576	690	541

The fair values of the value-added tax recoverable and the long-term debt are estimated based on the expected timing of future cash flows and the company's incremental borrowing rate are prepared by

internal company experts. The fair value estimate of investments held to maturity were prepared by an independent party. These estimates may not reflect the actual trading value of the instruments.

Notes to the Consolidated Financial Statements

(Expressed in United States dollars)

14. Segment Information

In 1998, the company adopted Statement of Financial Accounting Standards No. 131, *Disclosure about Segments of an Enterprise and Related Information*. The company's sole activity is exploration for and development of mineral properties containing silver

and, consequently substantially all of the company's long-lived assets are in Bolivia. The company's other principal assets consist primarily of short-term, long-term and restricted investments held in U.S. government and U.S. corporate securities.

15. Quarterly Results of Operations (Unaudited)

The following table summarizes the company's quarterly results of operations for the years ended December 31, 2004, 2003 and 2002:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	<i>(in thousands except per share)</i>			
2004				
Net loss for the period	\$ (4,661)	\$ (3,166)	\$ (6,612)	\$ (4,406)
Net loss per Ordinary Share—basic and diluted	\$ (0.11)	\$ (0.07)	\$ (0.14)	\$ (0.09)
2003				
Net loss for the period	\$ (1,693)	\$ (2,061)	\$ (955)	\$ (1,335)
Net loss per Ordinary Share—basic and diluted	\$ (0.05)	\$ (0.06)	\$ (0.03)	\$ (0.04)
2002				
Net loss for the period	\$ (1,070)	\$ (3,265)	\$ (2,412)	\$ (1,907)
Net loss per Ordinary Share—basic and diluted	\$ (0.03)	\$ (0.09)	\$ (0.07)	\$ (0.05)

16. Subsequent Events

On January 7, 2005, the company entered into an Open Pit Contract Mining Services Agreement (the "Agreement") with Washington Group Bolivia S.R.L. (the "Contractor"), under which the Contractor will provide contract mining services for the company's San Cristobal silver, zinc and lead open pit mine development project in Bolivia. These services will include construction and maintenance of site access and haul roads, open pit preproduction stripping, mining of ore and waste, construction and manage-

ment of waste dumps and ore stockpiles, and various other contract mining services. The Contractor will be compensated on a cost reimbursable basis for the actual costs incurred plus certain fees. The Contractor will receive special bonuses and incentive payments for achieving or exceeding the production requirements at cost levels below those agreed as targets with the company. The Contractor has certain obligations and caps on liability with respect to the performance of defective work.

Notes to the Consolidated Financial Statements

(Expressed in United States dollars)

The Agreement expires ten years after commencement of production mining, unless earlier terminated by the company or the Contractor. The company may terminate the Agreement at any time by giving written notice to the Contractor to that effect. Terminating the Agreement may subject the company to the payment of a termination fee and other capital costs. The Contractor may terminate the Agreement in the event of certain defaults of the company.

In March 2005, the company signed an agreement with a Bolivian company to extend a power line approximately 180 kilometers from the community of Punutuma to San Cristobal. The construction of this line is expected to be completed by mid-2006 at a cost of approximately \$22 million. Should the company terminate the agreement, it would be required to reimburse costs and expense incurred and in certain circumstances, a termination fee. Until the power line is completed, power for construction at the San Cristobal project will continue to be obtained from on-site generators.

Board of Directors

Jeffrey G. Clevenger
President and Chief Executive Officer
Apex Silver Mines Limited
Age 55

Kevin R. Morano
Executive Vice President and Chief Financial Officer
Lumenis Ltd.
Age 51

Harry M. Conger
Former Chairman
Homestake Mining Company
Age 74

Terry M. Palmer
Former Partner
Ernst & Young LLP
Age 60

Charles L. Hansard
Director
Moore Global Investments, Ltd.
Age 56

Charles B. Smith
Former President and Chief Operating Officer
Southern Peru Copper Company
Age 66

Ove Hoegh
Senior Partner
Hoegh Invest
Age 68

Paul Soros
Investment Advisory Committee Member
Quantum Industrial Partners LDC
Age 78

Keith R. Hulley
Executive Chairman
Apex Silver Mines Limited
Age 65

Corporate Information

Shareholder Information

Investor Relations Contact:

Igor Levental
Vice President, Investor Relations and
Corporate Development
Apex Silver Mines Corporation
1700 Lincoln Street, Suite 3050
Denver, CO 80203
(303) 839-5060
(888) 696-2739
Email: information@apexsilver.com
Fax: (303) 839-5907

Stock Transfer Agent

Questions regarding your Shareholder account
should be addressed to:

American Stock Transfer
59 Maiden Lane
New York, NY 10038
(718) 921-8200
(800) 937-5449
Attn: Geraldine Zarbo

Market Information

Apex Silver Mines Limited Ordinary Shares
trade on the American Stock Exchange under
the symbol "SIL".

Independent Accountants

PricewaterhouseCoopers LLP
1670 Broadway, Suite 1000
Denver, CO 80202

Annual Meeting

Thursday, June 2, 2005, 4:00 p.m. (EDT)

St Regis Hotel
La Maisonnette I Room
2 East 55th Street at Fifth Avenue
New York, NY 10022

General Information

Corporate Headquarters Address

Apex Silver Mines Limited
Walker House
Mary Street
George Town, Grand Cayman
Cayman Islands, British West Indies

Unit Conversion Table:

1 troy ounce = 31.103 grams
1 (short) ton = 0.907 (metric) tonnes
1 (metric) tonne = 2204.62 pounds
1 troy ounce per (short) ton = 34.286 grams
per (metric) tonne
1 foot = 0.305 meters
1 mile = 1.609 kilometers
1 acre = 0.405 hectares

Stock Market Information

Our company's Ordinary Shares are listed on the American Stock Exchange under the symbol "SIL". As of March 16, 2005, we had approximately 178 shareholders of record and an estimated 12,000 additional beneficial holders whose Ordinary Shares were held in street name by brokerage houses.

Our company has never paid any dividends on its Ordinary Shares and expects for the foreseeable future to retain all of its earnings from operations for use in expanding and developing its business. Any future decision as to the payment of dividends will be at the discretion of our Board of Directors and will depend upon our earnings, receipt of dividends from our subsidiaries, financial position, capital

requirements, plans for expansion and such other factors as our Board of Directors deems relevant.

The following table sets forth the high and the low sale prices per share of our Ordinary Shares for the periods indicated. The closing price of the Ordinary Shares on March 16, 2005 was \$18.70.

Period	Ordinary Shares			
	2004		2003	
	High	Low	High	Low
1st Quarter	\$24.22	\$19.35	\$16.42	\$12.90
2nd Quarter	\$22.76	\$15.30	\$15.38	\$12.35
3rd Quarter	\$21.70	\$16.75	\$18.06	\$13.40
4th Quarter	\$21.64	\$16.68	\$21.51	\$12.70