

APEX SILVER MINES LTD  
Form 10-Q  
May 09, 2007

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, DC 20549

**FORM 10-Q**

(MARK ONE)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES**

**EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED**

**MARCH 31, 2007.**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES**  
**EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM        TO        .**

COMMISSION FILE NUMBER 1-13627

**APEX SILVER MINES LIMITED**

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(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

**CAYMAN ISLANDS, BRITISH WEST INDIES**  
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)

**NOT APPLICABLE**  
(I.R.S. EMPLOYER IDENTIFICATION NO.)

**WALKER HOUSE**  
**MARY STREET**  
**GEORGE TOWN, GRAND CAYMAN**  
**CAYMAN ISLANDS, BRITISH WEST INDIES**  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

**NOT APPLICABLE**  
(ZIP CODE)

**(345) 949-0050**

(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

INDICATE BY CHECK MARK WHETHER THE REGISTRANT (1) HAS FILED ALL REPORTS REQUIRED TO BE FILED BY SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 DURING THE PRECEDING 12 MONTHS (OR FOR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO FILE SUCH REPORTS), AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST 90 DAYS: YES  NO

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A LARGE ACCELERATED FILER, AN ACCELERATED FILER, OR A NON-ACCELERATED FILER:

LARGE ACCELERATED FILER  ACCELERATED FILER  NON-ACCELERATED FILER

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A SHELL COMPANY (AS DEFINED IN RULE 12B-2 OF THE EXCHANGE ACT): YES  NO

AT MAY 9, 2007, 58,637,525 ORDINARY SHARES, \$0.01 PAR VALUE PER SHARE, WERE ISSUED AND OUTSTANDING.

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APEX SILVER MINES LIMITED  
FORM 10-Q  
QUARTER ENDED MARCH 31, 2007

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

**APEX SILVER MINES LIMITED**  
**An Exploration and Development Stage Company**

**CONSOLIDATED BALANCE SHEETS**  
**(Expressed in United States dollars)**  
**(Unaudited)**

|  | March 31,<br>2007<br>(in thousands, except share data) | December 31,<br>2006 |
|--|--|----------------------|
| <b>Assets</b>  |  |                      |
| Current assets   |  |                      |
| Cash and cash equivalents  | \$ 147,792   | \$ 49,840            |
| Restricted cash  | 10,192   | 31,942               |
| Investments  | 223,198  | 325,536              |
| Restricted investments   | 35,850   | 65,343               |
| Ore inventories  | 6,609  | 3,183                |
| Material and supply inventories  | 3,025  | 3,149                |
| Prepaid expenses and other assets  | 11,002   | 9,984                |
| Total current assets   | 437,668  | 488,977              |
| Property, plant and equipment, net   |  |                      |
| Ore inventories  | 746,425  | 641,758              |
| Deferred financing costs   | 26,797   | 21,341               |
| Value added tax recoverable  | 18,150   | 19,485               |
| Investments  | 63,614   | 54,158               |
| Deferred tax asset   | 32,980   | 42,255               |
| Other  | 1,596  | 1,596                |
| Total assets   | \$ 1,327,373   | \$ 1,270,096         |
| <b>Liabilities and Shareholders Equity (Deficit)</b>   |  |                      |
| Current liabilities  |  |                      |
| Accounts payable and other accrued liabilities   | \$ 52,272  | \$ 47,979            |
| Accrued interest payable   | 1,151  | 3,405                |
| Derivatives at fair value  | 88,046   | 39,080               |
| Current portion of long term debt  | 6,688  | 4,408                |
| Total current liabilities  | 148,157  | 94,872               |
| Long term debt   | 538,489  | 492,195              |
| Derivatives at fair value  | 621,846  | 779,118              |
| Deferred gain on sale of asset   | 945  | 1,400                |
| Uncertain tax positions  | 1,596  | 1,596                |
| Asset retirement obligation  | 6,053  | 5,761                |
| Total liabilities  | 1,317,086  | 1,373,346            |
| Minority interest in subsidiaries  | 395  | 40                   |
| Commitments and contingencies (Note 13)  |  |                      |
| Shareholders' equity (deficit)   |  |                      |
| Ordinary Shares, \$.01 par value, 175,000,000 shares authorized; 58,628,150 and 58,577,700 shares issued and outstanding at respective dates | 586  | 586                  |
| Additional paid in capital   | 670,922  | 669,487              |
| Accumulated deficit during development stage   | (661,360)  | (773,339)            |
| Accumulated other comprehensive income (loss)  | (256)  | (24)                 |
| Total shareholders' equity (deficit)   | 9,892  | (103,290)            |
| Total liabilities and shareholders' equity   | \$ 1,327,373   | \$ 1,270,096         |

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



**APEX SILVER MINES LIMITED**  
**An Exploration and Development Stage Company**

**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**  
**(Expressed in United States dollars)**  
**(Unaudited)**

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|   | Three Months Ended<br>March 31,<br>2007 |                   | 2006          | For the Period<br>from December<br>22, 1994<br>(inception)<br>through<br>March 31, 2007 |
|---|---|-------------------|---------------|---|
|   | (in thousands, except share data)       |                   |               |   |
| <b>Operating income and expenses:</b>                           |   |                   |               |   |
| Exploration   | \$ (2,731 )                             | \$ (1,450 )       | \$ (84,478 )  | \$ (84,478 )  |
| Administrative  | (6,290 )                                | (5,313 )          | (97,395 )     | (97,395 )   |
| Gain (loss) on commodity derivatives                            | 108,306                                 | (172,818 )        | (757,362 )    | (757,362 )  |
| Gain (loss) on foreign currency derivatives and transactions    | 984                                     | 113               | 2,597         | 2,597   |
| Asset retirement accretion expense                              | (139 )                                  | (48 )             | (545 )        | (545 )  |
| Amortization and depreciation                                   | (114 )                                  | (95 )             | (1,913 )      | (1,913 )  |
| Total operating expenses  | 100,016                                 | (179,611 )        | (939,096 )    | (939,096 )  |
| <b>Other income and expenses:</b>                               |   |                   |               |   |
| Interest and other income                                       | 6,786                                   | 2,904             | 61,136        | 61,136  |
| Royalty income  | 294                                     |                   | 1,913         | 1,913   |
| Gain on sale of interest in subsidiary                          |   |                   | 199,600       | 199,600   |
| Gain on extinguishment of debt                                  |   | 2,875             | 9,640         | 9,640   |
| Interest expense and other borrowing costs (1)                  |   | (519 )            | (11,696 )     | (11,696 )   |
| Total other income and expense                                  | 7,080                                   | 5,260             | 260,593       | 260,593   |
| Income (loss) before minority interest and income taxes         | 107,096                                 | (174,351 )        | (678,503 )    | (678,503 )  |
| Income taxes  | (47 )                                   | (54 )             | (1,175 )      | (1,175 )  |
| Minority interest in (income) loss of consolidated subsidiaries | 4,930                                   | (7 )              | 18,318        | 18,318  |
| Net income (loss)   | \$ 111,979                              | \$ (174,412 )     | \$ (661,360 ) | \$ (661,360 )   |
| <b>Other comprehensive income:</b>                              |   |                   |               |   |
| Unrealized gain (loss) on securities                            | \$ (232 )                               | \$ 390            | \$ (499 )     | \$ (499 )   |
| Reclassification for loss on securities included in net income  |   | 495               | 243           | 243   |
| Other comprehensive income (loss)                               | (232 )                                  | 885               | (256 )        | (256 )  |
| Comprehensive income (loss)                                     | \$ 111,747                              | \$ (173,527 )     | \$ (661,616 ) | \$ (661,616 )   |
| <b>Net Income (loss) per Ordinary Share basic</b>               | <b>\$ 1.91</b>                          | <b>\$ (3.39 )</b> |               |   |
| <b>Net Income (loss) per Ordinary Share diluted</b>             | <b>\$ 1.90</b>                          | <b>\$ (3.39 )</b> |               |   |
| <b>Weighted average Ordinary Shares outstanding - basic</b>     | <b>58,610,698</b>                       | <b>51,420,587</b> |               |   |
| <b>Weighted average Ordinary Shares outstanding - diluted</b>   | <b>58,898,719</b>                       | <b>51,420,587</b> |               |   |

(1) Interest expense and other borrowing costs are net of \$10.8 million and \$4.3 million capitalized for the three month periods ended March 31, 2007 and 2006, respectively and \$46.3 million for the inception to date period ended March 31, 2007.

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



**APEX SILVER MINES LIMITED**  
**An Exploration and Development Stage Company**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Expressed in United States dollars)**  
**(Unaudited)**

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|   | Three Months Ended<br>March 31,<br>2007<br>(in thousands) | 2006         | For the period<br>from December<br>22, 1994<br>(inception)<br>through<br>March 31, 2007 |
|---|---|--------------|---|
| Cash flows from operating activities:   |   |              |   |
| Net cash used in operating activities   | \$ (16,473 )  | \$ (12,111 ) | \$ (194,077 )   |
| Cash flows from investing activities:   |   |              |   |
| Purchase of available for sale investments  | (254,309 )  | (34,000 )    | (2,074,821 )  |
| Sale of available for sale investments  | 351,632   | 84,191       | 1,740,426   |
| Purchase of held-to-maturity investments  |   |              | (263,869 )  |
| Maturities of held-to-maturity investments  | 5,000   | 1,000        | 227,620   |
| Purchase of available for sale restricted investments   | (29,800 )   | (191,612 )   | (296,250 )  |
| Sale of available for sale restricted investments   | 65,600  | 104,869      | 345,835   |
| Purchase of held-to-maturity restricted investments   |   |              | (49,877 )   |
| Maturity of held-to-maturity restricted investments   | 2,800   |              | 84,252  |
| Payment of derivative premiums & settlements, net   |   | (3,168 )     | (48,394 )   |
| Advances for construction of port facility  |   |              | (2,000 )  |
| Advances to suppliers and contractors   |   | (3,405 )     |   |
| Released from (transfer to) restricted cash to collateralize credit facility,<br>letters of credit and interest payments, net | 21,750  | 88,568       | (13,155 )   |
| Proceeds from the sale of interest in subsidiary  |   |              | 224,000   |
| Payment of selling costs related to sale of interest in subsidiary  |   |              | (6,384 )  |
| Capitalized costs and acquisitions of property, plant and equipment   | (68,851 )   | (76,186 )    | (632,580 )  |
| Net cash provided by (used) in investing activities   | 93,822  | (29,743 )    | (765,197 )  |
| Cash flows from financing activities:   |   |              |   |
| Proceeds from issuance of Ordinary Shares   |   | 5,728        | 580,357   |
| Proceeds from issuance of convertible notes   |   |              | 339,987   |
| Payment of debt issuance costs  |   | (209 )       | (24,992 )   |
| Payments of notes payable and long term debt  | (4,463 )  | (569 )       | (9,915 )  |
| Proceeds from note to power line contractor   |   |              | 1,415   |
| Borrowings under project finance facility   | 20,000  | 40,000       | 200,000   |
| Minority interest contributions   | 4,585   |              | 4,585   |
| Proceeds from exercise of stock options and warrants  | 481   | 1,414        | 15,629  |
| Net cash provided by financing activities   | 20,603  | 46,364       | 1,107,066   |
| Net increase (decrease) in cash and cash equivalents  | 97,952  | 4,510        | 147,792   |
| Cash and cash equivalents - beginning of period   | 49,840  | 4,808        |   |
| Cash and cash equivalents - end of period   | \$ 147,792  | \$ 9,318     | \$ 147,792  |

See Note 15 for supplemental cash flow information.

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

**APEX SILVER MINES LIMITED**

**An Exploration and Development Stage Company**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

(Expressed in United States dollars)

**1. Basis of Preparation of Financial Statements and Nature of Operations**

These unaudited interim consolidated financial statements of Apex Silver Mines Limited (the Company) and its subsidiaries have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (SEC). Such rules and regulations allow the omission of certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America, so long as such omissions do not render the financial statements misleading. Certain prior period amounts have been reclassified to conform to the current period presentation.

In the opinion of management, these financial statements reflect all adjustments that are necessary for a fair statement of the results for the periods presented. All adjustments were of a normal recurring nature. These interim financial statements should be read in conjunction with the annual financial statements of the Company included in its 2006 Annual Report on Form 10-K.

The Company is a mining exploration and development company that holds a portfolio of exploration and development properties primarily in South America and Central America. The Company currently focuses its resources primarily on the development of its San Cristobal Project in Bolivia. At present, none of the Company's properties are in production and, consequently, the Company does not have current operating income.

**2. Significant Accounting Policies**

Effective January 1, 2007, the Company adopted Financial Accounting Standards Interpretation No. 48, Accounting for Uncertainty in Income Taxes, (FIN 48), an interpretation of Financial Accounting Standards Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation requires that the Company recognize in its financial statements the impact of uncertain tax positions. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods and disclosure. The adoption of FIN 48 did not have a material impact on the Company's financial position or results of operations (see Note 10).

*New Accounting Standards*

During February 2007 the Financial Accounting Standards Board (FASB) issued Financial Accounting Standards No. 159 The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115 (FAS No. 159). FAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Most of the provisions of FAS No. 159 apply only to entities that elect the fair value option. However, the amendment to FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, applies to all entities with available-for-sale and trading securities. FAS No. 159 is effective as of the beginning of the first fiscal year that begins after November 15, 2007 (fiscal year 2008 for the Company). The Company does not expect the adoption of FAS No. 159 to have a material impact on its financial position or results of operations.

During September 2006 the FASB issued Financial Accounting Standards No. 157 Fair Value Measurements (FAS No. 157). FAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Standard addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under U.S. GAAP. Accordingly, this Standard does not require any new fair value measurements. FAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those

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fiscal years (fiscal year 2008 for the Company). The Company does not expect the adoption of FAS No. 157 to have a material impact on its financial position or results of operations.

### 3. Investments

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. The Company accounts for its investments in auction rate securities in accordance with Statement of Financial Accounting Standards No. 115,

Accounting for Certain Investments in Debt and Equity Securities such that if the underlying security of an auction rate security has a stated or contractual maturity date in excess of 90 days, regardless of the frequency of the interest rate reset date, the security is classified as a current available-for-sale investment. Short-term investments include investments with maturities greater than three months, but not exceeding twelve months and available for sale auction rate securities. Long-term investments include investments with maturities greater than twelve months.

The Company determines the appropriate classification of its investments in debt and equity securities at the time of purchase and re-evaluates classifications at each balance sheet date. Debt securities are classified as held to maturity when the Company has the intent and ability to hold the securities to maturity. Held to maturity debt securities are stated at amortized cost and include government agency and corporate obligations. Available for sale investments are marked to market at each reporting period with changes in value recorded as a component of other comprehensive income. If declines in value are deemed other than temporary, a charge is made to net loss for the period.

The Company invests only in government and corporate securities rated investment grade or better. The following tables, based on quoted market prices, summarize the Company's investments at March 31, 2007 and December 31, 2006:

| March 31, 2007                  | Cost<br>(in Thousands) | Fair Value        | Carrying Value    |
|---------------------------------|------------------------|-------------------|-------------------|
| <b>Investments:</b>             |                        |                   |                   |
| <b>Short-term</b>               |                        |                   |                   |
| <b>Available for sale</b>       |                        |                   |                   |
| Auction rate securities         | \$ 207,810             | \$ 207,810        | \$ 207,810        |
| Corporate notes                 | 998                    | 998               | 998               |
| Government bonds                | 11,868                 | 11,885            | 11,885            |
| Common stock                    | 761                    | 505               | 505               |
| <b>Total available for sale</b> | <b>221,437</b>         | <b>221,198</b>    | <b>221,198</b>    |
| <b>Held to maturity</b>         |                        |                   |                   |
| Government bonds                | 2,000                  | 1,998             | 2,000             |
| <b>Total held to maturity</b>   | <b>2,000</b>           | <b>1,998</b>      | <b>2,000</b>      |
| <b>Total short term</b>         | <b>\$ 223,437</b>      | <b>\$ 223,196</b> | <b>\$ 223,198</b> |
| <b>Long-term</b>                |                        |                   |                   |
| <b>Available for sale</b>       |                        |                   |                   |
| Corporate notes                 | \$ 6,990               | \$ 6,958          | \$ 6,958          |
| Government bonds                | 26,049                 | 26,022            | 26,022            |
| <b>Total available for sale</b> | <b>33,039</b>          | <b>32,980</b>     | <b>32,980</b>     |
| <b>Total long term</b>          | <b>\$ 33,039</b>       | <b>\$ 32,980</b>  | <b>\$ 32,980</b>  |
| <b>Restricted Investments:</b>  |                        |                   |                   |
| <b>Short-term</b>               |                        |                   |                   |
| <b>Available for sale</b>       |                        |                   |                   |
| Auction rate securities         | \$ 33,100              | \$ 33,100         | \$ 33,100         |
| <b>Total available for sale</b> | <b>33,100</b>          | <b>33,100</b>     | <b>33,100</b>     |
| <b>Held to maturity</b>         |                        |                   |                   |
| Government bonds                | 2,771                  | 2,750             | 2,750             |
| <b>Total held to maturity</b>   | <b>2,771</b>           | <b>2,750</b>      | <b>2,750</b>      |
| <b>Total short term</b>         | <b>\$ 35,871</b>       | <b>\$ 35,850</b>  | <b>\$ 35,850</b>  |



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| December 31, 2006              | Cost<br>(in Thousands) | Fair Value | Carrying Value |
|--------------------------------|------------------------|------------|----------------|
| <b>Short-term investments</b>  |                        |            |                |
| Available for sale             |                        |            |                |
| Common stock                   | \$ 761                 | \$ 779     | \$ 779         |
| Corporate notes                | 5,935                  | 5,995      | 5,995          |
| Bond funds                     | 6,972                  | 6,973      | 6,973          |
| Auction rate securities        | 306,785                | 306,789    | 306,789        |
| Total available for sale       | 320,453                | 320,536    | 320,536        |
| Held to maturity               |                        |            |                |
| Government bonds               | 5,000                  | 4,991      | 5,000          |
| Total held to maturity         | 5,000                  | 4,991      | 5,000          |
| Total short term               | \$ 325,453             | \$ 325,527 | \$ 325,536     |
| <b>Long-term investments</b>   |                        |            |                |
| Available for sale             |                        |            |                |
| Corporate notes                | 6,988                  | 6,960      | 6,960          |
| Government bonds               | 33,374                 | 33,295     | 33,295         |
| Total available for sale       | 40,362                 | 40,255     | 40,255         |
| Held to maturity               |                        |            |                |
| Government bonds               | 2,000                  | 1,996      | 2,000          |
| Total held to maturity         | 2,000                  | 1,996      | 2,000          |
| Total short term               | \$ 42,362              | \$ 42,251  | \$ 42,255      |
| <b>Restricted Investments:</b> |                        |            |                |
| Short-term                     |                        |            |                |
| Available for sale             |                        |            |                |
| Auction rate securities        | \$ 59,800              | \$ 59,800  | \$ 59,800      |
| Total available for sale       | 59,800                 | 59,800     | 59,800         |
| Held to maturity               |                        |            |                |
| Government bonds               | 5,543                  | 5,500      | 5,543          |
| Total held to maturity         | 5,543                  | 5,500      | 5,543          |
| Total short term               | \$ 65,343              | \$ 65,300  | \$ 65,343      |

Quoted market prices at March 31, 2007 and December 31, 2006 were used to determine the fair values of the above investments.

The Company maintains the majority of its investments in auction rate securities ( ARS ) which provide acceptable interest rates with high liquidity allowing the Company to convert the securities to cash every 7 to 35 days depending on the terms of the specific ARS. Auction rate securities are floating rate securities with long-term nominal maturities of 25 to 30 years but are marketed by financial institutions with maturity and interest rate reset dates at 7, 28, or 35 day intervals. The result is that the market always has large quantities of securities resetting their interest rates every week resulting in high liquidity. Most of the Company s ARS at March 31, 2007 have reset dates of either 7 days or 28 days and annual yields ranging from 2.83% to 5.58%.

*Credit Risk*

Credit risk is the risk that a third party might fail to fulfill its performance obligations under the terms of a financial instrument. For cash and equivalents and investments, credit risk represents the carrying amount on the balance sheet. We mitigate credit risk for cash and equivalents and investments by placing our funds and investments with high credit-quality financial institutions, limiting the amount of exposure to each of the financial institutions, monitoring the financial condition of the financial institutions and investing only in government and corporate securities rated investment grade or better.

The Company invests with financial institutions that maintain a net worth of not less than \$1 billion and are members in good standing of the Securities Investor Protection Corporation. Of the Company's \$450.0 million total of cash and cash equivalents, restricted cash, short and long term investments and restricted investments at March 31, 2007, \$444.8 million was held at twelve large multinational banks.

**4. Prepaid expenses and other assets**

Prepaid expenses and other assets consist of the following:

|  | <b>March 31,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|--|---------------------------|------------------------------|
|  | <b>(in thousands)</b>     |                              |
| Prepaid insurance                          | \$ 3,121                  | \$ 1,949                     |
| Accrued interest receivable                | 1,104                     | 1,348                        |
| Prepaid consulting & contractor fees       | 4,877                     | 3,507                        |
| Prepaid import taxes and duties receivable | 344                       | 1,637                        |
| Other                                      | 1,556                     | 1,543                        |
|  | \$ 11,002                 | \$ 9,984                     |

The prepaid consulting and contractor fees consist primarily of advance payments made to contractors for work being performed for the San Cristobal Project.

**5. Value Added Tax Recoverable**

The Company has recorded value added tax ( VAT ) paid in Bolivia and related to the San Cristobal project 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 is expected to be recovered through future production from the San Cristobal project. Future changes to Bolivian tax law could have an adverse effect on the Company's ability to recover the VAT paid in Bolivia. At March 31, 2007 and December 31, 2006, the VAT recoverable was \$63.6 million and \$54.2 million, respectively. The VAT recoverable amounts include \$6.2 million and \$5.3 million of recoverable Bolivian import duties for the periods ended March 31, 2007 and December 31, 2006, respectively.

The Company has also paid VAT in Bolivia as well as other countries, primarily related to exploration projects, which has been charged to expense as incurred because of the uncertainty of the recoverability.

## 6. Property, Plant and Equipment

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

|                                | March 31,<br>2007<br>(in thousands) | December 31,<br>2006 |
|--------------------------------|-------------------------------------|----------------------|
| Mineral properties             | \$ 117,533                          | \$ 117,390           |
| Construction in progress       | 564,894                             | 482,979              |
| Buildings                      | 13,590                              | 13,590               |
| Mining equipment and machinery | 14,928                              | 13,580               |
| Other furniture and equipment  | 3,629                               | 3,166                |
|                                | 714,574                             | 630,705              |
| Less: Accumulated depreciation | (7,785 )                            | (6,962 )             |
|                                | 706,789                             | 623,743              |
| Equipment under capital lease  | 45,150                              | 22,183               |
| Less: Accumulated depreciation | (5,514 )                            | (4,168 )             |
|                                | 39,636                              | 18,015               |
|                                | \$ 746,425                          | \$ 641,758           |

For the three months ended March 31, 2007 and 2006 the Company recorded depreciation expense of \$114,000 and \$95,000, respectively. Also, for the three months ended March 31, 2007 and 2006 the Company capitalized depreciation associated with the San Cristobal Project in the amounts of \$2.0 million and \$1.1 million respectively.

The March 31, 2007 and December 31, 2006 construction in progress balances include \$46.3 and \$35.5 million of capitalized interest respectively. The capitalized interest amounts are related to the Convertible Senior Subordinated Notes, the project finance facility and equipment under capital lease (see Note 7).

At March 31, 2007 the Company had recorded a lease obligation of \$36.1 million related to outstanding capital leases (see Note 7).

## 7. Debt

The Company's debt consists of the following:

|   | March 31, 2007 |            | December 31, 2006 |            |
|---|----------------|------------|-------------------|------------|
|   | Current        | Long term  | Current           | Long term  |
|   | (in thousands) |            |                   |            |
| 2.875% Convertible Senior Subordinated Notes due 2024 | \$             | \$ 180,000 | \$                | \$ 180,000 |
| 4.0% Convertible Senior Subordinated Notes due 2024   |                | 109,987    |                   | 109,987    |
| Project finance facility                              |                | 200,000    |                   | 180,000    |
| Note payable to Ingelec for power line                | 1,216          |            | 1,415             |            |
| Note assigned to Sumitomo                             |                | 8,013      |                   | 7,853      |
| Capital lease and other obligations                   | 5,459          | 30,594     | 2,993             | 14,355     |
| Other obligations                                     | 13             | 9,895      |                   |            |
|   | \$ 6,688       | \$ 538,489 | \$ 4,408          | \$ 492,195 |



*2.875% Notes and 4.0% Notes*

Both the 2.875% Notes and the 4.0% Notes are convertible into the Company's Ordinary Shares at a conversion rate of 34.9406 shares per \$1,000 principal amount of the Notes (equal to an initial conversion price of approximately \$28.62 per share), subject to adjustment in certain circumstances. Holders 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 10.1 million of the Company's Ordinary Shares. Accumulated interest on the Notes is paid twice a year in March and September.

During 2006 the Company issued 1,086,653 of its Ordinary Shares, valued at \$17.1 million, and repurchased \$20.0 million of its outstanding 4.0% Notes. The transaction represented an early extinguishment of debt and the Company recorded a gain of \$2.9 million and recognized accelerated amortization of deferred issuance costs of \$0.5 million related to the transaction. The Notes purchased in the transactions have been cancelled.

Costs incurred in connection with the issuance of the Notes were deferred and are being amortized to interest expense over ten years which corresponds to the related call provisions. At March 31, 2007 the unamortized balance of deferred financing costs related to the Notes was approximately \$7.3 million.

The indenture relating to the 4.0% Notes requires the Company to maintain restricted investments to cover the payment of interest through 2007. The amount invested will at maturity equal the interest payments due. As of March 31, 2007, \$2.8 million of restricted investments were designated for this purpose.

*San Cristobal Project Finance Facility*

In December 2005 the Company closed on a \$225 million project finance facility (the Facility), arranged by BNP Paribas and Barclays Capital, and funded by a group of international financial institutions including banks, export credit agencies and the Andean Development Corporation, a multilateral financial agency that promotes sustainable development in South America. Borrowings from the Facility are being used to complete the development of the Company's San Cristobal Project. At March 31, 2007 the Company had borrowed \$200.0 million under the Facility. The Company is required to pay a 1.0% annual commitment fee on the undrawn amount of the Facility. Interest on the outstanding amounts drawn under the Facility is based on LIBOR plus a credit spread. The first principal payment under the Facility is due in December 2008, and the Facility must be fully repaid in December 2012.

In connection with the sale to Sumitomo Corporation (Sumitomo) of a 35% interest in the subsidiaries that own and will operate the San Cristobal project, Sumitomo has guaranteed the repayment of 35% of the project finance facility debt through completion of the project (which is no later than December 2008).

The Facility contains covenants that require the Company to, among other things, maintain certain security interests, financial ratios after project completion, insurance coverage, minimum sales contracts and metals price protection contracts as well as other requirements. Failure to comply with these covenants or to cure related violations within specified periods could result in an event of default, pursuant to which the project lenders could require immediate repayment of all amounts outstanding under the Facility and immediate cash settlement of the outstanding derivative positions associated with the San Cristobal Project.

Pursuant to the debt covenants contained in the Facility, the Company is required annually to submit a revised Construction Budget, Operating Plan, and Financial Model (collectively the Updated Plan) for the San Cristobal Project. The covenants require that the Updated Plan reflect certain set metals prices that are substantially less than current metals prices. As such, representatives of the lenders and the Company have been engaged in discussions to agree upon mutually acceptable prices and other terms for the Updated Plan. The representatives of the lenders have proposed higher metals prices than those contained in the original agreement that will allow the Company to present an Updated Plan that will meet the Facility's

financial requirements. The representatives of the lenders have also proposed an adjustment to the Facility's repayment schedule to require a larger percentage of principal to be repaid in earlier years and an increase in the mandatory cash flow sweep from 35% to 45% of excess cash flow. In connection with these proposed amendments to the terms of the Facility, the Company and Sumitomo have agreed to purchase put options to protect additional cash flow needed for the accelerated loan schedule. The Company will also fund a \$91 million margin account with the two banks holding the derivative positions and Sumitomo will provide a post-completion guarantee of the derivative positions in the amount of \$49 million. This support will be decreased by 33% at the end of each of the years from 2008 through 2010.

At the date of this filing, formal approval of the amendments to the agreements and the Updated Plan by the requisite majority of lenders has not yet been obtained. While there can be no assurances that lender approval will be obtained, management believes the necessary amendments and the Updated Plan will be approved by the requisite majority of lenders.

If the amendments and the Updated Plan are not approved by the lenders, until such time as approval is obtained, the Company would be required to operate in all material respects, as defined by the Facility, in compliance with the Initial Plan. If the Company's operations fail to comply with the Initial Plan in all material respects, the lenders could declare a default and require the Company to settle all amounts outstanding under the Facility and derivatives liability. Because the Company's current projections indicate that cash flows and operating ratios will exceed those in the Initial Plan, the Company believes that operations will comply in all material respects with the Initial Plan. However, the Company cannot predict what actions the lenders might take if they deem that the Company is not in material compliance with the Initial Plan.

If an event of default occurs, the lenders could require immediate payment of amounts outstanding under the Facility and settlement of the derivatives liability. If such a demand were successfully made, the Company would require additional debt or equity financing in order to satisfy its obligations. There is no assurance that the Company would be able to obtain additional financing on acceptable terms, or at all.

Direct costs incurred in obtaining the Facility were deferred and will be amortized to interest expense over the term of the facility. At March 31, 2007 the unamortized balance of deferred financing costs related to the Facility was approximately \$10.8 million.

#### *Power Line Notes*

The Company has loaned funds to San Cristobal Transportadora de Electricidad, S.A. ( SC Tesa ), the contractor that has constructed the power line for the San Cristobal Project and holds a note receivable from SC Tesa in the amount of \$22.3 million. The Company expects to receive repayment of the note from SC Tesa in the form of credits against charges for the delivery of power. In connection with the sale of 35% of the San Cristobal Project to Sumitomo, the Company assigned 35% of the \$22.3 million note to Sumitomo. As the Company receives payments from SC Tesa it must pay Sumitomo its 35% share of such payments. As a result, the Company has recorded a note payable to Sumitomo in the amount of \$8.0 million, including accrued interest.

SC Tesa borrowed approximately \$1.2 million from its parent company, Ingelec, to complete the construction of the power line. Per the guidance of FASB Interpretation No. 46R Variable Interest Entities ( FIN 46R ) the Company consolidates the accounts of SC Tesa and recorded the note payable of \$1.2 million on its consolidated books.

*Capital Leases and Other Financing Obligations*

During the three months ended March 31, 2007 the Company placed in service \$23.0 million of additional mining equipment to be used in stripping and mine production, and recorded the transaction as a capital lease, resulting in total capital lease obligations of \$36.1 million at March 31, 2007. During the three months ended March 31, 2007 the Company made payments of approximately \$4.3 million related to capital lease obligations including \$3.2 million of upfront mobilization fees.

The Company has a 17-year contract with a third party to provide port services following construction of port facilities in Mejillones, Chile. Certain assets being constructed at the port will be made available for the exclusive use of the Company, including concentrate reception, unloading, and storage facilities. The Company has evaluated its contractual agreement with the company and has determined that such agreement contains a leasing arrangement with respect to the assets that will be operated exclusively for the use of the Company. Following the guidance of EITF 97-10 the Company is deemed the owner of the project during construction. Accordingly, for the period ended March 31, 2007, the Company recorded on its balance sheet \$12.1 million to construction in progress and a financing obligation of \$9.9 million, which is net of \$2.2 million of funds previously advanced to the port contractor including interest.

**8. Sales Contracts and Derivative Instruments**

Certain covenants related to the project finance facility required the Company to provide price protection for a portion of its planned production of metals from San Cristobal. During the third quarter of 2005, the Company entered into certain derivative positions utilizing primarily forward sales but also puts and calls to comply with the project finance facility covenants. In order to maintain leverage to silver market prices, the Company entered into proportionally more zinc and lead positions than silver positions. Non-cash mark-to-market gains and losses from the open derivative positions may fluctuate substantially from period to period based on spot and forward prices and option volatilities.

In addition, in the past the Company made limited investments in shorter duration put and call options and other metals derivatives not required by the project financing facility. During 2006, the Company liquidated all of its discretionary derivative contracts. At March 31, 2007 the Company did not hold any derivative contracts other than those required by the project finance facility.

The Company marks its open derivative positions to fair value at the end of each accounting period with the related change in fair value recorded to earnings. The Company recorded a gain of \$108.3 million as a result of marking to market its open derivative position for the quarter ended March 31, 2007 compared to a mark to market derivative loss of \$172.8 million for the same quarter of 2006. The gain is primarily the result of lower spot and forward prices for silver and zinc at March 31, 2007 as compared to spot and forward prices at December 31, 2006. The actual final financial impact of the required project financing facility derivative positions will not be known until the positions are closed on their future settlement dates. The Company does not intend to use cash to settle the open derivatives position contracts relating to the project financing facility prior to their settlement dates beginning in September of 2007. At the time of final settlement, the gain or loss recorded will exclude previously recognized non-cash mark-to-market gains or losses.

As the result of the sale of a 35% interest in the subsidiary that holds the derivative positions to Sumitomo, Sumitomo has guaranteed the payment of 35% of the hedge positions required by the project finance facility through completion (which is no later than December 2008).

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The following table sets forth the Company's open derivative positions at March 31, 2007.

|                                      | Current Maturity Date |               |               |            | Total   |
|--------------------------------------|-----------------------|---------------|---------------|------------|---------|
|                                      | Year 1                | Years 2 and 3 | Years 4 and 5 | Thereafter |         |
| <b>Forward Contracts</b>             |                       |               |               |            |         |
| Silver (000 ounces)                  | 110                   | 160           | 180           | 140        | 590     |
| Average price (per ounce)            | \$ 7.40               | \$ 7.15       | \$ 7.14       | \$ 7.13    | \$ 7.19 |
| Zinc (000 pounds)                    | 65,918                | 466,269       | 243,609       |            | 775,796 |
| Average price (per pound)            | \$ 0.48               | \$ 0.48       | \$ 0.48       | \$         | \$ 0.48 |
| Lead (000 pounds)                    | 67,569                | 239,087       | 16,314        |            | 322,970 |
| Average price (per pound)            | \$ 0.30               | \$ 0.30       | \$ 0.28       | \$         | \$ 0.30 |
| <b>Put Option Contracts Owned</b>    |                       |               |               |            |         |
| Silver (000 ounces)                  | 300                   | 1,760         | 4,455         | 2,585      | 9,100   |
| Average price (per ounce)            | \$ 5.25               | \$ 5.60       | \$ 5.82       | \$ 5.88    | \$ 5.78 |
| <b>Call Option Contracts Written</b> |                       |               |               |            |         |
| Silver (000 ounces)                  |                       | 8,285         | 1,380         | 135        | 9,800   |
| Average price (per ounce)            | \$                    | \$ 8.20       | \$ 8.98       | \$ 8.95    | \$ 8.32 |
| Zinc (000 pounds)                    | 2,205                 | 11,574        |               |            | 13,779  |
| Average price (per pound)            | \$ 0.57               | \$ 0.57       | \$            | \$         | \$ 0.57 |
| Lead (000 pounds)                    | 4,409                 | 23,148        |               |            | 27,557  |
| Average price (per pound)            | \$ 0.39               | \$ 0.39       | \$            | \$         | \$ 0.39 |

The Company determines the fair value of its open derivative positions by applying market values obtained from the counterparties holding the Company's derivative positions. The Company independently verifies that the values received from the counterparties are based on major commodities price indices such as the LME and COMEX and other available market data.

The following table sets forth the fair value of the Company's open derivative positions based on indices such as the LME and COMEX and valuations from counterparties holding the Company's derivative positions at March 31, 2007 and December 31, 2006 and the change for the quarter ended March 31, 2007.

| Period Ended | Amount To Be Realized In              |                 |                 |            | Total         |
|--------------|---------------------------------------|-----------------|-----------------|------------|---------------|
|              | Less Than<br>1 Year<br>(in thousands) | 2 to 3<br>Years | 4 to 5<br>Years | Thereafter |               |
| 12/31/06     | \$ 39,080                             | \$ 570,982      | \$ 207,696      | \$ 440     | \$ 818,198    |
| 03/31/07     | \$ 88,046                             | \$ 484,871      | \$ 135,917      | \$ 1,058   | \$ 709,892    |
| 2007 Change  | \$ 48,966                             | \$ (86,111 )    | \$ (71,779 )    | \$ 618     | \$ (108,306 ) |

**9. Asset Retirement Obligations**

The Company has developed an asset retirement plan for its San Cristobal Project which is currently under construction and is expected to begin producing in the third quarter of 2007. The plan includes estimated reclamation, remediation and closure requirements based on Bolivian government requirements, World Bank financing requirements and the Company's policies. Beginning in the third quarter of 2005 the Company has been conducting activities at its San Cristobal Project including earthworks, plant construction and mining activities that fall within the scope of the asset retirement plan and as such will require future reclamation and closure expenditures.

The Company prepares estimates of the timing and amount of expected cash flows when an asset retirement obligation ( ARO ) is incurred. The fair value of the ARO is measured by discounting the expected cash flows using a discount factor that reflects the credit-adjusted risk-free rate of interest. The

Company records the fair value of an ARO when it is incurred and changes in the fair value of the ARO are recorded as an adjustment to the corresponding asset carrying amounts. The ARO is adjusted to reflect the passage of time (accretion cost) calculated by applying the discount factor implicit in the initial fair-value measurement to the beginning-of-period carrying amount of the ARO. The Company records accretion costs to expense as incurred.

The following table reconciles the beginning and ending balance for the Company's asset retirement obligations:

|                                 | The Three Months Ended<br>March 31, 2007<br>(in thousands) | The Year Ended<br>December 31, 2006 |
|---------------------------------|--|-------------------------------------|
| Beginning balance               | \$ 5,761   | \$ 2,003                            |
| ARO arising in the period       | 153  | 3,367                               |
| Changes in estimates, and other |  |                                     |
| Liabilities settled             |  |                                     |
| Accretion expense               | 139  | 391                                 |
| Ending balance                  | \$ 6,053   | \$ 5,761                            |

**10. Income Taxes**

The Company and certain of its subsidiaries operating in the Cayman Islands do not file income tax returns as the Cayman Islands currently does not impose any income taxes. The Company files Bolivian, United States and certain other foreign country income tax returns. These tax returns and the amount of taxable income or loss reported are subject to examination by the relevant taxing authorities. The Company and subsidiaries have not generated taxable income since inception. For the first quarter 2007 and 2006 the Company recorded approximately \$0.1 million and \$0.1 million of income tax expense related to withholding taxes on certain services provided to one of our Bolivian subsidiaries.

In January 2007, the Company adopted Financial Accounting Standards Interpretation No. 48, Accounting for Uncertainty in Income Taxes, (FIN 48), an interpretation of Financial Accounting Standards Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of an uncertain tax position taken or expected to be taken in a tax return. FIN 48 requires that the Company recognize in its financial statements the impact of uncertain tax positions. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods and disclosure.

Because the Company has primarily engaged in exploration and development activities, relatively few uncertain tax positions have arisen. As of March 31, 2007, the Company had \$1.8 million of total gross unrecognized tax benefits. Certain of the unrecognized tax benefits resulted in a reduction of the Company's operating loss carryforwards by approximately \$0.2 million. The Company has recorded a non-current tax payable and corresponding non-current deferred tax asset of approximately \$1.6 million for all remaining unrecognized tax benefits. There is no impact to retained earnings as a result of the adoption of FIN 48.

Tax years as early as 2001 remain open and are subject to examination in the Company's principal tax jurisdictions. Management has estimated that unrecognized tax benefits will not significantly increase or decrease within the next twelve months. There is no interest or penalties estimated on the underpayment of income taxes as a result of these unrecognized tax benefits. The Company's policy is to classify tax related interest and penalties as income tax expense.

**11. Shareholders Equity (Deficit)**

The following table sets forth the changes in shareholders equity during the first three months of 2007:

|   | Ordinary Shares<br>Shares<br>(in thousands except share data) | Amount          | Additional<br>Paid-in<br>Capital | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>income (loss) | Total<br>Shareholders<br>Equity |
|---|---|-----------------|----------------------------------|------------------------|--|---------------------------------|
| <b>Balance, December 31, 2006</b>                 | <b>58,577,700</b>   | <b>\$ 585.8</b> | <b>\$ 669,487</b>                | <b>\$ (773,339 )</b>   | <b>\$ (24 )</b>  | <b>\$ (103,290 )</b>            |
| Stock compensation accrued                        |   |                 | 954                              |                        |  | 954                             |
| Stock options exercised (\$10.54 per share)       | 45,650  | 0.5             | 481                              |                        |  | 481                             |
| Stock granted as compensation (\$16.40 per share) | 4,800   |                 |                                  |                        |  |                                 |
| Unrealized loss on marketable equity securities   |   |                 |                                  |                        | (232 )   | (232 )                          |
| Net Income  |   |                 |                                  | 111,979                |  | 111,979                         |
| <b>Balance, March 31, 2007</b>                    | <b>58,628,150</b>   | <b>\$ 586.3</b> | <b>\$ 670,922</b>                | <b>\$ (661,360 )</b>   | <b>\$ (256 )</b>                                       | <b>\$ 9,892</b>                 |

Stock Option Plans The Company established a plan to issue share options and other share awards for officers, employees, consultants and agents of the Company and its subsidiaries as well as a share option plan for its non-employee directors (the Plans ).

The Company recognizes stock based compensation costs using a graded vesting attribution method whereby costs are recognized over the requisite service period for each separately vesting portion of the award. The Company recognized stock based compensation costs, including amounts capitalized of \$1.0 million and \$0.7 million for the three month periods ended March 31, 2007 and 2006 respectively.

A summary of the Company s stock options issued under the Plans at March 31, 2007 and changes during the three months then ended is presented in the following table:

| Options                                   | Number of<br>Shares | Weighted Average<br>Exercise Price<br>Per Share |
|---|---------------------|---|
| Outstanding at beginning of period        | 2,992,572           | \$ 14.90  |
| Granted during period                     | 57,335              | \$ 15.28  |
| Forfeited or expired during period        | (141,750 )          | \$ 16.97  |
| Exercised during period                   | (45,650 )           | \$ 10.54  |
| Outstanding at end of period              | 2,862,507           | \$ 14.87  |
| Exercisable at end of period              | 2,160,834           | \$ 14.24  |
| Expected to vest at the end of the period | 667,624             | \$ 16.84  |

The fair value of each option award is estimated on the date of grant using the Black-Scholes option-pricing model.

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A summary of the status of the Company's non-vested restricted stock grants issued under the plans at March 31, 2007 and changes during the three months then ended is presented in the following table:

| Non-vested Shares                 | Number of<br>Shares | Weighted Average<br>Grant Date<br>Fair Value<br>Per Share |
|-----------------------------------|---------------------|---|
| Non-vested at beginning of period | 223,575             | \$ 17.30  |
| Granted during period             | 37,200              | \$ 12.98  |
| Vested during period              | (16,025 )           | \$ 18.05  |
| Forfeited during period           | (4,050 )            | \$ 17.18  |
| Nonvested at end of period        | 240,700             | \$ 16.60  |

The fair value of each restricted stock grant is based on the closing price of the Company's shares on the date of grant.

The Company has granted stock-based performance bonuses under the Plan to certain employees, related to cost targets and completion date targets for the construction of the San Cristobal Project. The Company may be required to issue up to 26,000 shares with a grant date fair market value of \$15.21 per share upon completion of the San Cristobal project. The fair value of each performance bonus grant was based on the closing price of the Company's shares on the date of grant.

### 12. Minority Interest

#### *Sumitomo Corporation*

During 2006 the Company sold to Sumitomo a 35% interest in three of the Company's subsidiaries that own its San Cristobal Project, market Project concentrates and hold the metals hedge positions required by the Project lenders. The Company continues to own 65% of these three subsidiaries.

Subsequent to the close of the transaction with Sumitomo, the Company incurred certain losses during 2006, primarily related to marking to market its open derivative positions required by the project finance facility. Such losses would normally be shared by Sumitomo in proportion to its 35% interest in the subsidiary recording the losses. However, generally accepted accounting principles do not permit the allocation of losses to the minority interest in excess of the minority owner's recorded interest in the subsidiary, unless the minority interest has a primary obligation to fund such losses. The Company and Sumitomo have each guaranteed their respective share of the project finance obligations and the related metals derivative positions through the completion of the San Cristobal Project at which time the guarantees will terminate and the lenders' recourse will be solely to the project. Since the derivative positions are expected to be funded through future earnings from the San Cristobal project, the Company does not anticipate that Sumitomo will be required to fund their proportionate interest in the mark-to-market losses prior to the completion of the San Cristobal project. Accordingly, at December 31, 2006 the Company reduced the minority interest balance on its consolidated balance sheets related to Sumitomo to \$0 and absorbed approximately \$98.8 million of non-cash losses that normally would have been allocated to Sumitomo.

During the first quarter 2007 the Company recorded net income of \$112.0 million primarily related to the mark to market gain recorded on the open derivative positions required by the project finance facility. The net income includes a \$42.2 million portion of the gain that would normally be allocated to Sumitomo's minority interest position. In addition Sumitomo contributed \$4.6 million during the quarter ended March 31, 2007 to fund its share of certain excess costs related the San Cristobal project. Sumitomo's additional funding, interest receivable from the Company and share of the gain retained by the Company reduced the \$98.8 million of losses previously absorbed by the Company to \$52.0 million at March 31, 2007. The Company anticipates recovering the remaining \$52.0 million of losses it absorbed, and any additional losses it may absorb related to Sumitomo's minority interest, from future earnings prior to the allocation of earnings to Sumitomo or from future contributions by Sumitomo.

*SC Tesa*

During 2005 the Company entered into a long-term contract with SC Tesa to construct a power line and transport power to the San Cristobal project from the Bolivian power grid. The Company has loaned SC Tesa \$22.3 million to construct the power line which will be repaid through credits against charges for the delivery of power (see Note 7). Per the guidance of FIN 46R the Company fully consolidates the accounts of SC Tesa.

During the fourth quarter 2006, the San Cristobal project began receiving limited amounts of power from the grid resulting in SC Tesa earning a transmission fee and recorded earnings. Because SC Tesa is treated as a consolidated entity, the inter company profit earned by SC Tesa is eliminated and the Company recognizes a minority interest offset to net income equal to SC Tesa's share of the transmission fee earnings representing 100% of such earnings. For the quarter ended March 31, 2007 the Company recorded \$0.4 million as SC Tesa's minority interest in the earnings.

**13. Commitments and Contingencies**

Escrow Amounts At March 31, 2007 the Company had \$4.0 million in an escrow account to provide for certain requirements related to the development of the port facility for the San Cristobal project and recorded the amount as restricted cash.

Project Financing Per the terms and conditions of the San Cristobal project finance facility the Company was required to deposit cash and investments in an account the use of which is restricted to the development of the San Cristobal project. At March 31, 2007 the remaining balance in the account was \$29.0 million of which \$6.2 million was recorded to restricted cash and \$22.8 million recorded to restricted investments.

Capital Commitments The Company will be required to spend approximately \$120 million to complete construction of its San Cristobal project which is scheduled to begin production in the third quarter of 2007.

Taxes The Company is receiving certain tax and duty benefits on a portion of the equipment it is importing for its San Cristobal project. The benefits are contingent upon fulfilling certain expenditure commitments within a specified period of time and returning certain equipment off shore within a specified period of time. Failing to comply with these commitments would obligate the Company to refund the benefits received.

Performance Bonus The Company may be required to pay up to an estimated \$4.0 million bonus to the San Cristobal Project construction management contractor contingent upon certain project completion parameters and a \$2.3 million bonus to the company constructing the port facilities for early completion of the facilities. Based on the project status at March 31, 2007 the Company believes it is probable that it will be required to pay the construction management contractor a portion of the bonus up to \$1.3 million and the company constructing the port facilities a bonus amount up to \$2.3 million and has accrued those amounts at March 31, 2007 with the offset recorded to construction in progress.

Political Contingencies The Company continues to monitor the political uncertainties in Bolivia resulting from the Bolivian government's renegotiation of agreements with oil and gas producers and statements regarding possible changes in current policies affecting the mining industry. If the San Cristobal Project were nationalized, or if taxes were substantially increased or significant royalty payments imposed, the Company might be unable to recover its investment in the project and could have substantial liabilities including liabilities to the lenders under the project finance facility and liabilities to counterparties holding the metals derivative positions required by the project lenders. In addition, changes in Bolivian law may have an adverse effect on the Company's ability to recover the VAT receivable (see Note 5).

In May 2006, the Constitutional Court of Bolivia issued a ruling declaring certain articles of the 1997 Mining Code unconstitutional. The Court's ruling is not effective until May 2008 and the Court urged the Bolivian Congress to enact legislation during that time which may supersede the



ruling. Although the

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Court's ruling is not expected to impact our ability to operate the San Cristobal project, the ruling may limit the transferability of our mining concessions and restrict our ability to mortgage our San Cristobal mining concessions as collateral to the lenders providing financing for the project.

Other Contingencies As previously disclosed, the Company has concluded, based on the results of an internal investigation conducted under the direction of our Audit Committee, that certain senior employees of one of our South American subsidiaries were involved in making impermissible payments of approximately \$125,000 to government officials in 2003 and 2004 in connection with an inactive, early stage exploration property that is not related to any of our active exploration or development properties. Based on findings to date, no changes to our previously filed financial statements are warranted as a result of these matters. We have contacted the Department of Justice ( DOJ ) and SEC and reported the results of our internal investigation. We have been informed that the SEC and DOJ have commenced an investigation with respect to these matters, including possible violations of the Foreign Corrupt Practices Act. We are cooperating fully with the SEC and DOJ investigations. We cannot predict with any certainty the final outcome of the investigations, including any fines or penalties that may be imposed.

**14. Foreign Currency**

Gains and losses on foreign currency derivatives and transactions consist of the following:

|   | <b>Three Months Ended March 31,</b> |             |
|---|-------------------------------------|-------------|
|   | <b>2007</b>                         | <b>2006</b> |
|   | <b>(in thousands)</b>               |             |
| Gain (loss) on re-measurement of monetary assets denominated in other than US dollars | \$ 984                              | \$ 113      |
| Total   | \$ 984                              | \$ 113      |

The re-measurement of monetary assets is related to certain taxes receivable and other accounts denominated in Bolivia's local currency.

**15. Supplemental cash flow information**

The following table reconciles net loss for the period to cash from operations:

|  | <b>Three Months Ended<br/>March 31,<br/>2007<br/>(in thousands)</b> | <b>2006</b>   | <b>For the period<br/>from December<br/>22, 1994<br/>(inception)<br/>through<br/>March 31,<br/>2007</b> |
|--|---|---------------|---|
| <b>Cash flows from operating activities:</b>   |   |               |   |
| Net gain (loss)  | \$ 111,979  | \$ (174,412 ) | \$ (661,360 )   |
| <b>Adjustments to reconcile net loss to net cash used in operating activities:</b>         |   |               |   |
| Amortization and depreciation  | 114   | 92            | 1,913   |
| Amortization of deferred financing costs   |   | 552           | 3,134   |
| Accretion of asset retirement obligation   | 139   | 48            | 545   |
| Amortization of premiums and discounts   | (58 )   | (439 )        | (2,111 )  |
| Mark-to-market (gain) loss on derivative positions   | (108,306 )  | 172,818       | 758,820   |
| Loss (gain) on Euro hedge  |   |               | (534 )  |
| Gain on extinguishment of debt   |   | (2,875 )      | (9,640 )  |
| Gross gain on sale of interest in subsidiary   |   |               | (199,600 )  |
| Minority interest in loss of consolidated subsidiary                                       | (4,930 )  | 7             | (18,268 )   |
| Stock compensation   | 707   | 1,098         | 19,884  |
| Shares issued in consideration for services  |   |               | 8,585   |
| Shares issued to purchase mineral rights   |   |               | 1,799   |
| <b>Changes in operating assets and liabilities:</b>  |   |               |   |
| (Increase) decrease in accrued interest receivable   | 244   | (152 )        | (1,164 )  |
| (Increase) decrease in prepaid expenses and other assets net of amounts capitalized        | 1,732   | (592 )        | (2,602 )  |
| (Increase) in inventories  | (8,759 )  | (3,620 )      | (36,431 )   |
| Increase in value added tax recoverable (net)  | (9,456 )  | (6,011 )      | (63,614 )   |
| Increase in accrued interest payable net of amounts capitalized                            |   | (117 )        | 1,680   |
| Increase (decrease) in accounts payable and accrued liabilities net of amounts capitalized | 193   | 1,074         | 4,830   |
| Other increase (decrease)  | (72 )   | 418           | 57  |
| Net cash used in operating activities  | \$ (16,473 )  | \$ (12,111 )  | \$ (194,077 )   |

The following table sets forth supplemental cash flow information and non-cash transactions:

|   | Three Months Ended<br>March 31<br>2007<br>(in thousands) | 2006      |
|---|--|-----------|
| <b>Supplemental disclosure:</b>                           |  |           |
| Interest paid, net of amounts capitalized                 | \$   | \$ 5,477  |
| <b>Supplemental disclosure of non-cash transactions:</b>  |  |           |
| Capitalized stock based compensation costs                | \$ 247   | \$ 267    |
| Payment of debt with Ordinary Shares                      | \$   | \$ 17,125 |
| Capitalized consulting services paid with ordinary Shares | \$   | \$ 45     |
| Depreciation expense capitalized                          | \$ 2,028   | \$ 1,145  |
| Initial measurement of asset retirement obligation        | \$ 153   | \$ 1,882  |
| Equipment acquired through capital lease                  | \$ 22,967  | \$ 1,270  |

**16. Subsequent Events**

In April 2007 the Company advanced \$4.0 million as previously agreed, to the company constructing and operating the port facilities from which the San Cristobal mine concentrates will be shipped. The advance brought to \$6.0 million the total advances made to the port. The Company expects to be repaid for the advances plus interest in the form of reduced port charges once San Cristobal begins shipping product. Construction of the port facilities was substantially completed during April 2007.

During May 2007 the Company borrowed an additional \$20 million against the \$225 million San Cristobal project finance facility, bringing to \$220 million the total borrowings against the facility. The funds are restricted to the development of the San Cristobal Project.

## Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

### General

The following discussion and analysis summarizes the results of operations of Apex Silver Mines Limited ( Apex Silver or we ) for the three month period ended March 31, 2007 and changes in our financial condition from December 31, 2006. This discussion should be read in conjunction with the Management's Discussion and Analysis included in our Annual Report on Form 10-K for the period ended December 31, 2006.

Apex Silver is a mining exploration and development company that holds a portfolio of exploration and development properties primarily in South America and Central America. We currently focus our resources primarily on the development of our San Cristobal Project in Bolivia. At present, none of our properties are in production and, consequently, we have no current operating income.

### Overview

#### Development of San Cristobal

Construction of our San Cristobal Project in southwestern Bolivia is substantially complete. All of the engineering has been completed and all of the major mechanical equipment has been installed. We are in the process of commissioning and testing the processing plant including the crushing, conveying, grinding and flotation circuits. The rail spur and the port facilities are substantially completed and we expect they will be available to handle concentrates which we anticipate to begin shipping from San Cristobal in the third quarter 2007 with the first sale of concentrates also scheduled for the third quarter of 2007.

We continue mining ore at the San Cristobal Project and at March 31, 2007 we had stockpiled approximately 9.9 million tonnes of work-in-process ore inventories recorded at a cost of approximately \$33.4 million. Work-in-process inventories include ore produced and stockpiled for which further processing is necessary before a product is ready for sale. Work-in-process inventories at March 31, 2007, are comprised of 2.6 million tonnes of sulfide ores and 7.3 million tonnes of oxide ores. The sulfide ores will be processed through the San Cristobal mill first with the oxide ores scheduled for processing later in the mine life. Final processing of work-in-process ore inventories to a saleable product is scheduled to begin during the third quarter of 2007.

#### Financing and Commodity Derivatives Matters

During the first quarter of 2007 we borrowed \$20 million under the \$225 million San Cristobal project finance facility (the Facility ) and during May 2007 we borrowed an additional \$20 million bringing the total borrowings against the facility to \$220 million. Pursuant to the covenants contained in the facility, we are required annually to submit a revised Construction Budget, Operating Plan, and Financial Model (collectively the Updated Plan ) for the San Cristobal project by November 1. We are currently operating under the Construction Budget, Operating Plan, and Financial Model initially approved by the lenders when the facility was entered into (the Initial Plan ) which remains in effect until the Updated Plan is approved. We submitted our Updated Plan for 2007 in a timely manner. The Updated Plan required the use of prices for silver, zinc and lead that are lower than recent spot prices. The Updated Plan also reflected higher operating costs than previously assumed primarily as a result of the impact of record high commodity prices including costs for diesel fuel, reagents, and tires. The low metals prices required by the facility coupled with higher current operating costs resulted in projected cash flow that would be insufficient to meet certain other Facility requirements, including minimum cash flows and debt service coverage ratios required after completion. In January 2007, the lenders rejected the Updated Plan.

We continue to work with the Facility lenders to arrive at mutually agreeable terms to amend the agreements and allow us to use higher metals prices in the Updated Plan. The lenders have proposed higher metals prices than those contained in the terms of the Facility. The higher prices will allow us to present an Updated Plan that will meet the Facility's financial requirements. The lenders have also

proposed an adjustment to the Facility's repayment schedule to require a larger percentage of principal to be repaid in earlier years and an increase in the mandatory cash flow sweep from 35% to 45% of excess cash flow. In connection with these proposed amendments to the terms of the Facility, we and Sumitomo have agreed to purchase put options to protect additional cash flow needed for the accelerated loan schedule. We will also fund a \$91 million margin account with the two banks holding the derivative positions and Sumitomo will provide a post-completion guarantee of the derivative positions in the amount of \$49 million. This support will be decreased by 33% at the end of each of the years from 2008 through 2010.

We and Sumitomo have accepted these proposals and amendments to the facility agreements and an Updated Plan for submission to the lenders are being prepared. Once the amendments to the agreements and Updated Plan are complete, an affirmative vote by the lenders is required for final approval. At the date of this filing, formal approval of the amendments to the agreements and the Update Plan by the requisite number of lenders has not yet been obtained. While there can be no assurances that lender approval will be obtained, we believe the necessary amendments and the Updated Plan will be approved by the requisite number of lenders.

If the amendments and the Updated Plan are not approved by the lenders, or until such time as approval is obtained, we would be required to operate in all material respects, as defined by the Facility, in compliance with the Initial Plan. If our operations fail to comply with the Initial Plan in all material respects, the lenders could declare a default and require us to settle all amounts outstanding under the Facility including the derivatives liability. Because our current projections indicate that cash flows and operating ratios will exceed those in the Initial Plan, we believe that operations will comply in all material respects with the Initial Plan. However, we cannot predict what actions the lenders might take if they deem that we are not in material compliance with the Initial Plan.

For the quarter ended March 31, 2007, we recorded a \$108.3 million gain as a result of marking-to-market our open derivative positions established pursuant to the requirements of the project financing facility. The gain is the result of lower spot and forward prices for silver, zinc and lead at March 31, 2007 as compared to spot and forward prices at December 31, 2006. During the periods that the metals derivative positions are outstanding, gains and losses may fluctuate substantially from period to period based on spot prices, forward prices and quoted option volatilities. The actual final financial impact of the required project financing facility derivative positions will not be known until the positions are closed on their future settlement dates. We do not intend to use cash to settle the open derivatives positions prior to their settlement dates beginning in September of 2007. At the time of final settlement, the gain or loss recorded will exclude previously recognized non-cash mark-to-market gains or losses.

#### Political Matters in Bolivia

At various times since his election, President Morales and others in his administration have made public statements regarding their desire to exert greater state control over natural resource production in Bolivia. In addition, the Bolivian government is currently considering various changes to applicable mining taxes, which would have the effect of increasing the overall tax burden on the San Cristobal project. At present, various ideas have been proposed by government officials and others, but there is no legislation pending. Should these changes occur, the profitability of the San Cristobal project may be adversely effected.

On May 1, 2007 President Morales issued a Supreme Decree declaring a Mining Fiscal Reserve over the entire Bolivian national territory to include all mineral resources, granting the Bolivian Mining Corporation (COMIBOL) the authority and right to administer and exploit the Fiscal Reserve. The Supreme Decree provides that mining concessions granted prior to enacting the Supreme Decree, which includes the San Cristobal mining concessions, will be respected and will remain in effect.

## Results of Operations

### Three Months Ended March 31, 2007

*Exploration.* Exploration expense was \$2.7 million for the first quarter 2007 compared to \$1.5 million for the first quarter 2006. Exploration expense is incurred primarily in Argentina, Mexico, Bolivia, and Peru. During 2007 we have begun extensive drilling programs and other geologic testing to increase the rate of evaluation of many of our properties in order to take them to the point that decisions can be made to either advance them or divest them.

*Administrative.* Administrative expense of \$6.3 million for the first quarter 2007 is comparable to \$5.3 million for the first quarter 2006. Administrative expenses are incurred primarily by our corporate headquarters and consist primarily of compensation costs, professional fees paid for accounting and legal services, office and equipment lease costs and other general costs. Administrative costs are incurred supporting the areas of finance, compliance, marketing and other administrative requirements including the indirect support of the financing, development and other requirements of our San Cristobal Project.

*Gains and Losses - Commodity Derivatives.* For the first quarter of 2007 we recorded a gain related to our metals derivative positions in the amount of \$108.3 million compared to a loss of \$172.8 million on our derivative positions for the first quarter of 2006. The 2007 gain is the result of marking-to-market our open derivative positions based on lower spot and forward prices for silver, zinc and lead at March 31, 2007 as compared to spot and forward prices at December 31, 2006. The 2006 loss is the result of marking-to-market our open derivative positions based on higher spot and forward prices for silver, zinc and lead at March 31, 2006 as compared to spot and forward prices at December 31, 2005. During the periods that the metals derivative positions are outstanding, gains and losses may fluctuate substantially from period to period based on spot prices, forward prices and quoted option volatilities. (See Overview for additional discussion of the first quarter 2007 derivative gain).

*Interest and other income.* We recorded interest and other income of \$6.8 million for the first quarter 2007 as compared to \$2.9 million recorded during the first quarter 2006. The 2007 increase in interest and other income, as compared to 2006 was the result of the increased interest we earned on the higher average cash and investment balances that we held during the quarter resulting from the proceeds received from the Ordinary Share offering completed during the second quarter 2006 and the proceeds from the sale of a 35% interest in our San Cristobal project in September 2006. Available interest rates were also higher for the first quarter 2007 as compared to the same period of 2006.

*Royalty Income.* During the first quarter 2007, we received \$0.3 million of royalty income from a property in Mexico on which we retained a net smelter return royalty. The property is being test mined by a joint venture partner and we received royalties for product sold from the test mining operation. We did not receive any such royalties for the quarter ended March 31, 2006.

*Interest expense and other borrowing costs.* We recognized no interest expense and other borrowing costs during the first quarter 2007 as the total \$10.8 million of those costs was capitalized. During the first quarter 2006 we recognized \$0.5 million of interest expense and other borrowing costs which were net of approximately \$4.3 million capitalized. Interest costs for both periods are primarily related to the Convertible Senior Subordinated Notes Due 2024 and the project finance facility.

*Income Taxes.* For both the first quarter 2007 and 2006 we recorded nominal amounts of income tax expense consisting solely of withholding taxes on inter-company investment income and administrative charges associated with one of our Bolivian subsidiaries.

## Liquidity and Capital Resources

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At March 31, 2007, our aggregate cash, restricted cash, short and long-term investments and restricted investments totaled \$450.0 million compared to an aggregate of \$514.9 million in cash, restricted cash, short and long-term investments and restricted investments at December 31, 2006. The amounts held at March 31, 2007 include \$147.8 million in cash and cash equivalents, \$256.2 million in investments, \$6.2 million of cash and \$22.8 million of investments that are restricted to fund development at our San Cristobal project, \$4.0 million of cash restricted to develop the port facility, \$10.4 million of investments to collateralize certain letters of credit and \$2.8 million of investments that are restricted and at maturity will provide the amounts necessary to pay interest through September 2007 on the 4.0% Convertible Senior Subordinated Notes Due 2024.

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As of March 31, 2007, we had cash and cash equivalents of \$147.8 million, compared to \$49.8 million at December 31, 2006. The increase in our cash balance at March 31, 2007 is primarily the result of \$20.0 million of borrowings against the project finance facility, \$0.5 million of proceeds from employee stock options exercised, \$4.6 million contributed by Sumitomo as their share of a funding requirement for the San Cristobal Project, \$21.8 million of restricted cash released and a net \$141.0 million of investments liquidated during the period. The increases in our cash balances were all partially offset by \$69.0 million invested in property, plant and equipment related to the development of the San Cristobal Project, \$16.4 million used to fund operations, property holding costs and administrative costs, net of interest and other income and payments on long term debt (primarily capital lease payments) of \$4.5 million.

During the remainder of 2007, we and Sumitomo expect to spend approximately \$120 million on the San Cristobal Project, representing the remainder of the approximately \$650 million total project cost estimate, plus an additional \$40 million of working capital. These cash requirements will be funded from the restricted cash and the liquidation of restricted investments held by the project and set aside for this purpose and drawing the remaining funds available from the project financing facility. We anticipate funding our 65% share of any additional requirements from our existing cash and investments with Sumitomo funding the remaining 35%. In addition, for the remainder of the year we expect to spend approximately \$12 million on general corporate costs, \$11 million on exploration efforts and approximately \$10 million on interest payments related to the outstanding convertible debt. We plan to fund these expenditures from our existing cash and investment balances and from interest and other income. In addition, as a result of our negotiations with the project finance facility lenders discussed above, we may be required to deposit approximately \$91 million in a restricted fixed margin account during the second quarter of 2007 as security for the metals derivative positions. We expect operating cash flows to begin during the third quarter of 2007.

Because we were unable to timely file our December 31, 2006 annual report on Form 10-K our existing shelf registration statements will not be available as a source of equity or debt financing for at least one year.

### **Significant Accounting Policies**

Effective January 1, 2007, we adopted Financial Accounting Standards Interpretation No. 48, Accounting for Uncertainty in Income Taxes, ( FIN 48 ), an interpretation of Financial Accounting Standards Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Fin 48 requires that we recognize in our financial statements the impact of uncertain tax positions. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods and disclosure. The adoption of FIN 48 did not have a material impact on our financial position or results of operations.

### New Accounting Standards

During February 2007 the Financial Accounting Standards Board ( FASB ) issued Financial Accounting Standards No. 159 The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115 ( FAS No. 159 ). FAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Most of the provisions of FAS No. 159 apply only to entities that elect the fair value option. However, the amendment to FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, applies to all entities with available-for-sale and trading securities. FAS No. 159 is effective as of the beginning of the first fiscal year that begins after November 15, 2007, or fiscal year 2008 for us. We do not expect the adoption of FAS No. 159 to have a material impact on our financial position or results of operations.

During September 2006 the FASB issued Financial Accounting Standards No. 157 Fair Value Measurements ( FAS No. 157 ). FAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Standard addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under U.S. GAAP. Accordingly, this Standard does not require any new fair value measurements. FAS No. 157 is effective for financial

statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not expect the adoption of FAS No. 157 to have a material impact on its financial position or results of operations.

**Contractual Obligations**

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As discussed above, at March 31, 2007 we will be required to spend an additional approximately \$120 million to bring our San Cristobal project into production which we expect to begin in the third quarter of 2007.

During the three months ended March 31, 2007 we increased our borrowings against the \$225 million project finance facility by \$20 million and subsequent to March 31, 2007 we borrowed an additional \$20 million bringing to \$220 million total borrowings under the facility. In addition during the three months ended March 31, 2007 we placed in service \$23.0 million of equipment recorded as capital leases resulting in total capital lease obligations of \$36.1 million at March 31, 2007.

### **Forward-Looking Statements**

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Some information contained in or incorporated by reference into this report may contain forward-looking statements. These statements include comments regarding San Cristobal development and construction plans, capital and other costs, funding and timing; the timing of completion of San Cristobal construction, start-up and commencement of operations; anticipated spending during 2007; increased funding requirements, capital costs and working capital requirements for the San Cristobal Project; Contractual arrangements with Sumitomo, including Sumitomo's obligations with respect to funding commitments; the likely increased volatility in future earnings due to forward sales, derivative positions and metals trading activity; compliance with and anticipated amendments to the San Cristobal Project finance facility; anticipated San Cristobal production and the timing and amounts of spending on the evaluation and expansion of our exploration portfolio. The use of any of the words anticipate, continues, estimate, expect, may, will, project, should, believe and similar expressions are intended to identify uncertainties. We believe the expectations reflected in those forward-looking statements are reasonable. However, we cannot assure that these expectations will prove to be correct. Actual results could differ materially from those anticipated in these forward-looking statements as a result of the factors set forth below and other factors set forth in, or incorporated by reference into this report:

- worldwide economic and political events affecting the supply of and demand for silver, zinc and lead;
- political unrest and economic instability in Bolivia including the communities located near the San Cristobal Project and other countries in which we conduct business;
- future actions of the Bolivian government with respect to nationalization of natural resources or other changes in the mining or taxation policies of the Bolivian government;
- volatility in market prices for silver, zinc and lead;
- financial market conditions;
- uncertainties associated with developing a new mine, including potential cost overruns and the unreliability of production and cost estimates in early stages of mine development;
- variations in ore grade and other characteristics affecting mining, crushing, milling and smelting operations and mineral recoveries;
- geological, technical, permitting, mining and processing problems;
- failure to comply with obligations under the San Cristobal project finance facility;
- failure to reach agreement with Sumitomo Corporation regarding future development or operation of San Cristobal, or failure to comply with agreements with Sumitomo related to the San Cristobal Project;
- uncertainties regarding future changes in applicable law or implementation of existing law, including Bolivian laws related to tax, mining, environmental matters and exploration; and

- the factors discussed under Risk Factors in our Form 10-K for the period ended December 31, 2006.

Many of those factors are beyond our ability to control or predict. You should not unduly rely on these forward-looking statements. These statements speak only as of the date of this report on Form 10-Q. Except as required by law, we are not obligated to publicly release any revisions to these forward-looking statements to reflect future events or developments.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

**Interest Rate Risk**

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Our outstanding debt consists primarily of our 4.0% and 2.875% Convertible Senior Subordinated Notes due 2024 and amounts borrowed under our San Cristobal project finance facility. The Convertible Senior Subordinated Notes bear interest at a fixed rate and thus do not have exposure to interest rate changes. The project finance facility bears interest at the LIBOR rate plus a credit spread. As of the date of this filing, we had borrowed \$220 million under the facility. Assuming the full \$225 million was borrowed under the facility, a 1% increase in the LIBOR rate would result in an annual increase in interest expense of \$2.25 million. We have not entered into any agreements to hedge against unfavorable changes in interest rates, but may in the future manage our exposure to interest rate risk.

We invest excess cash in U.S. government and debt securities rated investment grade or better. The rates received on such investments may fluctuate with changes in economic conditions. As a result, our investment income may fall short of expectations during periods of lower interest rates. Based on the average cash, restricted cash, investments and restricted investment balances outstanding during the first three months of 2007, a 1% decrease in interest rates would have resulted in a reduction in interest income for the period of approximately \$1.2 million.

### **Foreign Currency Exchange Risk**

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Although most of our expenditures are in U.S. dollars, certain purchases of labor, operating supplies and capital assets are denominated in Bolivianos, Euros or other currencies. As a result, currency exchange fluctuations may impact the costs of our operations. Specifically, the appreciation of Bolivianos against the U.S. dollar may result in an increase in operating expenses and capital costs at the San Cristobal project in U.S. dollar terms. To reduce this risk, we maintain minimum cash balances in all foreign currencies, including Bolivianos, and complete most of our purchases, including purchases relating to the San Cristobal project, in U.S. dollars.

We have previously engaged in a limited amount of currency hedging activities primarily related to an equipment order for the San Cristobal project that was denominated in Euros. At March 31, 2007 we did not hold any foreign currency derivative positions.

### **Commodity Price Risk**



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None of our properties are in production and, consequently, we do not have any current revenue from sales. When the San Cristobal project begins production, our primary source of income will be from sales of concentrates containing silver, zinc and lead. As a result, changes in the price of any of these commodities could significantly affect our results of operations and cash flows.

To complete the San Cristobal project finance facility, we were required to implement price protection for a portion of our planned silver, zinc and lead production from San Cristobal. We have entered into contracts utilizing forward sales, puts and calls. Non-cash mark-to-market gains and losses from these and other derivative positions may fluctuate substantially from period to period based on spot and forward prices and option volatilities. The actual final financial impact of the derivative positions required by the project financing facility will not be known until the positions are closed on their future settlement dates. Our outstanding derivative positions represent 4%, 13% and 17% of planned life-of-mine payable production of silver, zinc and lead at San Cristobal but represent a significantly higher proportion of our planned production during the six years in which the derivative positions are in place. For the first six years of production, we have hedged approximately 10%, 24% and 32% of planned production of silver, zinc and lead, respectively.

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During the first quarter of 2007 we recorded a non-cash mark-to-market gain on our open derivative positions in the amount of \$108.3 million. For the year ended December 31, 2006 we recorded non-cash mark-to-market losses of \$672.5 million on our open derivative positions. As of March 31, 2007 the fair value of our open derivative positions reflected a \$709.9 million liability. Non-cash mark-to-market gains and losses from the open derivative positions have fluctuated substantially from period to period based on spot and forward prices and option volatilities and will most likely continue to do so as long as the derivative positions are outstanding. See Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations .

Related to certain pending amendments to the project finance facility agreement as discussed above, we and Sumitomo have agreed to purchase put options to protect additional cash flow needed for the accelerated loan schedule.

**Item 4. Controls and Procedures**

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### (a) Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports we file or submit under the Securities and 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 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 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(e) under the Securities Exchange Act of 1934. Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that as a result of the unremediated material weakness related to loan covenant compliance discussed below, our disclosure controls and procedures were not effective as of the end of the period covered by this report.

### (b) Change in Internal Control over Financial Reporting

Apex Silver's management is responsible for establishing and maintaining adequate 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 (GAAP). 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 policies and procedures may deteriorate.

Management issued a report on the effectiveness of our internal control over financial reporting as of December 31, 2006. In making its assessment, management used criteria set forth in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management's assessment concluded that, as of December 31, 2006, we did not maintain effective controls over the valuation of the metals derivatives positions and the monitoring of our compliance with certain covenants related to its project finance facility. As disclosed in management's report, these control deficiencies constituted material weaknesses as of December 31, 2006 and resulted in the following adjustments to our financial statements:

- Restatement of our 2005 annual consolidated financial statements; interim consolidated financial statements for the quarter ended September 30, 2005 and for each of the first three quarters of 2006 as a result of adjustments to the balances of our derivative liabilities, gain on the sale of an interest in subsidiaries, minority interest in subsidiaries, minority interest in loss of

consolidated subsidiaries and the accumulated deficit accounts as a result of reassessing available market data in the valuation of its metals derivatives.

- An audit adjustment to our 2006 annual consolidated financial statements to properly reflect the balances of our derivative liabilities, gain on sale of an interest in subsidiaries, minority interest in subsidiaries, minority interest loss of consolidated subsidiaries and the accumulated deficit accounts as a result of reassessing available market data in the valuation of its metals derivatives.

Throughout the first quarter of 2007, we have been actively engaged in the implementation of remediation efforts to address the two material weaknesses described above. As of March 31, 2007, the material weakness relating to the controls over the valuation of the metals derivatives positions had been remediated, but the material weakness relating to the controls over the monitoring of compliance with certain covenants related to our project finance facility had not been remediated.

We have implemented the following controls and procedures to remediate the material weakness relating to the valuation of our metals derivatives positions:

- We have implemented controls to accurately determine the fair value of its open derivative positions by applying market values obtained from the counterparties holding our derivative positions. We use independent valuation experts to verify that the values received from the counterparties are based on major commodities price indices such as the LME and COMEX and other available market data.

Based upon the action taken and evaluation of the effectiveness of the controls, we have concluded that remediation of the material weakness in the controls over the valuation of the metals derivative positions have been achieved as of March 31, 2007.

Our remediation efforts are not complete and we do not have sufficient evidence of the operational effectiveness of the controls undergoing remediation to conclude that such actions have been successful in addressing the material weakness relating to the controls over the monitoring of compliance with certain covenants related to our project finance facility, as described above. Remediation efforts completed or to be completed include:

- We have hired a Senior Treasury Analyst, with experience commensurate with the complexity of our loan compliance requirements and we are designing and implementing effective controls to ensure the Senior Treasury Analyst will closely monitor compliance of our project finance facility and other financing arrangements. Training will also be provided to all key personnel involved in the loan compliance processes and procedures.

We will continue to assign the highest priority to the remediation efforts in this area, with the goal of remediating this material weakness by the end of the second quarter of 2007.

There has been no other change in our internal control over financial reporting during the most recent fiscal quarter that has materially affected, or that is reasonably likely to materially affect, our internal control over financial reporting.

PART II: OTHER INFORMATION

**Item 1. Legal Proceedings**

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There were no material developments to proceedings previously discussed in our Form 10-K for the year ended December 31, 2006.

### **Item 1A. Risk Factors**

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There were no material changes from the risk factors as previously discussed in our Form 10-K for the year ended December 31, 2006.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**Item 3. Defaults Upon Senior Securities**



None.

**Item 4. Submission of Matters to a Vote of Security Holders**

None.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

10.1 Non-Employee Directors Deferred Compensation and Equity Award Plan

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act

32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C., 1350  
(Section 906 of the Sarbanes-Oxley Act)

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on behalf of the undersigned thereunto duly authorized.

APEX SILVER MINES LIMITED

Date: May 9, 2007

By: \s\ Jeffrey G. Clevenger  
Jeffrey G. Clevenger  
President and Chief Executive Officer

Date: May 9, 2007

By: \s\ Gerald J. Malys  
Gerald J. Malys  
Senior Vice President and Chief Financial Officer

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