CAMCO FINANCIAL CORP
Form 11-K
June 28, 2010

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 11-K

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2009

OR

o **TRANSITION REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission file number 000-25196

A. **Full title of the plan and the address of the plan, if different from that of the issuer named below:**

CAMCO FINANCIAL & SUBSIDIARIES SALARY SAVINGS PLAN

B. **Name of issuer of the securities held pursuant to the plan and the address of its principal executive office:**

Camco Financial Corporation
814 Wheeling Avenue
Cambridge, Ohio 43725

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REQUIRED INFORMATION

The following financial statements and supplemental schedules for Camco Financial and Subsidiaries Salary Savings Plan are being filed herewith:

Description
Contents of Financial Statements
Report of Independent Auditors
Statements of Net Assets Available for Benefits
Statement of Changes in Net Assets Available for Benefits
Notes to Financial Statements
Schedule H, Line 4i Schedule of Assets
(Held at End of Year)

The following exhibits are being filed herewith:

Exhibit No.	Description
23	Consent of Independent Registered Public Accounting Firm

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Camco Financial & Subsidiaries
Salary Savings Plan
Financial Report
December 31, 2009

Camco Financial & Subsidiaries Salary Savings Plan

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Report of Independent Registered Public Accounting Firm

To the Plan Administrator
Camco Financial & Subsidiaries Salary Savings Plan
Cambridge, Ohio

We have audited the accompanying statement of net assets available for benefits of Camco Financial & Subsidiaries Salary Savings Plan as of December 31, 2009 and the related statement of changes in net assets available for benefits for the year ended December 31, 2009. These financial statements are the responsibility of the Plan s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Plan is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the Plan as of December 31, 2009 and 2008 and the changes in net assets available for benefits for the year ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America.

Our audits were performed for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental schedule of assets held at end of year as of December 31, 2009 is presented for the purpose of additional analysis and is not a required part of the basic financial statements but is supplementary information required by the Department of Labor s Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. This supplemental schedule is the responsibility of the Plan s management. The supplemental schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

/s/ Plante & Moran, PLLC
Columbus, Ohio
June 22, 2010

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Camco Financial & Subsidiaries Salary Savings Plan

Statement of Net Assets Available for Benefits

	December 31 2009	December 31 2008
Assets		
Cash	$ 88,540	$ 39,269
Nonparticipant-directed investments Employer securities	23,660	42,889
Participant-directed investments:		
Money market fund		254
Common/Collective fund	651,550	1,268,304
Mutual funds	7,052,132	5,860,192
Employer securities	400,635	539,566
Participant loans	213,982	181,517
Total investments	8,341,959	7,892,722
Net Assets Available for Benefits at Fair Value	8,430,499	7,931,991
Adjustment from Fair Value to Contract Value for Interest in Common Collective Trust Funds Relating to Fully Benefit-responsive Investment Contracts	(3,057)	69,302
Net Assets Available for Benefits	**$ 8,427,442**	**$ 8,001,293**

See Notes to Financial Statements.

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Camco Financial & Subsidiaries Salary Savings Plan

Statement of Changes in Net Assets Available for Benefits
Year Ended December 31, 2009

Additions	
Contributions:	
Participant-directed Employee elective	$ 513,111
Participant-directed Employer matching	266,726
Participant-directed Rollover	3,177
Interest and dividends Participant-directed	259,710
Net (depreciation) appreciation in fair value of investments:	
Nonparticipant-directed employer securities	(10,577)
Participant-directed mutual funds	2,669,438
Participant-directed common/collective funds	82,321
Participant-directed employer securities	(1,685,695)
Total additions	2,098,211
Deductions	
Benefit payments to participants:	
Nonparticipant-directed	8,652
Participant-directed	1,629,322
Administrative expenses Participant-directed	34,088
Total deductions	1,672,062
Net Decrease in Net Assets Available for Benefits	426,149
Net Assets Available for Benefits Beginning of year	8,001,293
Net Assets Available for Benefits End of year	**$ 8,427,442**

See Notes to Financial Statements.

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Camco Financial & Subsidiaries Salary Savings Plan

Notes to Financial Statements
December 31, 2009 and 2008

Note 1 Description of the Plan

The following description of the Camco Financial & Subsidiaries Salary Savings Plan (the Plan) is provided for general information only. Participants should refer to the plan document for a more complete description of the Plan s provisions.

General The Plan is a defined contribution plan covering all employees of Camco Financial & Subsidiaries (the Company). Employees are eligible to participate in the Plan on their first day of employment with the Company. It is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

Contributions Each year, participants may contribute up to 92 percent of pretax annual compensation, subject to certain limitations. The Plan also allows any participant who has attained age 50 by the end of the plan year to make catch-up contributions in accordance with the Internal Revenue Code. Participants may also contribute amounts representing distributions from other qualified defined benefit or defined contribution plans. The Company makes a matching contribution equal to 100 percent of 401(k) deferrals made up to the first 3 percent of base compensation and 50 percent of 401(k) deferrals from 3.01 percent to 5 percent of base compensation. The Company may make an additional employer discretionary contribution. Contributions are subject to certain Internal Revenue Code (IRC) limitations.

Participant Accounts Each participant s account is credited with the participant s own contribution and an allocation of the Company s contributions, plan earnings, and expenses. Allocation of the Company s contributions, plan earnings, and expenses is based upon participants compensation and account balances, respectively. The benefit to which a participant is entitled is the benefit that can be provided from the participant s vested account.

Forfeited Accounts Forfeitures of terminated participants nonvested employer profit-sharing accounts are used to reduce employer contributions.

Vesting Participants are immediately vested in their own 401(k) contributions, employer matching contributions made after December 31, 1997, and any pension plan rollovers, plus actual earnings thereon. Vesting in the remainder of their account is based on years of credited service. A participant is 100 percent vested after six years of credited service.

Payment of Benefits Upon termination of service due to death, disability, retirement, or other reasons, a participant may elect to receive payment of their vested benefits as a lump-sum payment.

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Camco Financial & Subsidiaries Salary Savings Plan

Notes to Financial Statements
December 31, 2009 and 2008

Note 1 Description of the Plan (Continued)

Participant Loans The Plan allows participants to borrow money from the Plan, in amounts not to exceed one-half of the participant s vested account balance. Participants cannot have more than one loan from the Plan at any time and initial loans must be for at least $1,000, with a maximum of $50,000, as determined by the IRS.

Party-in-interest Transactions The Plan invests in employer stock as well as certain investment funds managed by the custodian or its affiliates. Charles Schwab Trust Company is the custodian of the Plan and, therefore, these transactions qualify as party-in-interest transactions as defined under ERISA guidelines.

Termination Although it has not expressed any intent to do so, the Company has the right under the Plan to discontinue its contributions at any time and to terminate the Plan subject to the provisions of ERISA and its related regulations. In the event of plan termination, participants will become 100 percent vested in their accounts.

Note 2 Summary of Accounting Policies

Investment Valuation The Plan s investments are stated at fair value, except for its benefit-responsive stable value common/collective trust fund investment, which is valued at contract value. Contract value represents investments at cost plus accrued interest income less amounts withdrawn to pay benefits. The fair value of the common/collective trust fund is based on discounting the related cash flows of the underlying guaranteed investment contracts based on current yields of similar instruments with comparable durations. The interest-bearing cash and participant loans are valued at their outstanding balances, which approximate fair value. All other investments are valued based on quoted market prices.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date

Use of Estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and changes therein and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

Administrative Expenses Various administrative expenses are paid by the Company on behalf of the Plan.

Benefit Payments Benefits are recorded when paid.

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Camco Financial & Subsidiaries Salary Savings Plan

Notes to Financial Statements
December 31, 2009 and 2008

Note 2 Summary of Accounting Policies (Continued)

Risk and Uncertainties The Plan provides for various investment options including any combination of mutual funds, Camco Financial Corporation common stock, common/collective funds, and other investment securities. The underlying investment securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statement of net assets available for benefits and participants individual account balances.

Concentration of Credit Risk At December 21, 2009 and 2008, approximately 5 percent and 7 percent of the Plan s assets, respectively, were invested in Camco Financial Corporation common stock.

Note 3 Tax Status

The plan document has been restated for recent law changes. The plan sponsor adopted the restated version of a non-standardized prototype plan document. The Internal Revenue Service has determined and informed the prototype plan sponsor, by a letter dated June 5, 2002, that the Plan and related trust are designed in accordance with applicable sections of the Internal Revenue Code (IRC). The Plan has not individually sought its own determination letter.

The plan administrator believes that the Plan is designed and is currently being operated in compliance with the applicable requirements of the IRC.

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Camco Financial & Subsidiaries Salary Savings Plan

Notes to Financial Statements
December 31, 2009 and 2008

Note 4 Significant Investments at Fair Value

Significant investments at fair value at December 31, 2009 and 2008 are listed as follows:

	2009	2008
Investments at fair value:		
Camco Financial Corporation common stock	$ 400,635	$ 539,566
Camco Financial Corporation common stock*	23,660	42,889
Growth Fund of America R5	1,071,972	901,744
Metropolitan West Total Return Bond Fund	978,415	879,833
American Beacon Largecap Value Fund		724,996
MFS Value	882,334	
Vanguard Short-term Investment Grade Fund	668,420	723,650
Europacific Growth Fund R5	852,958	694,805
Vanguard 500 Index Signal Fund	943,574	678,653
Artisan Midcap Value Fund	610,381	475,817
Columbia Acorn Fund Class 2	519,584	400,275
Investment at contract value Union Bond & Trust Co. Stable Value Fund	648,493	1,337,606

* Nonparticipant-directed investment

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Camco Financial & Subsidiaries Salary Savings Plan

Notes to Financial Statements
December 31, 2009 and 2008

Note 5 Fair Value

Accounting standards require certain assets and liabilities be reported at fair value on the financial statements and provide a framework for establishing that fair value. The framework for determining fair value is based on a hierarchy that prioritizes the inputs and valuation techniques used to measure fair value.

The following tables present information about the Plan s assets measured at fair value on a recurring basis at December 31, 2009 and 2008 and the valuation techniques used by the Plan to determine those fair values.

Level 1 In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets that the Plan has the ability to access.

Level 2 Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 Inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset. These Level 3 fair value measurements are based primarily on management s own estimates using pricing models, discounted cash flow methodologies, or similar techniques taking into account the characteristics of the asset.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Plan s assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset.

During 2009, the Plan adopted, on a prospective basis, new accounting standards which require disclosure of fair value by class of investments.

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Camco Financial & Subsidiaries Salary Savings Plan

Notes to Financial Statements
December 31, 2009 and 2008

Note 5 Fair Value (Continued)

Assets Measured at Fair Value on a Recurring Basis at December 31, 2009

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2009
Assets				
Common stock Camco Financial Corp.	$ 424,295	$	$	$ 424,295
Mutual funds				
Growth funds	1,959,663			1,959,663
Index funds	3,040,886			3,040,886
Fixed income fund	978,415			978,415
Balanced fund	404,748			404,748
Short term investment fund	668,420			668,420
Common collective trust fund[(1)]		651,550		651,550
Participant loans			213,982	213,982
Total	$ 7,476,427	$ 651,550	$ 213,982	$ 8,341,959

Assets Measured at Fair Value on a Recurring Basis at December 31, 2008

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2008
Common stock Camco Financial Corp	$ 582,455	$	$	$ 582,455
Money market fund	254			254
Mutual funds	5,860,192			5,860,192
Common collective trust fund		1,268,304		1,268,304
Participant loans			181,517	181,517
Total	$ 6,442,901	$ 1,268,304	$ 181,517	$ 7,892,722

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Camco Financial & Subsidiaries Salary Savings Plan

Notes to Financial Statements
December 31, 2009 and 2008

The following table sets forth a summary of changes in Level 3 assets measured at fair value of on a recurring basis for the year ended December 31, 2009 is as follows:

	Participant Loans
Balance at December 31, 2008	$ 181,517
Purchases, sales, issuances, and settlements Net	32,465
Balance at December 31, 2009	$ 213,982

(1) This category represents investments in an actively management common collective trust fund or pooled separate account that invests primarily in investment contracts, a variety of fixed income investments that may include corporate bonds, both U.S. and non-U.S. municipal securities, and wrapper contracts. Investments are valued at the net asset value per share multiplied by the number of shares held as of the measurement date.

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Camco Financial & Subsidiaries Salary Savings Plan

Schedule of Assets Held at End of Year
Form 5500, Schedule H, Item 4i
EIN 51-0110823, Plan 002
December 31, 2009

(a)(b) Identity of Issuer, Borrower, Lessor, or Similar Party	(c) Description of Investment, Including Maturity Date, Rate of Interest, Collateral, Par, or Maturity Value	(d) Cost	(e) Current Value
Nonparticipant-directed Investments			
** Camco Financial Corporation	Common stock, 11,948 shares	$ 145,766	$ 23,660
Participant-directed Investments			
** Camco Financial Corporation	Common stock, 202,776 shares	*	400,635
Charles Schwab Trust Company	Common/collective fund Union Bond & Trust Co. Stable Value Fund	*	651,550
Charles Schwab Trust Company	Mutual fund MFS Value	*	882,334
Charles Schwab Trust Company	Mutual fund Artisan Midcap Value Fund	*	610,381
Charles Schwab Trust Company	Mutual fund Columbia Acorn Fund Class 2	*	519,584
Charles Schwab Trust Company	Mutual fund Europacific Growth Fund R5	*	852,958
Charles Schwab Trust Company	Mutual fund Growth Fund of America R5	*	1,071,972
Charles Schwab Trust Company	Mutual fund Metropolitan West Total Return Bond Fund	*	978,415
Charles Schwab Trust Company	Mutual fund Schwab Markettrack Balanced Fund	*	404,748
Charles Schwab Trust Company	Mutual fund Vanguard Short-term Investment Grade Fund	*	668,420
Charles Schwab Trust Company	Mutual fund Vanguard 500 Index Signal Fund	*	943,574
Charles Schwab Trust Company	Mutual Fund Alger Small Cap Growth Fund	*	34,733
Charles Schwab Trust Company	Mutual Fund Northern Small Cap Value Fund	*	27,195
Charles Schwab Trust Company	Vanguard Small Cap	*	57,818
** Plan participants	Participant loans bearing interest at 3.25% to 9.25%		213,982
Total investments			**$ 8,341,959**

* Cost information not

required

** Denotes party-in-interest

Schedule 1 Page 1

SIGNATURES

The Plan. Pursuant to the requirements of the Securities Exchange Act of 1934, the trustees (or other persons who administer the employee benefit plan) have duly caused this annual report to be signed on its behalf by the undersigned hereunto duly authorized.

CAMCO FINANCIAL AND SUBSIDIARIES
SALARY SAVINGS PLAN

By its Administrator: Camco Financial Corporation

Date: June 28, 2010

By: /s/ James E. Huston
James E. Huston, Chief Executive Officer

n during pre-colonial times when natives produced silver and malachite in primitive ways. During the sixteenth century, the Spaniards founded the village of Chalchihuites and began intermittent exploitation of the mineral deposits in the area. By the nineteenth century, the Spanish operations achieved continuous silver production, which was interrupted by the Mexican War of Independence. At the beginning of the twentieth century the Eagle Pitcher Company mined the La Colorada property. In 1925 the Dorado family operated mines at two other locations on the La Colorada property. From 1929 to 1955 Candelaria y Canoas S.A., a subsidiary of Fresnillo S.A., installed a 100 ton per day flotation plant and worked the old dumps of two previous mines on the La Colorada property. From 1933 to the end of World War II La Compania de Industrias Penoles also conducted mining operations on a single breccia pipe on the property. From 1949 to 1993 Compania de Minas Victoria Eugenia S.A. de C.V. operated a number of mines on the La Colorada property. In 1994 MLC acquired the exploration and exploitation claims and surface rights of Compania de Minas Victoria Eugenia S.A. de C.V. Until 1997 MLC conducted mining operations on three of the old mines on the La Colorada property, producing approximately 6,000 tons per month. - 25 - GEOLOGY The La Colorada property is located along the southeast flank of the Sierra Madre Occidental at the contact between the lower volcanic complex and the upper volcanic supergroup. The sedimentary rocks were subjected to folding and intense deformation during the Laramide Orogeny which gave rise to the formation of the Sierra Madre Occidental and the extrusion of large volumes of trachytic volcanics. During the final stages of the orogeny, granodioritic intrusives were emplaced resulting in even greater deformation and generating the mineralizing fluids that formed the deposits. East-west block faulting affected the entire stratigraphic column and resulted in structural preparation of the host rocks for the mineralization. Tuffs and pyroclastic flows of rhyolitic composition post-date the mineralization. Four types of mineralization occur at the La Colorada property: (i) veins; (ii) mantos; (iii) breccia pipes; and (iv) replacement skarn. Veins display typical epithermal textures and occur both in the trachytes and limestone. Most veins strike east-northeast and dip steeply to the south. Vein widths generally average 1.5 to 2.0 metres. Vein fillings are mainly quartz and calcite, and where oxidation is not present pyrite, galena, sphalerite, silver sulfosalts and native silver are found. Mantos mineralization is found in close proximity to the veins and represents a wider replacement zone of the limestone host rock. Breccia pipes are circular to ovoid in plan and the larger pipes are continuous to depths of over 400 metres. The mineralization occurs in the matrix of the breccia, primarily as galena and sphalerite. Thirteen breccia pipes have been mapped on the surface or in the underground workings. The replacement skarn mineralization has been explored by nine deep holes drilled from underground. This zone probably represents a transition between upper level epithermal veins and deeper seated skarn mineralization and has significant bulk tonnage potential. During 2000 a new zone was discovered which represents a corridor of sheared, mineralised limestone with a high-grade quartz vein core. Exploration efforts in 2000 were focused on this zone, with a total of 5,312 metres of drilling and 730 metres of drifting completed during the year. No exploration drilling was done during

2002, however a surface exploration program of 1,000 metres was conducted. Exploration activities consisted of underground drifting to define ore zones prior to mining. Total exploration by Pan American at La Colorada consists of 31,448 metres of surface and underground drilling and 6,521 metres of underground drifting and development. DRILLING, SAMPLING AND ANALYSIS, SECURITY OF SAMPLES Drilling at La Colorada consisted of BQ (36.4 mm), NQ (47.6 mm) and HQ (63.5 mm) core in holes ranging from 100 to 350 meters. An independent laboratory conducted assaying for the diamond drill programs and development prior to 2001. A quality assurance/quality control program consisting of check assays and blank samples were used throughout the drilling program. Since 2001 assaying was carried out by the La Colorada laboratory. The quality assurance/quality control program consisted of check assays at an independent laboratory. All of the drilling, sampling and quality assurance/quality control programs were conducted under the direct supervision of Pan American's geology staff. - 26 - MINERAL RESERVES Pan American's management estimates that mineral reserves at La Colorada, as at December 31, 2002, are as follows: LA COLORADA MINERAL RESERVES 1, 2 OXIDE ----- RESERVE GRAMS OF SILVER GRAMS OF GOLD CATEGORY TONNES PER TONNE PER TONNE -------- --------- --------------- ------------ Proven 415,400 506 0.45 Probable 1,878,000 426 0.56 SULFIDE ------- RESERVE GRAMS OF SILVER GRAMS OF GOLD CATEGORY TONNES PER TONNE PER TONNE % LEAD % ZINC -------- -------- --------------- ------------ ------- ------ Proven 150,480 618 0.50 0.90 1.72 Probable 196,400 512 0.42 1.11 2.23 TOTAL ----- RESERVE GRAMS OF GOLD GRAMS OF GOLD CATEGORY TONNES PER TONNE PER TONNE -------- ---------- ------------- ------------ Proven 565,880 536 0.46 Probable 2,074,500 433 0.55 --------- --- ---- Total 2,640,380 455 0.53 -------------- 1 Calculated using a price of $4.75 per ounce of silver. 2 Mineral reserves have been prepared by the Company's wholly owned subsidiary, Pan American Mexico, under the supervision of the Company's "qualified person" Norm Pitcher, P.Geo, who is an employee of the Company. Mr. Pitcher reviewed and tested the information prepared by the Company's operating subsidiary and, based upon those reviews and tests, Pan American is satisfied with the accuracy of the reserve calculations. Management of the Company believes that reserves at the La Colorada Mine are sufficient for at least nine years at planned production rates. MINERAL RESOURCES Pan American's management estimates that mineral resources at La Colorada as at December 31, 2002 are as follows: VEIN AND MANTOS MINERAL RESOURCES(1),(2),(3) RESOURCE GRAMS OF SILVER GRAMS OF GOLD CATEGORY TONNES PER TONNE PER TONNE % LEAD % ZINC ---------- --------- --------------- ------------- ------ ------ Measured 387,800 275 0.16 0.68 0.98 Indicated 1,321,900 254 0.20 1.05 1.56 --------- --- ---- ---- ---- Total 1,709,700 259 0.19 0.89 1.43 --------- --- ---- ---- ---- Inferred 2,360,900 363 0.26 1.40 2.33 --------- --- ---- ---- ---- ----------- 1 Calculated using a price of $4.75 per ounce of silver. 2 These resources are in addition to La Colorada mineral reserves. 3 Mineral resources were prepared jointly by Pan American and Pan American's independent third party consultant, MRDI Canada Ltd., under the supervision of the Company's "qualified person" Norm Pitcher, P.Geo with the exception of the breccia resources which were calculated solely by Pan American. Mr. Pitcher is an employee of the Company. Mr. Pitcher reviewed and tested the information prepared by the Company's subsidiary and reviewed the information developed by MRDI Canada Ltd. and, based upon those reviews and tests, Pan American is satisfied with the accuracy of the resource calculations. - 27 - BRECCIA MINERAL RESOURCES(1),(2),(3) RESOURCE GRAMS OF SILVER GRAMS OF GOLD CATEGORY TONNES PER TONNE PER TONNE % LEAD % ZINC --------- ------ --------------- ------------ ------ ------ Inferred 5,000,000 108 0.24 1.65 0.57 ----------- 1 Calculated using a price of $4.75 per ounce of silver. 2 These resources are in addition to La Colorada mineral reserves. 3 Mineral resources were prepared jointly by Pan American and Pan American's independent third party consultant, MRDI Canada Ltd., under the supervision of the Company's "qualified person" Norm Pitcher, P.Geo with the exception of the breccia resources which were calculated solely by Pan American. Mr. Pitcher is an employee of the Company. Mr. Pitcher reviewed and tested the information prepared by the Company's subsidiary and reviewed the information developed by MRDI Canada Ltd. and, based upon those reviews and tests, Pan American is satisfied with the accuracy of the resource calculations. DEVELOPMENT OF PROJECT During 2000 development work at La Colorada included diamond drilling and underground drilling for reserve definition, the preparation of a bankable feasibility study, negotiation with banks for project financing, independent engineering review, repairs to the existing shaft and rehabilitation of the existing mill to restart operation in 2001. During the fall of 2000 repairs involving shotcrete and steel were made to the existing shaft to ready the mine for full development. Following successful drilling, which substantially increased the oxide reserves at the property, a bankable feasibility study was completed using H.A. Simons Ltd. for mill design, Agra Earth and Environmental Ltd. for tailing design, and Beacon Hill Consultants and

R. Barnes Consultant for mine design. An Environmental Impact Study ("EIS") was prepared to World Bank standards by Dew Point International, LLC and reviewed by Clifton Associates Ltd. Also in 2000, a credit facility mandate letter was signed with IFC. The feasibility study was reviewed by IFC's independent engineers and the EIS was posted on the World Bank's web site for review and comments. Pan American received conditional IFC board approval in February 2001 for a loan facility of up to $28.6 million for the construction and development of the La Colorada project. It was a condition precedent to loan drawdown that Pan American hedge enough silver to cover several years of operating costs at a price greater than $5.00 per ounce of silver. Due to declining silver prices in 2001 the definitive loan documentation was not signed and Pan American and the IFC allowed the financing arrangements to lapse. Pan American decided to rehabilitate the existing mill at La Colorada to allow for limited production in 2001. Limited production commenced in January 2001 at approximately 90 tonnes per day, which increased to approximately 120 tonnes per day as of March 2001 and reached a consistent production rate of 150 tonnes per day in June 2001. Following the addition of another small ball mill and additional lead flotation capacity, the mill commenced operating at 200 tonnes per day in January, 2002. The feed for the mill is underground sulphide ore from the La Colorada property. The mining method utilized is cut and fill, with backfill material largely coming from waste development. Mining and mine development are carried out by third party contractors with Pan American providing supervision. Pan American expended approximately US$250,000 to restart the mill in 2001 and payback of this capital expenditure was received within 12 months. Approximately US$100,000 was spent to upgrade the mill's capacity to 200 tonnes of sulphide ore per day in late 2001. - 28 - In January of 2002 Pan American prepared an internal update to the June 2000 Feasibility Study (qualified persons: John H. Wright, P.Eng. and Norman Pitcher, P.Geo) (the "Updated Feasibility Study"). This Updated Feasibility Study recommended proceeding with a 210,000 tonnes per year underground mining operation for oxide ore in conjunction with and continued mining of 70,000 tonnes per year of sulphide ore. Under the Updated Feasibility Study, the mining method utilized for the oxide ore will be mechanized cut and fill from the property's NCP, 4235 footwall, NC(2)W and San Fermin veins. Fill material will be sourced from internal mine waste, existing waste dumps and a surface borrow pit. Fill material including cement will be delivered to backfill mined-out areas via boreholes. During years ten and 11 of proposed production, historic tailings will be fed to the mill. Milling will consist of a 600 tonne per day conventional cyanide recovery plant for oxide ore as well as the existing 200 tonne per day flotation circuit for sulphide ore processing. During the mine's life, it is estimated that 80% of the silver will be produced in dore form and 20% of the silver will be contained in base metal concentrates. Independent test work has shown recovery for NCP and San Fermin vein oxide material will be greater than 85% for silver and 80% for gold, for NC(2)W and the 4235 footwall vein, recoveries of 90% silver and 88% gold, and for the tailings material 76% silver and 80% gold. Treatment of sulphide material will produce lead and zinc concentrates with the majority of silver reporting to the lead concentrate. Silver recoveries to concentrate will total 91% and is based on both test work and actual mill recoveries during 2001. Oxide test work has consisted of bottle roll tests, locked cycle tests and pilot plant testing. Sample materials include drift samples, drill hole samples and bulk samples obtained from three crosscuts in the NCP zone. Sulphide test work utilized drift back samples and drill hole samples, together with historic and current mill results. The total cost of the mine, mill, plant site and services (including debt financing) is estimated at US$20 million. Existing stock piles and pre-development ore will allow the new oxide mill to be operated at full capacity while the mine ramps up production. During construction the existing small-scale sulphide mill will continue to operate other than during periods of mine infrastructure development, such as mine hoist upgrade. Concentrates will be shipped by truck and sold to the Penoles smelter at Torreon, Mexico pursuant to the terms of an annual sales contract. Dore will be shipped to a refinery and sold internationally. The economics of the project have been calculated using constant prices and costs as at January 2002. The Peso exchange rate used was 9.25 Pesos to one U.S. dollar. Operating costs for the eleven year life of the mine are estimated at US$35 per tonne milled. The average cash cost per ounce of silver recovered will be US$2.56 per ounce net of gold, zinc and lead byproduct credits, with a total average cost per recovered ounce (assuming 100% equity funding), being US$3.66. The project has a present value (net of capital) of US$23.8 million using US$4.50 per ounce silver prices and an internal rate of return of 22.4%. The project is expected to return the capital investment in 3.4 years, including funding sustaining capital. Pan American purchased from NJB Mining Inc. an existing 600 tonne per day Congress mill, located in southern Arizona, for use at La Colorada for US$600,000. Construction of the new oxide mill commenced in July, 2002. By the end of 2002 the majority of the new mills foundation had been completed and equipment erection had commenced. Construction is expected to be completed early in the third quarter of 2003, and production is schedule to ramp up thereafter. During 2002 the existing sulphide mill treated 50,662 tonnes for a monthly average of 4,222 tonnes. Mill operations were adversely affected by the construction project. Milling operations were suspended for approximately eight consecutive weeks to allow underground infrastructure for the oxide ore body to be constructed and for a shorter duration during the fall of 2002 for other construction related tie ins. - 29 - On June 14, 2002, the Company's wholly-owned subsidiary Plata Panamericana S.A. de C.V. ("Plata") entered into a $10,000,000 project loan facility to partially finance the mine expansion. This loan bears interest at six month LIBOR plus 3.50% per annum until the mine achieves certain operating and financial performance measures after which the interest will be six month LIBOR plus 3.25%. The loan is repayable in semi-annual instalments of $1,000,000 commencing November 14, 2004. The Company's interest in Plata and substantially all of Plata's assets have been pledged as security for the loan. The Company has guaranteed Plata's performance under the loan agreement until certain completion tests are satisfied. In addition to the interest payments, on the outstanding balance of the loan, Plata would be required in certain circumstances to make additional payments to the lender. Such payments would be required if the average price of silver for a year exceeded $4.75 per ounce and would be equal to 20% of the positive difference between the average price per ounce of silver for a year and $4.75 multiplied by the number of ounces produced by the La Colorada mine in that year divided by $10,000,000 and multiplied by the greater of the loan balance outstanding at the end of that year or the originally scheduled loan balance at the end of that year. Plata pays the lender a commitment fee equal to one-half of one percent per annum of the amount of the loan not borrowed and cancelled. At December 31, 2002 there were no borrowings under the loan and no part of the loan had been cancelled. In March 2003, Plata borrowed $4,000,000 under the loan agreement and anticipates borrowing the full amount agreed to under the loan agreement over the course of 2003. MARKETING All of La Colorada's concentrate production is sold under a one-year contract expiring in 2003 to an arm's length integrated smelter located in Mexico. A sales agreement for dore production from the new oxide mill has not yet been completed. During 2002 the revenue per type of concentrate produced by the La Colorada mine was as follows: AVERAGE PRICE 2002 REVENUE TONNES PER TONNE ---- ---------- ------ ------------ Zinc Concentrate $ 211,529 641 $ 330 Lead Concentrate $ 2,144,344 939 $2,284 AVERAGE PRICE 2001 REVENUE TONNES PER TONNE ---- ---------- ------ ------------ Zinc Concentrate $ 180,223 580 $ 311 Lead Concentrate $ 2,677,582 1,142 $2,245 ENVIRONMENT An environmental impact study and risk assessment by Clifton Associates Ltd. on the La Colorada property was submitted to Mexican environmental authorities in early March 1999. The EIS described the impacts of proposed development and mining activities and provides conceptual plans for closure and remediation. The EIS was approved by the Mexican authorities in November 1999. The permits issued to Pan American Mexico allow for the commencement of construction and set out the conditions required for compliance prior to and during construction and operation. Approved design allows for an underground mine of up to 1,500 tonnes per day capacity and processing by either cyanide leaching, flotation or a combination of both. These permits are valid until November 2004. - 30 - The three most significant environmental issues currently associated with the La Colorada property are the erosional stability of existing tailings facilities on the property, domestic waste water discharge from on-site buildings, and an uncovered solid waste landfill on the western portion of the La Colorada property. Inactive tailings impoundments containing oxide and sulphide materials are located on the La Colorada property, neither of which have been regraded, covered or vegetated. The slopes of these impoundments have undergone extensive erosion and require remediation. Pan American estimates the costs of this remediation work to be less than $400,000. Pan American expects to profitably re-treat oxide tailings. Activities necessary to ensure long-term compliance with Mexican waste water discharge parameters will be completed during mine construction. As part of this construction an Imhoff tank was constructed to process domestic waste waters, with clarified waters discharged to the new tailings pond. A solid waste landfill is located on the western portion of the La Colorada property. The historic landfill wastes on the arroyo slope are not covered but new fill is deposited into open trenches atop the landfill and covered on a weekly basis. Reclamation of the landfill will require re-grading slopes to reduce the angle of repose, and covering. Culverts may be required to prevent blockage of the arroyo drainage. STOCKPILES Pan American mines and sells silver-rich pyrite Stockpiles at a small-scale operation in central Peru. These operations are not material to the Company. The Stockpiles were accumulated over several years by Volcan, a Peruvian mining company which is one of the largest silver producers in the Cerro de Pasco mining district in central Peru. Until recently silver could not be extracted from the Stockpiles by standard metallurgical processes. On November 8, 2002, Pan American entered into two agreements to acquire the Stockpiles. The first agreement grants Pan American the right to mine and sell 600,000 tonnes of the highest grade silver Stockpiles to a smelter, where ore is used as process flux and Pan American is paid for the silver contained. A ten-year contract to process the Stockpile material was negotiated with Doe Run's La Oroya smelter. Production from the Stockpiles in 2002 totalled 9,018 tonnes of ore containing 101,000 ounces of silver. For 2003 and beyond, Stockpile sales are expected to average approximately 45,000 tonnes per year resulting in annual silver production of approximately 500,000 ounces of silver. The second agreement gives Pan American the option to acquire a 60% ownership in a number of other Stockpiles by spending $2 million on exploration over a three-year period, with a further option to increase its interest to 100% by paying $3 million plus a production royalty within the following 12 months. Pan American has begun detailed definition drilling to confirm estimated resources and will perform metallurgical studies and an economic evaluation as to whether silver can be commercially extracted from these additional Stockpiles. Pan American's management has estimated mineral reserves and resources at the Stockpiles, as at December 31, 2002, to be as follows: STOCKPILE MINERAL RESERVES AND RESOURCES(1)(2) RESERVE OR RESOURCE CATEGORY TONNES GRAMS OF SILVER PER TONNE ---------- -------- ------------------------ Probable Reserve 591,000 313 Inferred Resource 20,342,400 157 1 Calculated using a price of $4.75 per ounce of silver. 2 Mineral reserves and resources have been calculated by staff of Pan American Peru, under the supervision of the Company's "qualified person" Norm Pitcher, P. Geo, who is an employee of the Company. Mr. Pitcher reviewed and tested the information prepared by the Company's subsidiary and, based upon those reviews and tests, Pan American is satisfied with the accuracy of the reserve calculations. Management of the Company believes that reserves at the Stockpiles are sufficient for at least 10 years of production at planned rates. METALS TRADING Pan American has engaged in hedging base metal prices for production from its mines. On January 7, 2002 Pan American sold forward 4,500 tonnes of zinc at an average price of $851 per tonne. These sales were a hedge of the future price for a portion of the February through July 2002 zinc production. On March 21, 2002 Pan American sold forward 1,500 tonnes of zinc at $879 per tonne. These sales were a hedge of the future price for a portion of the zinc production from August 2002 to January 2003. On January 8, 2002 Pan American sold 1,500,000 ounces of silver at $4.50 per ounce. On January 22, 2002 these ounces were re-purchased for a trading gain of $210,000. At December 31, 2002 the Company had sold 10,150 tonnes of zinc forward at an average price of $830 per tonne. During 2003, 8,950 tonnes (of the 10,150 tonnes sold forward) are to be delivered against these contracts. DEVELOPMENT PROJECTS ALAMO DORADO PROJECT LOCATION, ACCESS AND OWNERSHIP The Alamo Dorado Project is located 67 kilometres southeast of the town of Alamos, Sonora, near the border with the State of Sinaloa in northwest Mexico at 26 degrees, 44', 44.2" North Latitude and 108 degrees, 40', 00.7" West Longitude. The Alamo Dorado Project can be accessed from the United States via toll highway 15 which is a well-maintained, four-lane, paved road that starts at the border town of Nogales, Sonora. The project is 67 kilometres southeast of Alamos on a well-maintained gravel road. Major airports in the state of Sonora are located in Hermosillo in the central sector of the state, and Ciudad Obregon to the south. The airport at Ciudad Obregon is approximately 75 kilometres north of Navojoa. The Alamo Dorado Project consists of two concessions, the Alamo Ocho Concession and the Alamo Dorado Concession, covering a total area of 5,369 hectares. The Alamo Ocho Concession was purchased by - 31 - Corner Bay from Alfredo Duran Viramontes and Roberto Duran Viramontes for $425,000 in semi-annual payments from 1997 to 2002 and a balance payment of $300,000, all of which have been paid. An exploration concession for the Alamo Ocho Concession was granted on December 13, 1993 and Pan American has made an application for an exploitation concession to be granted in respect of this property. An exploration concession for the Alamo Dorado Concession was granted on May 27, 1998 and expires on May 26, 2004. Corner Bay has executed local land agreements with several individuals and ejidos (agricultural cooperatives in Mexico) in the mine site area. Corner Bay has received approval from thirteen existing water users for a transfer of sufficient water for the project. Pan American has officially applied to the Mexican Federal Agency ("CNA") for approval of the transfer. On approval from CNA a final contract is required to be signed by the existing users. Pan American does not anticipate any problems receiving the signed agreements. HISTORY Prior to 1997, there is no record of any modern exploration conducted on the Alamo Dorado Project nor are there any records of production, although there is evidence of a few old adits in the general area. All recorded drilling at the property has been undertaken since. GEOLOGY AND MINERALIZATION The Alamo Dorado Project, as presently known, occurs within a package of metamorphosed rocks ranging from Cretaceous to Paleozoic in age. These metamorphosed rocks occur as roof pendants resting on an extensive, relatively younger igneous rock (approximately 62 million years old) known as the Sonoran batholith. The composition of the rocks making up this batholith ranges from granodiorite to quartz monzonite, and is devoid of precious and base metals mineralization. Preliminary conclusions of a recent geologic mapping program suggest that the original rocks may have had a volcanic origin. The host rocks are dominantly tuffs and porphyritic rocks which underwent a metamorphic event. Intrusion of the Sonoran batholith has further fractured, dislocated and faulted these metamorphosed rocks; however, their original metamorphic (quasi-sedimentary) fabrics, which in the deposit area have a generalized strike to the north and a moderate dip (35-37 degrees) to the west, are still evident. The principal zone of silver and gold mineralization is observed at surface occurring as a 30-50 metre wide zone of oxidized, rusty and fractured rocks best described as gneisses and schists, both metamorphic grade rocks (altered from their original state). The surface occurrence on the ridge crest is subject to talus cover on the eastern flank of the ridge where it outcrops. Progressive drill programs have now shown the mineralized zone extends up to several hundred metres in width. The average length of drill hole has been approximately 250 metres. The mineralized body is currently defined to be approximately 500 metres in length, with an average width of approximately 150 metres. The mineralization has been drilled to a depth of approximately 250 metres. Drilling has traced the zone of mineralization for 600 metres from drill section 400 South to 200 North along the north-south drill grid. Several drill sections in the latest 2000 drill campaign were oriented northeast-southwest at the mineralized zone's northern extent to better intersect the mineralization in this area where the zone trends to the northwest. A number of major faults have been observed in the area; however, in the central mineralized area, no major faults appear to have affected the distribution of mineralization. Furthermore, it has been observed that, in general, the areal limits of mineralization may not be structurally controlled. The eastern edge of the deposit, however, is limited by a steep feature, which could be either a high-angle fault trending to the north-northwest, or the results of strong silicification of the rocks making up the cliffs in this sector of the deposit. - 32 - The dominant hydrothermal alteration in the metamorphic rocks, which has been enhanced by supergene effects and weathering, is argillic with an intense association of hematite. Hematite is abundant, giving the metamorphic rocks a reddish coloring; the Cerro Colorado (Red Hill) ridge is a result of this phenomenon. Classic hydrothermal alteration is evident by the presence of quartz-sericite and silicification. Silicification is pervasive on the eastern cliffs of the Cerro Colorado ridge. The batholithic rocks are essentially unaltered and barren. ENVIRONMENT Pan American holds all necessary permits for its current activities, but must obtain, on a timely basis, permits for work planned for the future development of, and production from, the Alamo Dorado Project. There is no guarantee that such permits will be issued. The environmental permitting work for the Alamo Dorado Feasibility Study was provided by Corner Bay in conjunction with Agauyo Consultoria Ambiental, Corner Bay's environmental consultant and coordinator. AMEC has reviewed the Environmental Impact Statement (MIA), submitted by Corner Bay to the Mexican Secretary for Environmental and Natural Resources (SEMARNAT) to identify potential major deficiencies and for appropriateness for permitting Alamo Dorado. Environmental impacts culminating from the development of the mine are greatly outweighed by the overall benefits. A finding of no significant impact was recommended in the impact statement/permitting document. ALAMO DORADO FEASIBILITY STUDY AMEC E&C Services, Inc. ("AMEC") was contracted in 2001 to provide a feasibility study for Alamo Dorado. Alamo Dorado is a greenfield project with no existing infrastructure or equipment. The basis for the Alamo Dorado Feasibility Study is utilizing a combination of new and used equipment, a mining contractor, and owner operated crushing, leaching, and processing facilities. The reserves planned for mining are currently estimated at 35.5 million tonnes averaging 68 gpt silver and 0.26 gpt gold, for a contained metal total of 77 million ounces of silver and 297,000 ounces of gold. This is based on $4.60 silver per ounce and $300 gold per ounce. The project design crushing rate is 4.5 million tonnes per year or approximately 12,500 tonnes per day. At this design rate the project is expected to produce an average of 6.0 million ounces of silver and 29,000 ounces of gold per year over the eight-year mine life and 11-year project life. Direct total cash costs are estimated at $3.25 per ounce silver equivalent and total costs including taxes and 10% employee profit sharing amount to $4.13 per ounce silver equivalent. The life of mine waste to ore stripping ratio is currently anticipated at 1.08:1. Capital costs for the project are estimated at $45.1 million. Silver production is higher in the first three years of production with peak production in year three. The product will be silver - gold dore, which will be shipped to a precious metal refiner for final processing and sale. MINEABLE RESERVES AND RESOURCES Mintec provided the mineable reserves for Alamo Dorado. AMEC reviewed the assay data, geology model, resources model and the resulting reserve statement and found the work to be acceptable for use in the Alamo Dorado Feasibility Study. A detailed audit of mineable reserves has not been conducted by AMEC. AMEC wrote a Quality Assurance/Quality Control Report for the Alamo Dorado Feasibility Study. - 33 - For the purposes of the Alamo Dorado Feasibility Study, the assumptions used to calculate the reserve and resource were a silver price of US$4.60 per ounce and a gold price of US$300 per ounce. Reserve and resource calculations are exclusive of each other and are as follows: ALAMO DORADO RESERVES AND RESOURCES(1),(2) GRAMS OF SILVER GRAMS OF GOLD CLASS TONNES PER TONNE PER TONNE ----- ---------- --------------- ------------- RESERVE CATEGORY Proven 23,360,000 71 0.27 Probable 12,144,000 60 0.24 ---------- -- ---- Total 35,504,000 67 0.26 RESOURCE CATEGORY Measured & Indicated 7,296,000 42 0.17 ---------- -- ---- Total 7,296,000 42 0.17 -------------- 1 Assumes $4.60 silver per ounce and US$300 gold per ounce. 2 John Thorton, Mintec Inc., qualified person. MINING The mine plan used in the Alamo Dorado Feasibility Study was prepared by Mintec and Corner Bay, prior to its acquisition by Pan American. The plan is based on a May 2002 technical report, pit designs and mining schedule prepared by Mintec. The mine plan is based on moving approximately 12,500 ore tonnes per day over a planning period of 350 operating days per year. It is proposed that mining operations will be conducted through a mining contractor with management by Pan American. Pan American would be responsible for all technical aspects of the mining operation, including, pit surveying, ore control, short and long term planning and other technical support. METALLURGY The primary metallurgical testing program for the Alamo Dorado Project was developed under the direction of Corner Bay in consultation with METCON. AMEC reviewed the methods and results obtained and as a result directed additional supplemental roll testing during the course of the Alamo Dorado Feasibility Study. Two metallurgically significant areas or zones have been defined through a combination of variability bottle roll testing and applied geological interpretation. These zones have been related to the metallurgical testing information to produce recovery and consumable estimates for the commercial heap leaching operations anticipated. Gold recoveries are estimated to be 71% in both zones. The more intensely oxidized and silicified supergene material in the epithermal core zone of the deposit was determined to be one geo-metallurgical zone (Zone 1) of significance. The core of the system is pipe-like at depth at the contact with the granodiorite, and widens laterally, or "mushrooms" upwards. This zone comprises 51% of the total leachable tonnes (75% of the first three years of production) and 56% of the projected heap leach contained silver. Based on column testing of core sample composites for this material, the average silver recovery from heap leaching is expected to be 71% distributed over three years. This accounts for 65% of the recoverable silver in the mine plan leach tonnes. The lesser oxidized/silicified supergene material, in the areas north and south of and below the epithermal core of the deposit, was determined to be a second geometallurgical zone (Zone 2) of significance. This zone 2 - 34 - comprises 49 percent of the total leachable tonnes (25 percent of the first three years of production) and 44 percent of the projected heap leach contained silver. Based on column testing of core sample composites for this material, the average silver recovery from heap leaching is expected to be 51 percent distributed over three years. This accounts for 35 percent of the recoverable silver in the mine plan leach tonnes. HEAP LEACH FACILITY AMEC carried out a geotechnical evaluation and basic level design for the heap leach facility. AMEC also carried out a site selection study, a preliminary geotechnical evaluation of the preferred leach pad site that included site reconnaissance, geotechnical investigation, laboratory testing and evaluation of the results for the purpose of design of the heap leach facilities for use in mine planning and project permitting. The design consists of an integrated facility consisting of two phases with nine internal cells with a width of 85 metres spaced uniformly across the pad. The initial construction will consist of Phase 1 with a design storage capacity of 13.5 million tonnes. Phase 1 will achieve the required storage capacity stacked to approximately six lifts (36 metres in height). Phase 1 covers an area of approximately 374,150 square metres and Phase 2 covers an area of 227,900 square metres. The ultimate design capacity of the heap leach facility is for storage of 36 million tonnes. Three ponds will be constructed adjacent to the southwest corner of the Phase 1 facility that will serve both phases of the facility. The pond system consists of two process solution ponds (a pregnant solution pond and an intermediate solution pond), and an emergency storm pond. The two process solution ponds will be double lined with a geomembrane and will have leak detection, collection and monitoring systems. Pregnant solution will be pumped to the adjacent process facility while intermediate solution will be returned to the heap for enrichment (secondary leaching). The emergency storm pond will be single-lined with provision made to pump solution back to the process. CRUSHING, CONVEYING AND STACKING The proposed crushing, conveying and stacking system for Alamo Dorado consists of all equipment required to receive ore from the mine and place it on the heap leach pad. The system is designed to produce a crushed product size of P80 minus 6.4 mm (1/4 inch) and convey and stack the material on the heap leach pad in 6-metre lifts. The feed for the crushing system was based on standard Run-of-Mine tables since no Run-of-Mine material was available for gradation analysis. This complete system is designed to process approximately 12,500 tonnes per day including regularly scheduled maintenance.

During the course of the Alamo Dorado Feasibility Study, two used equipment opportunities were identified which were evaluated by AMEC. The Briggs Mine Crushing Plant, located in California and owned by Canyon Resources Corporation, was found to provide significant synergy and opportunity for the Alamo Dorado Project. The plant was inspected, the flow sheet modified for increased rates, and capital and operating costs were developed, all of which supported the incorporation of the Briggs Mine Crushing Plant. Based on this work and a recommendation by AMEC, on June 14, 2002, Corner Bay purchased the Briggs Mine Crushing Plant. PROCESS PLANT The proposed process plant will recover silver and gold from leach solution to produce dore. The precious metals will be recovered from the pregnant solution in a typical Merrill-Crowe zinc precipitation circuit. The precipitate will be mixed with fluxes and will be added to a 150 kilowatt, 500 kilogram steel-capacity electric furnace. At the end of the melt in the furnace, 1000 ounce dore bars will be poured. Dore will be cleaned, weighed, sampled and stored in a vault awaiting shipment to an independent outside refinery. - 35 - The major unit processes include: o Solution application to the heap; o Merrill-Crowe circuit to recover silver and gold; o Acid treatment of zinc precipitated to remove leached metals including copper, zinc, selenium and cadmium; o Neutralization of leach solution; and o Refining of leach residue to produce silver-gold dore. The process plant is designed based on a 4,500,000 tonnes per year heap leach facility and will process 908 cubic metres per hour of pregnant leach solution. At the planned throughput rate, the plant will produce 1,940 kilograms per day of zinc precipitate. OPERATING COSTS The Alamo Dorado Feasibility Study estimates average operating expenditures to be $24.4 million dollars per year. Direct cash costs are estimated to be $3.25 per ounce silver equivalent. The total estimated site operating cost (operating, capital, taxes and 10% employee profit sharing) is $4.13 per ounce silver equivalent produced. PROJECT CAPITAL COSTS Excluding the cost of the Briggs Mine Crushing Plan, which is considered a sunk cost, the AMEC estimated cost to construct, install and commission the facilities described in the Alamo Dorado Feasibility Study is $45.1 million. This amount covers the direct field costs of executing the project, plus owner's costs and indirect costs associated with design, construction and commissioning. The estimate is based on utilizing the Briggs Mine Crushing Plant, which was purchased on June 14, 2002 from Canyon Resources Corporation. Working Capital is calculated as a percentage of operating supplies in the financial model. The initial working capital required is $3,800,000 in the pre-production period and the balance peaks in the third year at $5,000,000. FINANCIAL OVERVIEW Alamo Dorado was analyzed assuming 100 percent equity financing using a discounted cash-flow approach starting in the second quarter of 2002. In addition, a 70:30 debt to equity ratio was also reviewed as an alternative for project financing. Mintec's reserve was calculated using metal prices of $4.60 silver per ounce and $300 gold per ounce to produce a conservative mine plan for project financing. The base case metal prices used for the Alamo Dorado Feasibility Study financial overview were $5 per ounce of silver and $325 per ounce of gold. Projections for annual revenues and costs are based on data developed for the mine plan, leach and process plant production, capital expenditures and operating costs. The estimated project cashflows were used to determine the pre-tax and after-tax internal rate of return (IRR). The results of the 100% equity base case analysis yield a pre-tax IRR of 30% and an after-tax IRR of 17.3%. The results of the analysis with a 70:30 debt equity ratio at 5.5% interest with debt being repaid in - 36 - four years indicates a pre-tax IRR of 57% and an after-tax IRR of 33%. The 100% equity base case scenario has a projected payback period of approximately 2.8 years. 2003 PROGRAM For 2003 Pan American has budgeted approximately $1,000,000 for diamond drilling to undertake metallurgy testing and to update the feasibility study. The review will examine the economic merits of processing the ore in a conventional oxide leaching mill circuit versus heap leach processing. Capital and operating costs will be detailed, as well as a financial model prepared. The study will also examine a combination mill for high grade ore and heap leach for low grade ore. Expected mill recoveries are estimated at over 90% based on preliminary metallurgical testing versus in excess of 60% for the heap leach process. INVESTMENT AND EXPLORATION PROPERTIES AND EXPENDITURES PROPERTIES Pan American owns interest in a variety of exploration and resource properties in Mexico, Argentina, Peru, Russia, Bolivia and the United States, none of which are material to the Company. A brief description of the most advanced of these properties follows: RESERVE OR RESOURCE OZ/T G/T PROPERTY LOCATION TYPE CATEGORY(1) TONS TONNES AG AG BY-PRODUCTS -------- -------- ---- ----------- ---- ------ --- --- ----------- Manantial Espejo(2)(3) Argentina vein Meas. resource 1,398,000 235 5.23 g/t Au vein Ind. Resource 2,993,000 277 4.17 g/t Au vein Inf. resource 1,590,000 258 3.65 g/t Au Dukat(2)(4) Russia vein P&P reserve 10,550,000 755 1.5 g/t Au vein M&I resource 3,750,000 489 1.0 g/t Au vein Inf. resource 17,060,000 295 0.66 g/t Au San Vicente(5) Bolivia vein Ind. resource 2,053,000 393 4.5% Zn vein Inf. resource 1,754,000 398 4.4% Zn Hog Heaven(6) Montana stockwork Meas. resource 2,095,000 4.04 0.016 oz/t Au stockwork

Ind. resources 928,000 7.06 0.021 oz/t Au stockwork Inf. resource 8,205,000 4.11 0.004 oz/t Au Waterloo(6) California stockwork Ind. resource 37,235,000 2.71 13.4% barite ------------ 1 P&P = proven and probable reserves M&I = measured and indicated resources Meas. resource = measured resources Ind resource = indicated resources Inf resource = inferred resources 2 Totals include only 50% of Manantial Espejo and 20% of Dukat. 3 Resource estimate by Pincock Allen & Holt, Stewart Wallis, P. Geo., "qualified person". 4 Reserve and resource calculations were prepared by Kilborn Engineering Pacific Ltd. in a supplemental feasibility study completed in January 1999 and were reviewed and tested by the Company's "qualified person", Norm Pitcher, P. Geo., who is an employee of the Company. Mr. Pitcher reviewed and tested the information prepared by Kilborn Engineering Pacific Ltd. and, based upon those reviews and tests, Pan American is satisfied with the accuracy of the reserve and resource calculations. 5 Mineral resources have been prepared by the Company's wholly owned subsidiary, Pan American Bolivia, under the supervision of the Company's "qualified person", Norm Pitcher, P. Geo., who is an employee of the Company. Mr. Pitcher reviewed and tested the information prepared by the Company's subsidiary and, based upon those reviews and tests, Pan American is satisfied with the accuracy of the resource calculations. - 37 - 6 Resources for Hog Heaven and Waterloo are based on historic estimates prepared by CoCa Mines and American Mine Services in 1988 as part of a feasibility study in the case of Hog Heaven and exploration records of ASARCO Incorporated in the case of Waterloo. Pan American believes these historical estimates to be relevant and reliable. In November 2002, OAO MNPO Polimetall ("Polimetall"), the 80% owner of the Dukat deposit, announced that it had started production at Dukat by mining ore from both open pit and underground sources, and processing the ore at a refurbished mill to produce a silver concentrate. Polimetall reported that the concentrate is being stockpiled in Magadan, Russia for future export to refining facilities pending receipt of Russian governmental approvals, including a Presidential export decree. Since no revenues can be generated until the concentrates can be sold, Dukat, is not yet a commercial operation. As of the date hereof, the consolidated balance sheet of Pan American ascribes no value to Dukat. In late 2001, Pan American and COMIBOL, the Bolivian state mining company that has optioned the San Vincente property to Pan American, entered into a two-year toll mining agreement with EMUSA, a well-established Bolivian mining company, to process up to 250 tonnes of San Vincente's ore per day at EMUSA's nearby mill. Pan American does not take credit for silver ounces produced by EMUSA's toll mining operation but books proceeds derived from a gross revenue royalty. Pan American earned $202,000 in revenues from San Vicente in 2002, which more than offsets the project's holding costs. MINERAL PROPERTY EXPENDITURES The following table sets out Pan American's acquisition, exploration and development expenditures for the periods indicated: YEARS ENDED DECEMBER 31 (in thousands of U.S. dollars) ----------------------------- TOTAL 2002 2001 EXPENDITURES ------- --------- ------------ Acquisition $ 2,012 $ - $ 8,065 ------- --------- --------- 2,012 - 8,065 ------- --------- --------- Development Huaron 957 4,899 17,427 Quiruvilca 349 La Colorada 8,300 358 6,100 Other - 299 2,298 ------- --------- --------- 9,606 5,556 25,825 ------- --------- --------- Exploration Manantial Espejo 461 - 461 San Vicente 180 179 650 La Colorada 11 - 492 Ocotlan 139 175 175 Other (field office costs) 96 - 786 ------- --------- --------- 887 354 2,103 ------- --------- --------- Investment Waterloo 55 56 109 Hog Heaven 23 24 50 ------- --------- --------- 78 80 159 ------- --------- --------- TOTAL $12,583 $ 5,990 $ 36,152 ======= ========= ========= 1 Pan American's option on the Ocotlan property was allowed to lapse in early 2003, after drilling programs did not return positive results. EMPLOYEES The Company employs ten full-time employees at its head office in Vancouver, including three geologists, one metallurgical engineer, and one environmental specialist. As at December 31, 2002, Mina Quiruvilca employed 495 persons in connection with the operation of the Quiruvilca mine and indirectly employed an additional 763 persons through private agreements with a number of Peruvian contractors. Approximately 309 of the workers employed by Mina Quiruvilca are members of either the Sindicato de Trabajadores de Pan American Silver S.A.C. - Mina Quiruvilca (the "Quiruvilca Union") or the Sindicato de Trabajadores de Shorey y Anexos (the "Shorey Union"). Mina Quiruvilca considers its relations with its employees to be satisfactory. Negotiations for 2003 are proceeding at the present time. Minera Huaron employs 119 full time employees and indirectly 853 persons through agreements with Peruvian mining contractors. Pan American Peru employs 22 full-time employees and three contractors, including one mining engineer. Pan American Mexico employs 32 employees, 127 mining contractors, including four geologists, one civil engineer and three mining engineers, and 355 construction contractors. Pan American Bolivia has 16 employees and one part-time contractor, including one geologist. - 38 - RESEARCH AND DEVELOPMENT Pan American conducts research and development activities in order to develop improved production processes and exploration techniques. Costs associated with this work are expensed as incurred. Pan American did not incur any significant research and development costs during 2001 or 2002 and has not budgeted for any significant costs during 2003. COMPETITIVE CONDITIONS The mining industry is intensely competitive particularly in the acquisition of additional reserves and resources in all of its phases and Pan American competes with many companies possessing greater financial and technical resources. Competition in the mining business for limited sources of capital could adversely affect Pan American's ability to acquire and develop suitable silver mines, silver developmental projects, silver producing companies or properties having significant silver reserves or resources or significant exploration potential. As a result, there can be no assurance that Pan American's acquisition and exploration programs will yield new mineral reserves to replace or expand current mineral reserves. Pan American's competitive position is largely determined by its costs compared to other producers throughout the world and its ability to maintain its financial integrity through metal price cycles. Costs are governed to a large extent by the location, grade and nature of Pan American's mineral reserves as well as by operating and management skills. As one of few mining companies focusing on silver production, development and exploration, Pan American is subject to unique competitive advantages and disadvantages related to the price of silver. If silver prices substantially increase Pan American will be in a relatively stronger competitive position than diversified mining companies that produce, develop and explore for other minerals in addition to silver. Conversely, if silver prices substantially decrease, Pan American would be at a competitive disadvantage to diversified mining companies. WORKING CAPITAL Management of Pan American believes that its working capital of $2.4 million (as at December 31, 2002) together with the working capital of $2.3 million acquired in connection with the Company's acquisition of Corner Bay and monies available in connection with the IFC Loan is sufficient to ensure liquidity throughout 2003. ENVIRONMENT All phases of Pan American's operations are subject to environmental regulation in the various jurisdictions in which it operates. To the best of management's knowledge, Pan American is currently in compliance in all material respects with such environmental regulations applicable to its mining operations and exploration activities. The costs associated with environmental compliance are considered to be normal operating costs necessary to maintain operations on an ongoing basis. Other than specific environmental concerns discussed in this Annual Information Form under the headings "Quiruvilca Mine - Environment", "La Colorada - Environment" and "Huaron - Environment", the Company is not aware of any material environmental matters requiring significant capital outlays in the immediate future. In the financial year end dated December 31, 2002 Pan American's environmental operating costs were $748,856 and environmental project costs were $591,942. Operating costs were incurred principally for the acid water treatment plant at Quiruvilca and project costs were principally for tailings dam stabilization and rehabilitation of a drainage tunnel at Huaron. - 39 - Other than the Quiruvilca and Huaron mines and the La Colorada property, none of Pan American's properties has any outstanding material reclamation or environmental concerns. As at December 31, 2002, an accounting provision for reclamation in the amount of $12,971,000 had been made in respect of the Quiruvilca, Huaron and La Colorada mines. Environmental legislation in all of the jurisdictions in which Pan American operates is evolving in a manner which will require stricter standards and will be subject to increased enforcement, fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and a heightened degree of responsibility for companies and their officers, directors and employees. Changes in environmental regulation, if any, may adversely affect Pan American's operations and profitability. In addition, environmental hazards may exist on Pan American's properties which are unknown to Pan American at present, which have been caused by previous or existing owners or operators of the property, or by the past or present owners of adjacent properties or by natural conditions. The occurrence of any of these hazards or conditions could have a material adverse effect on Pan American's operations or profitability. TRENDS AND UNCERTAINTIES The following is a discussion of trends, commitments, events and uncertainties that are both presently known to management of Pan American and are expected reasonably to have a material effect on Pan American's business, financial condition or results of operations. GOVERNMENTAL REGULATION Pan American's operations and exploration and development activities are subject to extensive Canadian, U.S., Peruvian, Mexican, Bolivian and other foreign federal, state, provincial, territorial and local laws and regulations governing exploration, development, production, exports, taxation, labour standards, land use, water use, waste disposal, health, safety, restrictions on production, price controls, currency remittance, maintenance of mineral rights, mineral tenure, and expropriation of property, remediation of environment, reclamation and historic and cultural preservation. Future changes in such laws and regulations in the various jurisdictions in which Pan American operates could adversely affect Pan American's operations and profitability. METAL PRICE AND EXCHANGE RATE FLUCTUATIONS Fluctuating metal prices, particularly the price of silver, zinc, lead, copper and gold, represent one of the most significant factors affecting Pan American's operations and profitability. The following table illustrates the volatility of the price of silver and sets forth the annual high, low, average and end of period London Fix prices in U.S. dollars for an ounce of silver for the periods indicated. YEAR ENDED DECEMBER 31 -- 2002 2001 2000 1999 1998 ---- ---- ---- ---- ---- High $ 5.10 $ 4.80 $ 5.45 $ 5.75 $ 7.31 Low 4.24 4.10 4.58 4.88 4.77 Average 4.60 4.40 4.95 5.22 5.53 End of Period 4.66 4.52 4.58 5.33 5.05 On pages 33 through 38 of the Company's 2002 Annual Report under the heading "Management's Discussion & Analysis of Financial Conditions and Results of Operations" there are tables that illustrate the impact of higher and lower metal prices (silver, zinc, lead and copper) on Pan American's expected revenue. - 40 - In addition, fluctuations in currency exchange rates between the United States dollar (being the currency in which Pan American's revenues are currently earned) and the Canadian dollar (used to pay corporate head office costs), the Peruvian sole and the Mexican peso (being the currencies in which a significant portion of Pan American's operating costs are currently incurred) could also have a significant impact on Pan American's operations and profitability. The following table sets forth the exchange rates between the Canadian dollar and the U.S. dollar for the periods indicated including the high, low and average exchange rates for such periods (such rates, which are expressed in Canadian dollars, are the noon buying rates for U.S. dollars reported by the Bank of Canada). YEAR ENDED DECEMBER 31 (CDN.) --- 2002 2001 2000 1999 1998 ---- ---- ---- ---- ---- High 1.6155 1.6021 1.5590 1.5475 1.5845 Low 1.5123 1.4936 1.4341 1.4200 1.4037 Average 1.5704 1.5484 1.4850 1.4858 1.4831 End of Period 1.5776 1.5926 1.5002 1.4433 1.5333 The price of silver and other metals or currency exchange rates are affected by numerous factors beyond Pan American's control including, but not limited to, international economic and political conditions, inflation, interest rates, global or regional consumptive patterns, speculative activities, levels of supply and demand, increased production due to new mine developments and improved mining and production methods, availability and costs of metal substitutes, metal stock levels maintained by producers and others and inventory carrying costs. The effect of these factors on the price of base and precious metals, and therefore the profitability of Pan American's operations, cannot accurately be predicted. Changes in the market price of these metals and changes in such currency exchange rates could adversely affect Pan American's operations and profitability. OPERATING HAZARDS AND RISKS The operation and development of a mine or a mineral property involves many risks, which even a combination of experience, knowledge and careful evaluation may not be able to overcome. These risks include, without limitation: ground fall; explosions and other accidents; flooding; environmental hazards; the discharge of toxic chemicals; and other hazards and risks. Such occurrences may result in work stoppages, delayed production, increased production costs, damage to or destruction of mines and other producing facilities, damage to life and property, environmental damage and possible legal liability for any or all damage. Although Pan American maintains insurance in an amount, which it considers adequate for its operations, the nature of these risks is such that liabilities could exceed policy limits or may not be insurable. The occurrence of any of these events could incur significant costs, which could have a materially adverse effect upon the Company's operations or profitability. EXPLORATION AND DEVELOPMENT RISKS The long-term operation of Pan American's business and its profitability is dependent, in part, on the cost and success of its exploration and development programs. Mineral exploration and development involve a high degree of risk and few properties that are explored are ultimately developed into producing mines. There is no assurance that Pan American's mineral exploration and development programs will result in any discoveries of bodies of commercial mineralization. There is also no assurance that even if commercial quantities of mineralization are discovered that a mineral property will be brought into commercial production. For example, the Manantial Espejo, Lucita and Tres Cruces properties are in the exploration stages only and are without a known body of commercial mineralization. Development of Pan American's mineral properties will follow only upon obtaining satisfactory exploration results. Discovery of mineral deposits is dependent upon a number of factors, not - 41 - the least of which is the technical skill of the exploration personnel involved. The commercial viability of a mineral deposit once discovered is also dependent upon a number of factors, some of which are the particular attributes of the deposit (such as size, grade and proximity to infrastructure), metal prices and government regulations, including regulations relating to royalties, allowable production, importing and exporting of minerals and environmental protection. Most of the above factors are beyond the control of Pan American. As a result, there can be no assurance that Pan American's acquisition, exploration and development programs will yield new reserves to replace or expand current reserves. Unsuccessful exploration or development programs could have a material adverse impact on Pan American's operations and profitability. PERMITTING Operations at the Quiruvilca, Huaron, La

Colorada, and San Vicente properties and the Stockpiles are subject to receiving and maintaining permits from appropriate governmental authorities in Peru, Mexico and Bolivia, respectively. Although Pan American currently has all required permits for its operations as currently conducted, there is no assurance that delays will not occur in connection with obtaining all necessary renewals of such permits for the existing operations or additional permits for any possible future changes to operations at these properties including any proposed capital improvement programs. Prior to any development on any of its other properties Pan American must receive permits from appropriate governmental authorities. Although the permitting processes with such authorities have progressed well to date and Pan American expects that all necessary permits will be forthcoming, there is no guarantee that Pan American will obtain all permits necessary to develop or continue operating at any particular property. UNCERTAINTY IN THE CALCULATION OF MINERAL RESERVES, RESOURCES AND SILVER RECOVERY There is a degree of uncertainty attributable to the calculation of mineral reserves and mineral resources and corresponding grades being mined or dedicated to future production. Until mineral reserves or mineral resources are actually mined and processed the quantity of mineral and reserve grades must be considered as estimates only. In addition, the quantity of mineral reserves and mineral resources may vary depending on, among other things, metal prices. Any material change in quantity of mineral reserves, mineral resources, grade or stripping ratio may affect the economic viability of Pan American's properties. In addition, there can be no assurance that silver recoveries or other metal recoveries in small scale laboratory tests will be duplicated in larger scale tests under on-site conditions or during production. INFRASTRUCTURE Mining, processing, development and exploration activities depend, to one degree or another, on adequate infrastructure. Reliable roads, bridges, power sources and water supply are important determinants, which affect capital and operating costs. Unusual or infrequent weather phenomena, sabotage, government or other interference in the maintenance or provision of such infrastructure could adversely affect Pan American's operations and profitability. SMELTER SUPPLY ARRANGEMENTS The zinc, lead and copper concentrates produced by Pan American are sold through long-term supply arrangements to metal traders or integrated mining and smelting companies. Should any of these counter parties not honour supply arrangements, or should any of them become insolvent, Pan American may be forced to sell its concentrates in the spot market or it may not have a market for its concentrates and therefore its future operating results may be materially adversely affected. ENVIRONMENTAL FACTORS See "Environment". - 42 - TITLE TO ASSETS The validity of mining or exploration titles or claims, which constitute most of Pan American's property holdings, can be uncertain and may be contested. Pan American has used its best efforts to investigate its title or claims to its various properties and, to the best of its knowledge, those titles or claims are in good standing. However no assurance can be given that applicable governments will not revoke or significantly alter the conditions of the applicable exploration and mining titles or claims and that such exploration and mining titles or claims will not be challenged or impugned by third parties. Pan American operates in countries with developing mining laws and changes in such laws could materially affect Pan American's rights to its various properties or interests therein. Although Pan American has received title opinions for those properties in which it has a material interest there is no guarantee that title to such properties will not be challenged or impugned. Pan American has not conducted surveys of all the claims in which it holds direct or indirect interests and therefore, the precise area and location of such claims may be in doubt. Pan American's properties may be subject to prior unregistered liens, agreements or transfers, native land claims or undetected title defects. FOREIGN OPERATIONS As at December 31, 2002, the majority of the Company's current operations were conducted by its subsidiaries outside of Canada in Peru and Mexico. All of Pan American's current production and revenue is derived from its operations in Peru and Mexico. As Pan American's business is carried on in a number of foreign countries it is exposed to various levels of political, economic and other risks and uncertainties. These risks and uncertainties include, but are not limited to, terrorism, hostage taking, military repression, expropriation, changing tax laws, extreme fluctuations in currency exchange rates, high rates of inflation and labour unrest. Local opposition to mine development projects has arisen in Peru in the past, and such opposition has at times been violent. In particular, in February of 2001, the exploration premises of a Canadian mineral exploration company, Manhattan Minerals Inc., at Tambo Grande in Northern Peru, were stormed by approximately 5,000 people, who burned machinery and injured approximately 30 people. Although Pan American's operations in Peru are located in communities that have been traditionally supportive of mining for decades and no discernable local opposition has arisen to Pan American's projects, there can be no assurance that such local opposition will not arise in the future. Changes, if any, in mining or investment policies or shifts in political attitude in Peru, Mexico or Bolivia may adversely affect Pan American's operations or profitability. Operations may be affected in varying degrees by government regulations with respect to, but not limited to, restrictions on production, price controls, export controls, currency remittance, income taxes, expropriation of property, foreign investment, maintenance of claims, environmental legislation, land use, land claims of local people, water use and mine safety. In certain countries where Pan American has properties or interests failure to comply strictly with applicable laws, regulations and local practices relating to mineral right applications and tenure, could result in loss, reduction, or expropriation of entitlements, or the imposition of additional local or foreign parties as joint venture partners with carried or other interests. The occurrence of these various factors and uncertainties cannot be accurately predicted and could have an adverse effect on Pan American's operations or profitability. UNITED STATES LEGISLATION There is a movement in the United States Congress to reform the current mining laws. While it is not expected that any reform legislation will pass the United States Congress in the current session, it is not unlikely that - 43 - some changes to U.S. mining laws will occur in the future. These changes may include the payment of royalties to the government, increased holding fees and restrictions or prohibitions on patenting mining claims. In addition, prospective legislation could be expected to include various environmental and land use requirements, which may restrict, or in some cases, prevent mining operations. Although none of the mineralization on the properties on which Pan American holds direct or indirect interests are within unpatented claims, Pan American's interest in unpatented claims on federal land could have an overall impact on the value of its properties in the United States. - 44 - SELECTED CONSOLIDATED FINANCIAL INFORMATION -- ANNUAL INFORMATION Selected consolidated financial information of the Company for each of the last five completed financial years is as follows: 2002 2001 2000 1999 1998 --------- --------- ---------- --------- --------- (thousands of U.S. dollars, except per share amounts) Revenue $ 45,093 $ 37,296 $ 29,931 $ 26,851 $ 30,219 Operating loss (34,910) (8,540) (46,650) (5,837) (6,016) Operating loss per share ($1.37) ($0.20) ($0.93) ($0.24) ($0.24) Net loss (33,658) (8,077) (45,878) (5,837) (5,987) Net loss per share ($1.35) ($0.20) ($0.80) ($0.22) ($0.24) Cash and short-term investments 10,198 3,844 7,590 15,873 10,139 Total assets 94,966 97,517 83,087 107,829 70,719 Total long-term financial liabilities 3,942 5,010 4,987 -- -- Total shareholder's equity 55,492 58,877 57,544 94,884 61,656 Selected unaudited consolidated financial information of the Company for each of the last eight quarterly periods is as follows: 2002 2001 -- -- THREE THREE THREE THREE THREE THREE THREE THREE MONTHS MONTHS MONTHS MONTHS MONTHS MONTHS MONTHS MONTHS ENDED ENDED ENDED ENDED ENDED ENDED ENDED ENDED MARCH 31 JUNE 30 SEPT. 30 DEC. 31 MARCH 31 JUNE 30 SEPT. 30 DEC. 31 -------- -------- -------- -------- -------- ------- -------- -------- (thousands of U.S. dollars, except per share amounts) Total Revenue $10,199 $11,615 $ 11,195 $ 12,084 $ 4,541 $ 8,051 $13,790 $10,914 Expenses: Operating costs 9,202 10,807 11,447 11,705 4,894 9,083 14,471 12,143 Depreciation 1,429 1,435 1,316 692 708 1,034 1,278 1,292 General & admin. 359 498 379 462 505 476 471 686 Reclamation 198 221 226 215 115 108 107 290 General exploration 83 260 234 629 152 171 115 454 Investment income, net 231 (119) (149) 13 292 (28) (147) (437) Write-off resource ppty 15,129 12,089 Operating loss (1,303) (1,487) (17,387) (13,721) (1,541) (2,849) (2,799) (4,388) Gain on sale of land -- -- -- -- -- -- 3,500 -- Net income (loss) for the period $(1,303) $(1,247) $(17,387) $(13,721) $(1,541) $(2,849) $ 701 $(4,388) Earnings (loss) per share ($0.03) ($0.03) $ (0.40) ($0.40) ($0.04) ($0.08) $ 0.02 ($0.12) Quarterly per share amounts have been adjusted to reflect the weighted average common shares of the Company outstanding for the full year. - 45 - Further discussion of the Company's financial results is contained in the "Management's Discussion and Analysis" incorporated by reference into this Annual Information Form. DIVIDENDS The Company has not, since the date of its incorporation, declared or paid any dividends on its common shares and does not currently intend to pay dividends. Earnings will be retained to finance further exploration and development. Currently there are no restrictions with respect to the Company's present or future ability to declare or pay dividends. MANAGEMENT'S DISCUSSION AND ANALYSIS -- Reference is made to "Management's Discussion and Analysis of Financial Condition and Results of Operations" ("MD&A") and the Consolidated Financial Statements of the Company for the years ended December 31, 2002 and 2001, set out on pages 33 through 38 and 41 through 55, respectively, of the Company's 2002 Annual Report, which are incorporated by reference herein. MARKET FOR SECURITIES -- The Company's common shares are listed and posted for trading on the Toronto Stock Exchange under the symbol "PAA". The common shares of the Company are also quoted on the Nasdaq National Market and trade under the symbol "PAAS".

Warrants to purchase common shares of the Company are also listed and posted for trading on the Toronto Stock Exchange and trade under the symbol "PAA.WT". - 46 - DIRECTORS AND OFFICERS --- The names and municipalities of residences of the directors and officers of the Company, the positions held by them with the Company and their principal occupations for the past five years are set forth below: NAME AND MUNICIPALITY PRINCIPAL OCCUPATION DURING THE OF RESIDENCE POSITION WITH THE COMPANY PAST FIVE YEARS --------------------- ------------------------ -------------------------------- ROSS J. BEATY(2),(3),(4) Director, Chairman and Chief Chairman and Chief Executive Officer Vancouver, B.C. Executive Officer (director of of the Company the Company since September 30, 1988) WILLIAM A. FLECKENSTEIN(3),(4) Director of the Company since President of Fleckenstein Capital, Seattle, Washington, U.S.A. May 9, 1997 Inc. (an investment counselling firm) from 1996 to present; prior thereto Partner of Olympic Capital Management Inc. (an investment counselling firm) MICHAEL J.J. MALONEY(1),(2),(3),(4) Director of the Company from Private Investor Seattle, Washington, U.S.A. Sept. 11, 1995 to Nov. 29, 1999 and then re-elected on May 15, 2000 PAUL B. SWEENEY(1),(4) Director of the Company since Vice President and Chief Financial Surrey, B.C. August 6, 1999 Officer of Canico Resource Corp. (a mining company) since February 2002; prior thereto Chief Financial Officer of Manhattan Minerals Inc. (a mining company) from December 1999 to May, 2001; Chief Financial Officer of Sutton Resources Inc. (a mining company) from February, 1998 to April, 1999; and prior thereto Senior Vice President and Chief Financial Officer at Princeton Mining Corp. MICHAEL LARSON(4) Director of the Company since Investment Advisor and Manager of Seattle, Washington November 29, 1999 Cascade Investment LLC (a private investment company) JOHN H. WRIGHT(4) Director, President and Chief President of the Company Vancouver, B.C. Operating Officer (director of the Company since September 30, 1988) JOHN WILLSON(1),(2),(4) Director since April 4, 2002 Retired since April 2000; formerly CEO of Placer Dome Inc. - 47 - NAME AND MUNICIPALITY PRINCIPAL OCCUPATION DURING THE OF RESIDENCE POSITION WITH THE COMPANY PAST FIVE YEARS --------------------- ------------------------ -------------------------------- ANTHONY HAWKSHAW Chief Financial Officer Chief Financial Officer of the Vancouver, B.C. Company NORM PITCHER Chief Geologist Chief Geologist of the Company since North Vancouver, B.C. February, 1998 and prior thereto consulting geologist with H.A. Simons Engineering STUART A. MOLLER Vice President, Vice President, Exploration of the La Paz, Bolivia Exploration Company since July 1997; and prior thereto Exploration Manager in Bolivia with Barrick Gold Corporation. ROSALIE MOORE Vice President, Vice President, Corporate Relations West Vancouver, B.C. Corporate Relations of the Company. GORDON JANG Controller and Secretary Controller of the Company Vancouver, B.C. ----------------------- 1 Member of the Audit Committee 2 Member of the Compensation Committee 3 Member of the Nominating and Governance Committee 4 Member of the Environmental Committee The directors of the Company are elected at each annual general meeting to hold office until the next annual general meeting or until their successors are elected or appointed. The board currently consists of seven directors five of whom, John Willson, Paul B. Sweeney, Michael Larson, William A. Fleckenstein and Michael J.J. Maloney, qualify as unrelated directors who are independent of management. On January 1, 2003, Mr. Robert Pirooz rejoined Pan American as its Vice President, Legal Affairs. Mr. John Wright has advised that, for family reasons, at the end of May, 2003 he is stepping down as President and Chief Operating Officer of Pan American. Mr. Wright will remain an active director of the Company. Mr. Geoff Burns has joined Pan American effective May 1, 2003 and will fulfill Mr. Wright's functions. As well, on March 1, 2003 Mr. Bill Faust joined Pan American as Vice President, Alamo Dorado. Lastly, Ms. Rosalie Moore has resigned from the Company effective May 1, 2003. Replacing Ms. Moore is Ms. Brenda Radies. The board has established four committees: the Audit Committee, the Compensation Committee, the Environmental Committee and the Nominating and Governance Committee. The board does not have an Executive Committee. The composition of the various committees as at December 31, 2002 is set forth in the preceding table. As of May 12, 2003, Mr. Beaty no longer serves on the Compensation Committee or the Nominating and Governance Committee. - 48 - As at March 28, 2003, the directors and officers of the Company as a group beneficially owned, directly or indirectly, 5,105,000 common shares of the Company representing 17.12% of the issued and outstanding common shares of the Company. CONFLICTS OF INTEREST Certain officers and directors of the Company are officers and/or directors of, or are associated with, other natural resource companies that acquire interests in mineral properties. Such associations may give rise to conflicts of interest from time to time. However, the directors are required by law to act honestly and in good faith with a view to the best interests of the Company and its shareholders and to disclose any personal interest which they may have in any material transaction which is proposed to be entered into with the Company and to abstain from voting as a director for the approval of any such transaction. ADDITIONAL INFORMATION -- Additional information, including directors' and officers' remuneration and indebtedness, principal holders of the Company's securities, options to purchase securities and interests of insiders in material transactions, is contained in the Information Circular for the Annual General Meeting of the Company to be held on May 12, 2002. Additional financial information is also provided in the Company's Audited Consolidated Financial Statements for the years ended December 31, 2002 and 2001 which are contained in the Company's 2002 Annual Report. The Company shall provide to any person, upon request to the Secretary of the Company: (a) when the securities of the Company are in the course of a distribution pursuant to a shelf or short form prospectus or a preliminary short form prospectus has been filed in respect of a distribution of its securities: (i) one copy of the Annual Information Form of the Company, together with a copy of any document or the pertinent pages of any document, incorporated by reference in the Annual Information Form; (ii) one copy of the comparative financial statements of the Company for its most recently completed financial year together with the accompanying report of the auditor and one copy of any interim financial statements of the Company subsequent to the financial statements for the Company's most recently completed financial year; (iii) one copy of the information circular of the Company in respect to its most recent annual meeting of shareholders that involved the election of directors; and (iv) one copy of any other documents that are incorporated by reference into a preliminary short form prospectus or shelf or short form prospectus and are not required to be provided under (i) to (iii) above; or (b) at any other time, one copy of any of the documents referred to in (a) (i), (ii) and (iii) above, provided that the Company may require the payment of a reasonable charge if the request is made by a person who is not a security holder of the Company. Requests for copies pursuant to the foregoing should be made to the Secretary of the Company at 1500 - 625 Howe Street, Vancouver, British Columbia, Canada, V6C 2T6. - 49 - - 50 - GLOSSARY OF TERMS -- "adit" - a horizontal or nearly horizontal passage driven from the surface for the working of a mine. "adularia" - a very low-temperature monoclinic potassium feldspar. "andesite" - a dark-coloured, fine-grained extrusive rock that, when porphyritic, contains phenocrysts composed primarily of zoned sodic plagioclase (esp. andesine) and one or more of the mafic minerals (e.g. biotite, horneblend, pyroxene), with a ground-mass composed generally of the same minerals as the phenocrysts; the extrusive equivalent of diorite. "argillic" - pertaining to clay or clay minerals, e.g. in "argillic alternation" in which certain minerals are converted to minerals of the clay group. "arroyo" - a term applied in the arid and semi-arid southwestern U.S. to a small deep flat-floored channel or gully of an ephemeral or intermittent stream. It is usually dry and has steep or vertical banks of unconsolidated material. "basalt" - a dark-coloured igneous rock, commonly extrusive, composed primarily of calcic plagioclase and pyroxene. "berm" - the space left between the upper edge of a cut and the toe of an embankment. "breccia", "brecciation" - rock broken up by geological forces. "calcareous" - containing calcium carbonate. When applied to a rock name, it implies that as much as 50% of the rock is calcium carbonate. "chalcopyrite" - a bright brass-yellow tetragonal mineral; generally found massive and constitutes the most important ore of copper. "chert" - a hard, dense, dull to semivitreous, microcrystalline or cryptocrystalline sedimentary rock, consisting dominantly of interlocking crystals of quartz less than about 30mu m in diameter; it may contain amorphous silica (opal). It sometimes contains impurities such as calcite, iron oxide, and the remains of siliceous and other organisms. Chert occurs principally as nodular or concretionary nodules in limestone and dolomites, and less commonly as layered deposits (bedded chert). "conglomerate" - a coarse-grained clastic sedimentary rock, composed of rounded to sub-angular fragments larger than 2mm in diameter (granules, pebbles, cobbles, boulders) set in fine-grained matrix of sand or silt and commonly cemented by calcium carbonate, iron oxide, silica or hardened clay. "cut-and-fill" - a method of stoping in which ore is removed in slices, or lifts, following which the excavation is filled with rock or other waste material known as back fill, before the subsequent slice is mined. The back fill supports the walls of the stope. "dacite" - a fine-grained extrusive rock with the same general composition as andesite, but having less calcic plagioclase and more quartz. "diamond drill" - a type of rotary drill in which the cutting is done by abrasion rather than by percussion. The drill cuts a core of rock which is recovered in long cylindrical sections. "dore" - unrefined gold and silver in bullion form. "drift" - a horizontal passage underground that follows along the length of a vein or rock formation. "enargite" - a grayish-black or iron-black orthorhombic mineral. It is an important ore of copper. "epidote" - a basic silicate of aluminium, calcium and iron. "epithermal" - formed by low-temperature (100 - 200 degrees C.) hydrothermal processes. "fault" - a fracture in a rock where there has been displacement of the two sides. "feldspar" - a prominent group of rock-forming silicate minerals. "fracture" - breaks in a rock, usually due to intensive folding or faulting. - 51 - "galena" - the most important ore of lead, found in hydro-thermal veins and as a replacement mineral. "gangue" - that part of an ore deposit from which a metal or metals is not extracted. "gneiss" - a foliated rock formed by regional metamorphism, in which bands or lenticles of granular minerals alternate with bands or lenticles in which minerals having flaky or elongate prismatic habits predominate. "granodioritic" - similar to granitic, except that graphic texture does not seem to occur, and a lower percentage of silicon, and a higher calcium and magnesium content is present. "indicated mineral resource" - mineral resources for which quantity, grade or quality, densities, shape, physical characteristics are so well established that they can be estimated with confidence sufficient to allow the appropriate application of technical and economic parameters, to support mine planning and evaluation of the economic viability of the deposit. The estimate is based on detailed and reliable exploration and testing information gathered through appropriate techniques from locations such as outcrops, trenches, pits, workings and drill holes that are spaced closely enough for geological and grade continuity to be reasonably assumed. "inferred mineral resource" - mineral resources for which quantity and grade or quality can be estimated on the basis of geological evidence and limited sampling and reasonably assumed, but not verified, geological grade and continuity. The estimate is based on limited information and sampling gathered through appropriate techniques from locations such as outcrops, trenches, pits, workings and drill holes. "lacustrine" - pertaining to, produced by, or inhabiting a lake or lakes. "loop" - a pattern of field observations that begin and end at the same point with a number of intervening observations. "manto" - a blanket-like replacement of rock (commonly limestone) by ore. In some districts, the term has been modified to designate a pipe-shaped deposit confined within a single stratigraphic horizon. "marls" - a variety of materials, most of which occur as loose, earthy deposits consisting chiefly of an intimate mixture of clay and calcium carbonate. "measured mineral resource" - the part of a mineral resource for which quantity, grade or quality, densities, shape, physical characteristics are so well established that they can be estimated with confidence sufficient to allow the appropriate application of technical and economic parameters, to support production planning and evaluation of the economic viability of the deposit. The estimate is based on detailed and reliable exploration, sampling and testing information gathered through appropriate techniques from locations such as outcrops, trenches, pits, workings and drill holes that are spaced closely enough to confirm both geological and grade continuity. "mineral reserve" - the economically mineable part of a measured or indicated mineral resource demonstrated by at least a preliminary feasibility study. This study must include adequate information on mining, processing, metallurgical, economic and other relevant factors that demonstrate, at the time of reporting, that economic extraction can be justified. A mineral reserve includes diluting materials and allowances for losses that may occur that when the material is mined. "mineralization" or "resources" or "mineral resources" - is a concentration or occurrence of natural, solid, inorganic or fossilized organic material in or on the Earth's crust in such form and quantity and of such a grade or quality that it has reasonable prospects for economic extraction. The location, quantity, grade, geological characteristics and continuity of a mineral resource are known, estimated or interpreted from specific geological evidence and knowledge. "monzonite" - a granular plutonic rock containing approximately equal amounts of orthoclase and plagioclase, and thus intermediate between syenite and diorite. Quartz is minor or absent. "muck" - ore or rock that has been broken by blasting. "open pit" - a surface working open to daylight, such as a quarry. - 52 - "ore shoot" - a pipelike, ribbonlike or chimneylike mass of ore within a deposit (usually a vein), representing the more valuable part of a deposit. "orogeny" - a period of mountain building. "pearceite" - a monoclinic mineral Ag(16)As(2)S(11), having copper as an apparent necessary minor component which is metallic black, brittle and occurs in low-to moderate-temperature silver and base-metal ores. "pinch" - a compression of the walls of a vein, or the roof and floor of a coal bed, which more or less completely displaces the ore or coal. "polybasite" - a monoclinic mineral (Ag,Cu)(16)Sb(2)S(11) that is soft, metallic and grey to black occurring in low-temperature veins. A source of silver. "porphyry" - an igneous rock of any composition that contains conspicuous phenocrysts in a fine-grained ground mass. "probable mineral reserve" - is the economically mineable part of an indicated, and in some circumstances, a measured mineral resource demonstrated by at least a preliminary feasibility study. This study must include adequate information on mining, processing, metallurgical, economic and other relevant factors that demonstrate, at the time of reporting, that economic extraction can be justified. "proustite" - a triangle mineral, Ag(3)AsS(3), with rhombohedral cleavage that is soft, ruby red and occurs in low temperature or secondary enrichment veins. A minor source of silver. "proven mineral reserve" - is the economically mineable part of a measured mineral resource demonstrated by at least a preliminary feasibility study. This study must include adequate information on mining, processing, metallurgical, economic, and other relevant factors that demonstrate, at the time of reporting, that economic extraction is justified. "pyrite" - a mineral containing iron sulphide. "pyroclastic" - rock formed by the mechanical combination of volcanic fragments. "pyrrhotite" - a monoclinic and hexagonal mineral, FeS, invariably deficient in iron, variably ferrimaganetic, which is metallic, bronze yellow with iridescent tarnish and occurs in mafic igneous rocks, contact metamorphic deposits, high temperature veins and granite pegmatites. "qualified person" - is an individual who is an engineer or geoscientist with at least five years experience in mineral exploration, mine development or operation or mineral project assessment, or any combination of these; and has experience relevant to the subject matter of the mineral project; and who is a member in good standing of a recognized self-regulatory organization of engineers or geoscientists. "raise" - a vertical or inclined underground working that has been excavated from the bottom upward. "resuing" - a method of stoping wherein the wall rock on one side of the vein has been blasted after the ore itself is broken, with the waste rock used as fill. Resuing is employed on narrow veins and permits a recovery with a minimum of dilution. "rhodochrosite" - a hexagonal carbonate mineral, found in lead and silver-lead ore veins and in metasomatic deposits. "schist" - a strongly foliated crystalline rock formed by dynamic metamorphism, that can be readily split into thin flakes or slabs due to the well developed parallelism of more than 50% of the minerals present, particularly those of lamellar or elongate prismatic habit (e.g., mica and hornblende). "shrinkage stoping" - a method of stoping which utilizes part of the broken ore as a working platform and as support for the walls. "silicified" - a rock altered by a silica hydrothermal solution. "skarn" - rocks composed nearly entirely of lime-bearing silicates and derived from nearly pure limestones and dolomites in which large amounts of silicon, aluminium, iron and magnesium has been introduced. "sphalerite" - the main zinc ore, found in metasomatic deposits with galena, in hydro-thermal vein deposits, and in replacement deposits. "split" - a coal seam that is separated from the main seam by a thick parting of other sedimentary rock. "stope" - an excavation in a mine from which ore is being or has been extracted. - 53 - "strike" - the course or bearing of a layer of rock. "stripping ratio" - the ratio of waste material to ore experienced in mining an ore body by open pit. "supergene" - said of a mineral deposit or enrichment formed near the surface, commonly by descending solutions; also, said of the solutions and of that environment. "swell" - an enlarged place in an orebody, as opposed to a pinch. "tailings" - material rejected from a mill after recoverable valuable minerals have been extracted. "tennantite" - a blackish lead-gray isometric mineral. It is isomorphous with tetrahedrite, and sometimes contains zinc, silver, or cobalt replacing part of the copper. It is an important ore of copper. "tetrahedrite" - a metallic isometric mineral. It is isomorphous with tennantite, and often contains silver or other metals replacing part of the copper. Tetrahedrite is an important ore of copper and sometimes an ore of silver. "trachytes" - fine-grained, alkali, intermediate igneous rocks. "tuff" - a general term for all consolidated pyroclastic rocks. Adj: tuffaceous. "tuffs" - upon consolidation, the general name for the material derived from solid volcanic material which has been blown into the atmosphere by explosive activity. "vein" - an epigenetic mineral filling of a fault or other fracture, in tabular or sheetlike form, often with associated replacement of the host rock; a mineral deposit of this form and origin. - 54 - DOCUMENT NO. 2 MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL INFORMATION The consolidated financial statements and all information in the Annual Report are the responsibility of the Board of Directors and management. The consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada from information available to March 7, 2003. Financial information presented throughout the Annual Report is consistent with the information presented in the consolidated financial statements. The Audit Committee of the Board of Directors meets with management to ensure that management maintains systems of internal and administrative controls to provide reasonable assurance that financial information is presented fairly. The audit committee also meets with the Company's external auditors to review the scope and results of their audit and auditors' report prior to submitting the consolidated financial statements to the Board of Directors for approval. The consolidated financial statements have been audited by Deloitte & Touche LLP, Chartered Accountants, who were appointed by the shareholders. The Auditors' Report sets out the scope of their examination and their opinion on the consolidated financial statements. /s/ Anthony Hawkshaw ---------------------- Anthony Hawkshaw Chief Financial Officer Vancouver, Canada March 7, 2003 AUDITORS' REPORT TO THE SHAREHOLDERS OF PAN AMERICAN SILVER CORP. We have audited the consolidated balance sheets of Pan American Silver Corp. as at December 31, 2002 and 2001 and the consolidated statements of operations, shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion of these financial statements based on our audits. We conducted our audits in accordance with Canadian and United States generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free from material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and 2001, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2002 in accordance with Canadian generally accepted accounting principles. /s/ Deloitte & Touche LLP -------------------------- Deloitte & Touche LLP Chartered Accountants Vancouver, British Columbia February 20, 2003, except for Note 9, which is at March 7, 2003 CONSOLIDATED BALANCE SHEETS AS AT DECEMBER 31 (IN THOUSANDS OF US DOLLARS) 2002 2001 ---------- ------------ ASSETS Current Cash and cash equivalents $ 10,185 $ 3,331 Short-term investments 13 513 Accounts receivable 4,598 6,037 Inventories (Note 4) 4,637 4,655 Prepaid expenses 3,197 6,534 ---------- ------------ Total Current Assets 22,630 21,070 Mineral property, plant and equipment, net (Note 5) 59,447 66,659 Investment and other properties (Note 6) 4,193 1,785 Direct smelting ore (Note 4) 4,303 - Other assets (Note 7) 4,393 2,003 ---------- ------------ Total Assets $ 94,966 $ 91,517 ========== ============ LIABILITIES Current Operating line of credit $ 125 $ 1,390 Accounts payable and accrued liabilities (Note 8) 15,227 12,283 Advances for metal shipments 2,158 4,071 Current portion of bank loans and capital lease (Note 9) 1,638 2,209 Current portion of severance indemnity and commitments (Note 14) 953 547 Current portion of deferred revenue (Note 7) 130 643 ---------- ------------ Total Current Liabilities 20,231 21,143 Deferred revenue (Note 7) 923 1,850 Bank loans and capital lease (Note 9) 3,942 5,010 Provision for reclamation (Note 5) 12,971 2,112 Severance indemnity and commitments (Notes 5, 6 and 14) 1,407 2,525 ---------- ------------ Total Liabilities 39,474 32,640 ========== ============ SHAREHOLDERS' EQUITY Share capital (Note 10) Authorized: 100,000,000 common shares of no par value Issued: December 31, 2001 - 37,628,234 shares December 31, 2002 - 43,883,454 shares 161,024 130,723 Additional paid in capital 1,092 1,120 Deficit (106,624) (72,966) ---------- ------------ Total Shareholders' Equity 55,492 58,877 ---------- ------------ Total Liabilities and Shareholders' Equity $ 94,966 $ 91,517 ========== ============ APPROVED BY THE BOARD /s/ Ross J. Beaty /s/ John H. Wright -------------------- --------------------- Ross J. Beaty, John H. Wright, Director Director See accompanying notes to consolidated financial statements. CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, (IN THOUSANDS OF US DOLLARS, EXCEPT FOR SHARES AND PER SHARE AMOUNTS) 2002 2001 2000 ------------ ------------ ------------ Revenue $ 45,093 $ 37,296 $ 29,931 ------------ ------------ ------------ Expenses Operating 43,161 40,591 27,561 General and administration 1,698 2,138 2,177 Depreciation and amortization 4,872 4,312 2,509 Reclamation 860 620 461 Exploration 1,206 892 800 Interest expense 988 783 326 Write down of mineral properties and reclamation (Notes 5 and 6) 27,218 - 42,747 Gain on sale of land (Note 3) - (3,500) - ------------ ------------ ------------ 80,003 45,836 76,581 ------------ ------------ ------------ Loss from operations (34,910) (8,540) (46,650) Interest income 269 236 641 Other income (Note 13) 983 227 131 ------------ ------------ ------------ Net loss for the year $ (33,658) $ (8,077) $ (45,878) ------------ ------------ ------------ Basic and fully diluted loss per share (Note 2) ($0.80) ($0.22) ($1.35) ------------ ------------ ------------ Weighted average shares outstanding 41,849,413 36,162,815 33,987,958 ------------ ------------ ------------ See accompanying notes to consolidated financial statements. CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY FOR THE YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000 (IN THOUSANDS OF US DOLLARS, EXCEPT FOR SHARES) COMMON SHARES ADDITIONAL ------------------------- PAID IN SHARES AMOUNT CAPITAL DEFICIT TOTAL ---------- ------------ ---------- ------------ ------------ Balance, December 31, 1999 32,460,845 $ 113,780 $ 115 $ (19,011) $ 94,884 Issued on acquisition of Huaron (Note 3) 1,780,389 7,015 - - 7,015 Issued for purchase of royalty 140,000 507 - - 507 Fair value of stock options granted - - 985 - 985 Fair value of warrants granted - - 69 - 69 Foreign exchange translation adjustment - - (38) - (38) Net loss for the year - - - (45,878) (45,878) ---------- ----------- ------- ----------- ----------- Balance, December 31, 2000 34,381,234 121,302 1,131 (64,889) 57,544 Exercise of stock options 247,000 789 - - 789 Shares issued for cash, net of share issue costs (Note 10c) 3,000,000 8,632 - - 8,632 Fair value of warrants granted (Note 10c) - - 27 - 27 Foreign exchange translation adjustment - - (38) - (38) Net loss for the year - - - (8,077) (8,077) ---------- ----------- ------- ---------- ---------- Balance, December 31, 2001 37,628,234 130,723 1,120 (72,966) 58,877 Exercise of stock options 1,445,400 6,102 - - 6,102 Shares issued for cash, net of share issue costs (Note

10b(i)) 3,450,000 15,599 - - 15,599 Issued on acquisition of Manantial Espejo (Notes 6 and 10bii) 231,511 1,250 - - 1,250 Issued on acquisition of royalty (Notes 5 and 10biii) 390,117 3,000 - - 3,000 Issued as compensation payable (Note 10b (v)) 69,000 253 - - 253 Issued to purchase silver stockpiles (Notes 4 and 10biv) 636,942 4,000 - - 4,000 Exercise of share purchase warrants 32,250 97 - - 97 Foreign exchange translation adjustment - - (28) - (28) Net loss for the year - - - (33,658) (33,658) ---------- ------------ ------- ----------- ----------- Balance, December 31, 2002 43,883,454 $ 161,024 $ 1,092 $ (106,624) $ 55,492 ========== ============ ======= =========== =========== The cumulative translation adjustment account at December 31, 2002 was $11 (2001 - $39). See accompanying notes to consolidated financial statements CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, (IN THOUSANDS OF US DOLLARS) 2002 2001 2000 ------------ ---------- --------- Operating activities Sales proceeds $ 44,015 $ 38,176 $ 30,085 Hedging activities 960 40 181 Interest paid (988) (783) (326) Other income and expenses 926 96 762 Products and services purchased (42,533) (36,759) (26,898) Exploration (1,102) (892) (811) Taxes paid - - (111) General and administration (2,020) (1,964) (2,267) ------------ ---------- --------- (742) (2,086) 615 ------------ ---------- --------- Financing activities Repayments of bank loans (3,325) (5,044) 10,043 Shares issued for cash 22,821 9,789 - Share issue costs (962) (340) - ------------ ---------- --------- 18,534 4,405 10,043 ------------ ---------- --------- Investing activities Mineral property, plant and equipment expenditures (9,780) (6,683) (1,077) Investment and other property expenditures (1,158) (24) (17,815) Short-term investment sales (purchases) - 256 (13) Other - (81) (59) ------------ ---------- --------- (10,938) (6,532) (18,964) ------------ ---------- --------- Increase (decrease) in cash and cash equivalents for the year 6,854 (4,213) (8,306) Cash and cash equivalents at beginning of year 3,331 7,544 15,850 ------------ ---------- --------- Cash and cash equivalents at end of year $ 10,185 $ 3,331 $ 7,544 ============ ========== ========= Supplemental Cashflow Information (Note 12c) See accompanying notes to consolidated financial statements NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2002, 2001 AND 2000 (TABULAR AMOUNTS ARE IN THOUSANDS OF US DOLLARS, EXCEPT FOR SHARES, PRICE PER SHARE AND PER SHARE AMOUNTS) 1. NATURE OF OPERATIONS The Company is a silver mining company operating in Peru, Mexico and Bolivia. 2. SIGNIFICANT ACCOUNTING POLICIES The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in Canada as set out below. The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant differences from United States accounting principles are disclosed in Note 16. A) BASIS OF PRESENTATION These consolidated financial statements are expressed in United States dollars and include the accounts of the Company and its subsidiaries. All intercompany transactions and balances have been eliminated. Certain comparative figures have been reclassified to conform to the current year's presentation. B) REVENUE RECOGNITION Revenue is recognized when title and risk of ownership of metals have passed and collection is reasonably assured. Revenue from the sale of metals may be subject to adjustment upon final settlement of estimated metal prices, weights and assays. Adjustments to revenue are recorded in the period leading up to and during the period of final settlement of prices, weights and assays. C) INVENTORIES Metals inventories are stated at the lower of cost and net realizable value determined by using the first-in, first-out method. Materials and supplies inventories are carried at the lower of average cost and replacement cost. Costs of direct smelting ore are charged to operations on a per tonne of ore sold basis over 600,000 tonnes (Note 4). D) MINERAL PROPERTY, PLANT AND EQUIPMENT i) Mineral properties Acquisition costs of mineral development properties together with costs directly related to mine development expenditures and any interest thereon are deferred. Once in production such costs are amortized on a units-of-production basis over a property's expected economic life. Exploration costs are charged to operations. ii) Mineral property, plant and equipment are stated at the lower of cost or estimated net recoverable value on the basis of undiscounted estimates of future cash flows. Maintenance, repairs and renewals are charged to operations. Betterments are capitalized. Any gains or losses on disposition of property, plant and equipment are reflected in the statement of operations. Depreciation is calculated on a straight-line basis over the lesser of an asset's estimated useful life ranging from five to twenty years and the life of the mineral property to which it relates. The carrying value of mineral properties and any related plant and equipment are reviewed periodically for impairment in value, utilizing undiscounted estimates of future cash flows. Any resulting write downs to net recoverable value are charged to operations. Deferred costs relating to abandoned properties are written off. E) RECLAMATION COSTS Ongoing reclamation costs are charged to operations in the period in which they are incurred. Estimated closure costs are accrued on a units-of-production basis. At operations where the carrying value of the related property, plant and equipment is deemed to be impaired because of uncertainty about the expected mine life, an estimate of the expected future reclamation and closure costs is made. The difference between the estimated future reclamation and closure costs and the amount of such costs accrued at the time of impairment is charged to operations. Should subsequent revisions of the estimated future costs be made, the effect of the revision on the amount accrued would be reflected as a charge or credit to operations. F) FOREIGN CURRENCY TRANSLATION The Company's functional currency is the US dollar. The accounts of self-sustaining foreign operations are accounted for by the current rate method. Under this method, assets and liabilities are translated into US dollars at prevailing rates of exchange at each balance sheet date and revenue and expense items are translated at exchange rates prevailing when such items are recognized in the statement of operations. Foreign currency gains and losses are deferred as a component of additional paid in capital. Foreign currency transactions and balances and the accounts of integrated foreign operations are accounted for by the temporal method. Under this method, monetary items are translated at the exchange rate in effect at the balance sheet date, non-monetary items are translated at historical rates, and revenue and expense items are translated at exchange rates prevailing when such items are recognized in the statement of operations. Foreign currency gains and losses are expensed. G) DERIVATIVE FINANCIAL INSTRUMENTS The Company, from time to time, uses forward sales instruments for the purpose of managing the price of anticipated metal sales. These instruments are accounted for as a hedge of anticipated transactions and are not recorded on the balance sheet of the Company. Gains and losses from these contracts are recorded as an adjustment of revenue in the period that related production is delivered. Occasionally, non-hedging derivative contracts are entered into. These contracts are recorded on the balance sheet and marked-to-market at each reporting date. Any mark-to-market gains or losses are included in the statement of operations. H) CASH AND CASH EQUIVALENTS Cash and cash equivalents include cash or highly liquid, fixed income securities or term deposits with an average yield of 1.25% (2001 -1.65%) and an average term to maturity, at the date of purchase, of one month. I) SHORT-TERM INVESTMENTS Short-term investments are carried at the lower of cost and market value. J) STOCK OPTION PLAN The Company provides options to buy common shares of the Company to directors, officers and service providers. The board of directors grants such options for periods of up to ten years at prices equal to or greater than the weighted average market price of the five trading days prior to the date the options are granted. The Company adopted the intrinsic value method of accounting for stock-based compensation. Under this method compensation expense is recognized for the excess, if any, of the quoted market price of the Company's common shares over the common share option exercise price on the day that options are granted. K) LOSS PER SHARE The diluted net loss per share is calculated based on the weighted average number of common shares outstanding during the year, plus the effects of dilutive common share equivalents. This method requires that the dilutive effect of outstanding call options and warrants issued should be calculated using the treasury stock method. This method assumes that all common share equivalents have been exercised at the beginning of the period (or at time of issuance, if later), and that the funds obtained thereby were used to purchase common shares of the Company at the average trading price of common shares during the period. 3. BUSINESS ACQUISITION On March 6, 2000, the Company acquired a 71.83 percent interest in Compania Minera Huaron S.A. ("Huaron"). The acquisition agreement provided for the issuance of 1,780,389 common shares of the Company valued at $7,015,000 and 700,000 common share purchase options with a value of $985,000. The share purchase options were exercisable over a ten-year period at $4.00 per share and would have expired on March 6, 2010. During 2002, all the share purchase options were exercised for proceeds of $2,800,000. The Company also granted the vendors a 2.16 percent net smelter return royalty payable after the Company has extracted 4,300,000 tonnes of ore from the property. As at December 31, 2002, the Company had extracted 974,000 tonnes of ore from the property. This royalty increases to a maximum of 3 percent if the Company acquires a 90 percent or more interest in Huaron. Included in liabilities of Huaron at the date of acquisition was a liability of $3,174,000 payable to the former majority shareholders of Huaron. This liability was discharged from the proceeds of sale of certain Huaron assets for $1,980,000 and corporate funds of $1,194,000. Between March 6 and October 20, 2000, the Company increased its ownership in Huaron to 72.64 percent by purchasing shares from minority shareholders for $65,000. The acquisition was accounted for by the purchase method and the accounts of Huaron have been consolidated from March 6, 2000. The fair value of assets and liabilities acquired and the consideration paid are summarized as follows: Current assets $ 1,297 Property, plant and equipment 12,968 ---------

14,265 Less: Current liabilities (3,649) Long-term liabilities (1,551) Severance indemnity (1,000) --------- Consideration, including cash of $65,000 $ 8,065 ========= On August 2, 2001, the Company increased its ownership of Huaron to 99.85 percent when the Company sold certain parcels of Huaron land to Volcan Compania Minera S.A. ("Volcan") in exchange for Volcan's 27.21 percent interest in Huaron, which was valued at $2,968,000. The Company also received $200,000 in cash, 1,800,000 Volcan "B" shares valued at $500,000 and other benefits as consideration for the sale of Huaron land and recorded a $3,500,000 gain (Note 13) as a result of this transaction. 4. INVENTORIES Inventories consist of: 2002 2001 ------- ------- Concentrate inventory $ 3,128 $ 2,115 Direct smelting ore 4,753 - Materials and supplies 1,059 2,540 ------- ------- 8,940 4,655 Long-term portion of direct smelting ore (4,303) - ------- ------- $ 4,637 $ 4,655 ======= ======= Under an agreement entered into on November 8, 2002 with Volcan, the Company acquired the right to mine and sell 600,000 tonnes of silver-bearing ore stockpiles to a nearby smelter. The consideration paid was 636,942 common shares of the Company with a value of $4,000,000, the return to Volcan of 1,800,000 Volcan "B" shares, carried on the Company's books at $500,000 and a one-third production bonus after the Company recovers $4,500,000, operating costs, deemed taxes and interest on the acquisition cost. In addition, the Company guaranteed that Volcan would receive a minimum $4,000,000 from the sale of the Company's common shares. Pursuant to this guarantee the Company made a $317,000 cash payment to Volcan. Under a second agreement with Volcan, the Company has the option to acquire a 60 percent interest in certain silver-bearing stockpiles by spending $2,000,000 over a three-year period ending November 8, 2005. In the twelve-months following this three-year period, the Company may increase its interest to 100 percent by paying Volcan $3,000,000 and granting Volcan a 7 percent royalty on commercial production from the stockpiles. The Company wrote-down the $1,807,000 carrying value of Quiruvilca's materials and supplies inventory in 2002. Notes to Consolidated Financial Statements, continued 5. MINERAL PROPERTY, PLANT AND EQUIPMENT Mineral property, plant and equipment consist of: LA COLORADA QUIRUVILCA HUARON OTHER 2002 2001 ---------- ---------- -------- ------ -------- --------- Mineral Property $ 4,153 $ - $ 1 $ - $ 4,154 $ 1,250 Plant and equipment 2,257 13,356 20,799 - 36,412 35,694 Mine development 26,757 9,817 14,500 - 51,074 43,001 Other - - - 527 527 1,108 ------- -------- -------- ------ -------- --------- $33,167 $23,173 $ 35,300 $527 $ 92,167 $ 81,053 ------- -------- -------- ------ -------- --------- Accumulated amortization and write downs (645) (23,173) (8,481) (421) (32,720) (14,394) ------- -------- -------- ------ -------- --------- $32,522 $ - $ 26,819 $ 106 $ 59,447 $ 66,659 ======= ======== ======== ====== ======== ========= Mineral property, plant and equipment is amortized using the straight-line method over the lesser of estimated useful life ranging from five to twenty years or estimated ore reserves. Mine development is amortized over estimated ore reserves. Until May 2001, mine development costs at the Huaron mine were capitalized as part of mineral properties. These costs were transferred to property, plant and equipment when commercial production began in May 2001. On May 23, 2002, the Company acquired a 5 percent net smelter return royalty over the La Colorada mine. The purchase price was 390,117 common shares of the Company valued at $3,000,000. In September 2002, the Company wrote down its investment in the Quiruvilca mine by $15,129,000. This decision was reached after an evaluation of the likelihood of recovering the carrying value of Quiruvilca in light of the mine's recent and expected operating and financial performance. The amount of the write down as at December 31, 2002 was $27,218,000, which includes a $10,000,000 provision for future reclamation, a $1,807,000 write down of the mine's materials and supplies inventory and $282,000 of capital asset expenditures that were expensed subsequent to September 30, 2002. As at December 31, 2002, the balance of Quiruvilca's future reclamation costs account was $12,467,000. The Company will continue to operate the mine and all spending at the Quiruvilca mine will be expensed as incurred. During the third quarter of 2002, the Company commenced a $20,000,000 expansion program at the La Colorada mine in Mexico. As at December 31, 2002, the Company had spent $7,143,000 on the project expansion, incurred $1,261,000 in deferred pre-operating costs and incurred $1,680,000 in additional commitments. Mine development costs will be transferred to mineral property, plant and equipment once commercial production begins. 6. INVESTMENT AND OTHER PROPERTIES Investment properties and other consist of: 2002 2001 ------- ------- Investment properties Waterloo, USA. $ 1,000 $ 1,000 Tres Cruces and others 785 785 ------- ------- 1,785 1,785 ------- ------- Other properties Manantial Espejo, Argentina 2,012 - Other 396 - ------- ------- 2,408 - ------- ------- $ 4,193 $ 1,785 ======= ======= WATERLOO, USA In 1994, the Company acquired a 100 percent interest in the Waterloo silver-barite property located in the Calico Mining District of San Bernardino County, California. MANANTIAL ESPEJO, ARGENTINA On March 4, 2002, the Company acquired a 50 percent interest in the Manantial Espejo property, located in Argentina, from Silver Standard Resources Ltd., which holds the other 50 percent. This interest is held through a 50 percent interest in two Argentina corporations, Minera Triton Argentina S.A. and Compania Minera Altovalle S.A. The purchase price was $662,433 in cash, 231,511 common shares of the Company valued at $1,250,000 and a further cash payment of $100,000 to eliminate a 1.2 percent NSR royalty on the property. All acquisition costs have been capitalized. Exploration costs have been charged to operations. On November 8, 2002, the Company acquired from Barrick Exploraciones Argentine S.A. a 3 percent NSR royalty over the Manantial Espejo property in exchange for certain of Quiruvilca's mineral concessions. These mineral concessions had no carrying value and no value was assigned to the royalty during the exchange. In December 2002, the Company sold 50 percent of this royalty to Silver Standard Resources Ltd. for $300,000 and recorded a gain of $300,000. TRES CRUCES, PERU On May 22, 2002, the Company entered into an agreement granting New Oroperu Resources Inc. ("Oroperu") an option to acquire a 100 percent interest in the Tres Cruces gold property in northern Peru, which is currently held 50 percent by the Company and 50 percent by Oroperu. In consideration for this option, Oroperu issued 500,000 of its common shares to the Company, which were valued at $1,000. In addition, Oroperu is required to issue to the Company an additional 1,000,000 common shares and spend $1,750,000 in exploration expenditures within 42 months. If the option is exercised, Oroperu will issue additional common shares to the Company to give the Company a 20 percent equity interest in Oroperu and the Company will retain a 2 percent net smelter return royalty on production. Oroperu has an option to reduce this royalty to 1.5 percent by paying the Company $500,000 prior to production. Upon exercise of the option, Oroperu is obligated to make annual advance royalty payments of $100,000. Upon a decision to place Tres Cruces into production, Oroperu will pay the Company $1,000,000 and assign to the Company a 30 percent interest in Tres Cruces. SAN VICENTE, BOLIVIA In June 1999, the Company entered into a joint venture agreement, that was amended on January 15, 2001, with COMIBOL, Bolivia's state mining company, to earn a 100% interest in the San Vicente mine and related infrastructure by spending $1,100,000 in exploration expenditures in the first two years of the agreement, which have been spent, and spending, at the Company's option, $1,150,000 in year three, $6,750,000 in years four and five and $11,000,000 in years six and seven of this agreement on exploration and development. Due to market conditions and the uncertainty about whether future exploration and development work would justify continuing the joint venture agreement, the Company wrote-off its $1,142,000 carrying value for San Vicente in December 2000. In October 2001, COMIBOL approved the Company's request for a state of force majeure, which extends the deadline for its annual spending commitments by a maximum of two years or until silver and zinc prices reach $5.00 per ounce and $0.50 per pound, respectively. On December 1, 2001, the Company and COMIBOL entered into a two-year contract to allow EMUSA, a Bolivian company, to extract from the mine, at its cost, up to 200,000 tonnes during the life of the contract. The Company will receive the greater of $13,000 per month, a 4% net smelter return royalty or depending on metal prices, 20% to 30% of net cash flow. During 2002, EMUSA continued with small scale operations, contributing a total of $170,000 in cash to the Company. OTHER During 2000, the Company wrote-off its $37,208,000 carrying value in Dukat silver project and various other mineral properties totaling $1,138,000. During 2002, the Company capitalized $396,000 in merger related costs with Corner Bay Silver Inc. which will be added to the carrying value of the Alamo Dorado property (Note 17d). 7. OTHER ASSETS AND DEFERRED REVENUE Other assets consist of: 2002 2001 ------- ------------ Prepaid taxes $ 3,000 $ - Long-term receivable 1,319 1,929 Reclamation bond 74 74 ------- ------------ $ 4,393 $ 2,003 ======= =========== The Company has $3,970,000 of prepaid value added taxes of which $3,000,000 is non-current. These taxes will be collectible as a portion of future metal sales. Long-term receivable consists of $581,000 remaining on future power credits received as partial consideration from the 1998 sale of an interest in a Peruvian power line, $1,052,000 remaining from the sale of Huaron land in 2001 and $266,000 in various tax and interest payments collectible over a ten-year period. The current portion of this long-term receivable of $580,000 (2001 - $643,000) is reflected in current assets. As at December 31, 2002, the deferred revenue portion of the 1998 transaction is fully amortized. The deferred revenue portion of the 2001 transaction (2002 - $1,053,000; 2001 - $1,183,000), which is subject to increase at the rate of Peruvian inflation, is payable as future power credits over a five-year period at the Huaron mine of which $130,000 (2001 - $223,000) is current and is reflected in current liabilities. 8. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES Accounts payable and accrued liabilities consist of: 2002 2001 -------- ---------- Trade accounts payable $ 13,528 $ 9,408 Payroll and related benefits 1,242 2,034 Sales taxes 237 320 Royalty 111 101 Other 109 420 -------- ---------- $ 15,227 $ 12,283 ======== ========== 9. BANK LOANS AND CAPITAL LEASE Bank loans consist of: 2002 2001 --------- --------- Huaron loan $ 5,146 $ 6,500 Operating loan - 719 --------- --------- 5,146 7,219 Current portion (1,625) (2,209) --------- --------- 3,521 5,010 --------- --------- Capital lease consists of: Capital lease 434 - Current portion (13) - --------- --------- 421 - --------- --------- $ 3,942 $ 5,010 ========= ========= The Huaron loan bears interest at 6 month LIBOR plus 3.00% and is repayable in monthly installments of $135,000 until February 2006. Certain of Huaron's assets have been pledged as security for this loan. Details of principal repayments due are as follows: YEAR AMOUNT DUE ---- ----------- 2003 $ 1,625,000 2004 1,625,000 2005 1,625,000 2006 271,000 The Company assumed an operating loan amounting to $719,100 as part of the acquisition of Compania Minera Huaron S.A. (Note 3). In September 2002, the operating loan was repaid. Notes to Consolidated Financial Statements, continued On June 14, 2002, the Company entered into a $10,000,000 project loan facility (the "Loan") with the International Finance Corporation ("IFC"), the private lending arm of the World Bank, to partially finance a $20,000,000 expansion program at the La Colorada mine in Mexico. The Loan bears interest at 6-month LIBOR plus 3.50% until certain technical and financial tests are achieved and 6-month LIBOR plus 3.25% thereafter and is repayable in semi-annual installments of $1,000,000, commencing November 15, 2004 until May 15, 2009. On March 7, 2003, the Company received the first Loan draw down of $4,000,000. The Company's interest in its wholly-owned subsidiary, Plata Panamericana S.A. de C.V. ("Plata") and substantially all of the assets of Plata have been pledged as security for the Loan. The Company has guaranteed the Loan repayments on behalf of Plata until the expanded La Colorada mine achieves certain production and financial performance targets. In addition to the interest payments on the outstanding balance of the Loan, Plata would be required, in certain circumstances, to make additional payments to IFC. Such payments would be required if the average price of silver for a year exceeded $4.75 per ounce and would be equal to 20 percent of the positive difference between the average price per ounce of silver for a year and $4.75 multiplied by the number of ounces of silver produced by the La Colorada mine divided by $10,000,000 and multiplied by the greater of the Loan balance at the end of the year or the originally scheduled Loan balance at the end of a year. The Company entered into a capital lease for the purchase of mining equipment for the La Colorada project. The capital lease bears interest at 6 percent per annum, payable in semi-annual payments over 5 years with the following repayment terms: YEAR AMOUNT DUE ---- ---------- 2003 $ 13,500 2004 14,300 2005 127,500 2006 135,200 2007 143,500 10. SHARE CAPITAL A) Transactions concerning stock options and share purchase warrants are summarized as follows: INCENTIVE SHARE PURCHASE STOCK OPTION PLAN WARRANTS ------------------------------ --------------------------- TOTAL SHARES PRICE SHARES PRICE SHARES ---------- ----------- --------- ----- ---------- Outstanding, December 31, 1999 2,375,300 2,487,110 4,862,410 Year ended December 31, 2000 Granted 1,552,500 $3.33-$4.00 100,000 $5.00 1,652,500 Expired (855,500) $6.17 - - (855,500) Cancelled (440,000) $6.17-$10.07 - - (440,000) ---------- ----------- --------- ----- ---------- Outstanding, December 31, 2000 2,632,300 $4.72 2,587,110 $5.37 5,219,410 Year ended December 31, 2001 Granted 790,000 $3.14 32,250 $3.00 822,250 Exercised (247,000) $3.14 - - (247,000) Expired - (1,950,000) $5.65 (1,950,000) Cancelled (130,000) $3.14-$5.81 - - (130,000) ---------- ----------- --------- ----- ---------- Outstanding, December 31, 2001 3,045,300 $4.27 669,360 $3.26 3,714,660 Year ended December 31, 2002 Granted 103,360 $5.39-$6.12 - - 103,360 Exercised (1,445,400) $3.17-$7.70 (32,250) $3.00 (1,477,650) Expired (522,900) $5.86 - - (522,900) Cancelled (15,000) $3.17 - - (15,000) ---------- ----------- --------- ----- ---------- Outstanding, December 31, 2002 1,165,360 $3.89 637,110 $3.26 1,802,470 ========== ========== ========= ===== ========== The Company has reserved 3,060,878 common shares available for the future grant of stock options. The following table summarizes information concerning stock options outstanding as at December 31, 2002: OPTIONS OUTSTANDING OPTIONS EXERCISABLE --- --------------------------- WEIGHTED NUMBER AVERAGE NUMBER OUTSTANDING REMAINING WEIGHTED EXERCISABLE WEIGHTED AS AT CONTRACTUAL AVERAGE AS AT AVERAGE RANGE OF YEAR OF DECEMBER LIFE EXERCISE DECEMBER EXERCISE EXERCISE PRICES EXPIRY 31, 2002 (MONTHS) PRICE 31, 2002 PRICE --------------------- ----------- ----------- --------- ----------- -------- $5.86 2004 100,000 18.66 5.86 100,000 5.86 $3.17-$5.86 2005 114,800 32.94 5.62 114,800 5.62 $3.17 2006 350,300 40.53 3.14 350,300 3.14 $5.39-$6.34 2007 103,360 58.53 5.98 103,360 6.34 $3.17 2010 496,900 94.45 3.17 496,900 3.17 --------- ----- ----- -------- ----- 1,165,360 60.92 $4.68 1,165,360 $4.68 ========= ===== ===== ========= ===== During the twelve month period ended December 31, 2002 the Company granted 103,360 (2001 - 790,000; 2000 - 1,552,500) options to purchase the Company's common shares at exercise prices equal to the quoted market value of the common shares on the dates that the options were granted. Consequently, under the intrinsic value method no compensation expense for the grant of such options has been recognized. The following pro forma financial information presents the net loss for the year and the basic loss per common share had the Company adopted the fair value method of accounting for stock options as set out in

CICA Handbook Section 3870, Stock-Based Compensation and Other Stock-Based Payments. 2002 2001 2000 -------- ------- -------- Net loss for the year $(33,658) $(8,077) $(45,878) Stock-based compensation costs (319) (1,369) (1,605) -------- ------- -------- Pro forma net loss $(33,977) $(9,446) $(47,483) -------- ------- -------- Pro forma basic loss per share ($0.81) ($0.26) ($1.40) -------- ------- -------- Using the fair value based method for stock-based compensation, additional costs of approximately $319,000, $1,369,000 and $1,605,000 would have been recorded for the years ended December 31, 2002, 2001 and 2000, respectively. These amounts were determined using an option pricing model assuming no dividends were paid, a weighted average volatility of the Company's share price of 67.5% (2001 - 45.98% and 2000 - 46.26%), weighted average annual risk free rate of 4.16% (2001 - 4.93% and 2000 - 5.71%) and resulted in a weighted average option price of $4.75 per share (2001 - $1.36 and 2000 - $1.63). B) During the year ended December 31, 2002, the Company: i) issued 3,450,000 common shares at $4.80 per share in a public offering, for net proceeds of $15,599,000 after fees. ii) issued 231,511 common shares at a value of $1,250,000 and made a cash payment of $762,443 to purchase a 50 percent interest in and to eliminate a 1.2 percent NSR royalty over the Manantial Espejo project, in Argentina. iii) issued 390,117 common shares at a value of $3,000,000 to purchase the existing 5 percent net smelter return royalty over the La Colorada silver mine in Mexico. iv) issued 636,942 common shares at a value of $4,000,000 for the purchase of the right to mine and sell 600,000 tonnes of silver-bearing ore stockpile from Volcan. v) Issued 69,000 common shares at a value of $253,000 for compensation. C) During the year ended December 31, 2001, the Company issued 3,000,000 common shares at $3.00 per share for net proceeds of $8,632,000 after fees. In addition, the Company granted 32,250 share purchase warrants, exercisable at $3.00 per share that had a fair value of $27,000 which forms a part of shareholders' equity. All of the share purchase warrants were exercised in 2002. 11. FINANCIAL INSTRUMENTS FAIR VALUE The Company's financial instruments include cash and cash equivalents, short-term investments, accounts receivable, an operating line of credit, accounts payable and accrued liabilities, a capital lease and advances for metal shipments. The carrying value of these instruments approximates their fair value due to their immediate or short-term maturity. Financial instruments also include a bank loan with a remaining maturity of 37 months and an interest rate of 6-month LIBOR plus 3%. Management considers that no events have occurred subsequent to the arrangement of this loan that would indicate that its fair value differs substantially from its carrying value. CONCENTRATION OF CREDIT RISK In 2002, the Company's five customers (2001 - five customers and 2000 - two customers) accounted for 100 percent of metal sales revenue. The loss of any of these customers or curtailment of purchases by such customers could have a material adverse affect on the Company's results of operations and financial condition. DERIVATIVES The Company sells metal under long-term contracts. Generally, the price received for such sales is the average metal price for a month Notes to Consolidated Financial Statements, continued that is one month before shipment or two months after the month in which the metal arrives at its destination. In order to establish the price received for portions of its production, the Company occasionally sells metal forward at a fixed price. During 2002, the Company sold 500 tonnes of copper at an average price of $1,525 per tonne, sold 1,500,000 ounces of silver at $4.50 per ounce and sold 11,000 tonnes of zinc at an average price of $843.25 per tonne. The copper sales settled between January and February 2002 for realized incremental revenue of $18,000. The silver sales settled in January 2002 and incremental revenue of $210,000 was recognized between February and July 2002. The zinc sales settled between February and December of 2002 for realized incremental revenue of $732,000. 12. A) CHANGES IN OPERATING CASH FLOWS USING THE INDIRECT METHOD The consolidated statements of cash flows reports the flow of cash provided by or consumed by the Company's operating, financing and investing activities. The following presents a reconciliation between cash provided by or consumed by operating activities and net loss for the year in order to identify differences between them. 2002 2001 2000 --------- -------- --------- Net loss for the year $ (33,658) $ (8,077) $ (45,878) Items not involving cash: Depreciation and amortization 4,872 4,312 2,509 Write down of mineral properties and reclamation (Note 5) 27,218 - 42,747 Gain on sale of land - (3,500) - Compensation expense - 253 - Operating cost provisions (366) 559 256 ------- -------- --------- Reclamation 860 620 461 (1,074) (5,833) 95 Changes in non-cash operating working capital Accounts receivable 2,041 (2,601) 218 Inventories (1,590) (242) 457 Prepaid expenses 1,038 (3,359) (99) Accounts payable and accrued liabilities 1,352 5,665 215 Advance payment for metals shipments (1,913) 4,071 - Current portion of deferred revenue (513) - - Severance indemnity (83) 213 (271) ------- -------- --------- 332 3,747 520 ------- -------- --------- Cash provided by (used in) operations $ (742) $(2,086) $ 615 ------- -------- --------- B) RECONCILIATION OF CHANGES IN NON-CASH OPERATING WORKING CAPITAL ITEMS SOURCES (USES) OF CASH ----------------------------- 2002 2001 2000 ------ -------- -------- Increases (decreases) in non-cash current assets $ 487 $(6,188) $ (901) Increases (decreases) in current liabilities (913) 3,324 7,200 ------ -------- -------- Changes in non-cash working capital (426) (2,864) 6,299 Less non-operating working capital items: Short-term investments reflected in investing activities - 467 30 Short-term investments reflected in other assets (500) - - Mineral property expenditures reflected in accounts receivable - 191 (879) Development expenditures reflected in accounts receivable 602 223 18 Development expenditures reflected in inventories 197 - 561 Mineral property expenditures reflected in prepaid expenses - - (27) Development expenditures reflected in prepaid expenses 701 291 1,774 Development expenditures reflected in accounts payable (1,590) (163) 768 Bank loans (repayments) reflected in financing activities 1,835 5,067 (7,276) Operating costs reflected in non-current liabilities (487) 535 (748) ------ -------- -------- Changes in non-cash operating working capital $ 332 $ 3,747 $ 520 ====== ======== ======== C) SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES 2002 2001 2000 ------- ------ ------ Shares issued for purchase of direct smelting ore stockpile (Note 4) $ 4,000 $ - $ - Shares issued for purchase of royalty (Note 10b(iii)) 3,000 - 507 Shares issued for acquisition of subsidiary (Note 3) - - 7,015 Shares issued for resource property (Notes 6 and 10b(ii)) 1,250 - - Shares issued for compensation payable 253 - - Warrants granted for purchase of royalty - - 69 Exchange of marketable securities for ore stockpiles (Note 4) 500 - - Shares received in exchange for Tres Cruces option agreement (Note 6) 1 - - Warrants granted pursuant to equity financing - 27 - Equity interest in subsidiary acquired through sale of land - 2,800 - Shares acquired through sale of land - 500 - Stock options granted on acquisition of subsidiary (Note 3) - - 985 -------- ------- ------- 13. SEGMENTED INFORMATION The Company operates in one industry, has three reporting segments and has activities in six countries. Segmented disclosures and enterprise-wide information are as follows: MINING & 2002 DEVELOPMENT CORPORATE EXPLORATION TOTAL ------------ --------- ---------- -------- Revenue from external customers $ 44,132 $ 961 $ - $ 45,093 Write off of mineral properties and reclamation (27,218) - - (27,218) Interest income 25 240 4 269 Interest expense (988) - - (988) Other income 789 24 170 983 Exploration (163) - (1,043) (1,206) Depreciation and amortization (4,852) (20) - (4,872) Net income (loss) (30,331) (2,569) (758) (33,658) -------- -------- ------- -------- Capital asset expenditures 9,759 21 1,158 10,938 Segment assets $ 78,661 $ 11,757 $ 4,548 $ 94,966 ======== ======== ======= ======== MINING & 2001 DEVELOPMENT CORPORATE EXPLORATION TOTAL ------------ --------- ---------- -------- Revenue from external customers $ 37,256 $ 40 $ - $ 37,296 Gain on sale of land 3,500 - - 3,500 Interest income 104 126 6 236 Interest expense (783) - - (783) Other income 204 23 - 227 Exploration (15) - (877) (892) Depreciation and amortization (4,257) (47) (8) (4,312) Net income (loss) (5,952) (1,796) (329) (8,077) -------- ------ ------- --------- Capital asset expenditures 6,704 3 - 6,707 Segment assets $ 86,424 3,784 $ 1,309 $ 91,517 ======== ====== ======= ========= MINING & 2000 DEVELOPMENT CORPORATE EXPLORATION TOTAL ------------ --------- ---------- -------- Revenue from external customers $ 29,901 $ 30 $ - $ 29,931 Write off of mineral properties - - (42,747) (42,747) Interest income 148 350 143 641 Interest expense (326) - - (326) Other income 116 15 - 131 Exploration - - (800) (800) Depreciation and amortization (2,400) (66) (43) (2,509) Net income (loss) (43) (1,918) (43,917) (45,878) -------- -------- ------- --------- Capital asset expenditures 1,065 4 17,823 18,892 Segment assets $ 33,299 $ 690 $49,098 $ 83,087 ======== ======== ======= ========= Notes to Consolidated Financial Statements, continued REVENUE NET CAPITAL ASSETS ---------------------------- ----------------- 2002 2001 2000 2002 2001 ------- ------- ------- ------- ------- Peru $42,588 $35,108 $29,901 $27,875 $45,527 Canada 960 40 30 20 19 Mexico 1,545 2,148 - 32,524 21,682 United States - - - 1,194 1,194 Argentina - - - 2,012 - Bolivia - - - 15 22 ------- ------- ------- ------- ------- $45,093 $37,296 $29,931 $63,640 $68,444 ======= ======= ======= ======= ======= Other income consists of: 2002 2001 2000 ----- ------ ----- Sale of royalty (Note 6) $ 300 $ - $ - Revenue from third party 170 - - Power credits (Note 7) 326 505 483 Other revenue and expenses, net 187 (278) (352) ----- ------ ----- $ 983 $ 227 $ 131 ===== ====== ===== 14. SEVERANCE INDEMNITIES AND COMMITMENTS Severance indemnities and commitments consist of: 2002 2001 ------- ------- Severance indemnity $ 1,435 $ 1,626 Employee benefits liability 578 825 Other provisions and non-current liabilities 347 621 ------- ------- 2,360 3,072 Less: current portion of severance indemnity and commitments (953) (547) ------- ------- $ 1,407 $ 2,525 ======= ======= The Company has an obligation to its Peruvian employees for severance indemnities. At December 31, 2002 the current portion of the obligation amounted to $753,000 (2001 - $786,000). On March 6, 2000 the Company acquired a 71.83% interest in Compania Minera Huaron S.A. (Note 3) and assumed a $1,000,000 severance indemnity relating to former employees of Huaron, which will be discharged over an estimated ten-year period. At December 31, 2002, the unpaid obligation amounted to $682,000 (2001 -$840,000) and a portion of this liability amounting to $157,000 is reflected in current liabilities. As at December 31, 2002, the Company had accrued a $578,000 (2001 - $825,000) liability for unpaid 1997 to 2000 hospital taxes. The amount outstanding accrues interest at 6% per annum and is to be repaid over a ten-year period ending in 2012. A portion of this liability amounting to $58,000 is reflected in current liabilities. As at December 31, 2002, the Company has provisions and other noncurrent liabilities totaling $347,000 (2001 - $621,000). 15. INCOME TAXES The recovery of income taxes reported differs from the amounts computed by applying the aggregate Canadian federal and provincial income tax rates to the loss before tax provision due to the following: 2002 2001 2000 -------- ------- -------- Statutory tax rate 39.6% 43.5% 45% Recovery of income taxes computed at statutory rates $ 13,328 $ 3,403 $ 20,645 Effect of write down of mineral property not recognized in the period (2,957) - - Effect of lower tax rates in foreign jurisdictions (4,818) (801) (14,652) Tax benefit of losses not recognized in the period that the loss arose (5,553) (2,602) (5,993) -------- ------- -------- $ - $ - $ - ======== ======= ======== The tax effect of each type of temporary difference that gives rise to the Company's future net tax assets have been determined and are set out in the following table. Until the Company can predict the timing of the realization of such potential tax assets they are not reflected in the accounts. Net Future Income Tax Assets 2002 2001 --------- --------- Excess of tax value of capital assets over book value $ 7,460 $ 4,105 Canadian resource pools 2,830 3,109 Excess tax value of mineral property over book value 1,614 1,614 Operating loss carry-forwards 20,174 18,946 --------- --------- 32,078 27,774 Less: valuation allowance (23,327) (16,330) --------- --------- Net future income tax assets 8,751 11,444 Future income tax liability - - Excess of book value of capital assets over tax value (8,751) (11,444) --------- --------- Net future income tax $ - $ - ========= ========= At December 31, 2002 the Company had the following loss carry forwards available for tax purposes: AMOUNT EXPIRY ----------- ---------- Canada $ 6,401,000 2005-2009 Peru 18,330,000 2004-2005 Peru 13,236,000 Indefinite Mexico 21,409,000 2007-2012 Bolivia 2,253,000 Indefinite ----------- ---------- Peruvian tax losses incurred after 2001 can be carried forward indefinitely and expire four years after the first utilization of such losses. The Company has tax loss carry-forwards in Russia and Cyprus that are unlikely to be utilized. 16. DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES These financial statements are prepared in accordance with accounting principles generally accepted in Canada ("Canadian GAAP"). The differences between Canadian GAAP and accounting principles generally accepted in the United States ("US GAAP") as they relate to these financial statements are summarized below. A) EXPLORATION EXPENDITURES Under US GAAP, exploration costs are expensed until a commercial body of ore has been established. Under Canadian GAAP, these costs may be deferred until there is evidence of impairment. In addition to the effect on operations, reported total assets under US GAAP would be lower by $1,993,000 at December 31, 2002 and 2001, respectively, and the reported deficit would increase by a corresponding amount. Under US GAAP, exploration expenditures would be classified as an operating activity rather than an investing activity within the statement of cash flows. 2002 2001 2000 --------- -------- --------- Consolidated Statements of Operations Net loss for the year under Canadian GAAP $ (33,658) $ (8,077) $ (45,878) Deferred exploration, previously written-off - - 378 Deferred exploration - (24) (2,347) --------- -------- --------- Net loss under US GAAP $ (33,658) $ (8,101) (47,847) --------- -------- --------- Basic loss per share under US GAAP ($0.81) ($0.22) ($1.41) --------- -------- --------- B) STOCK BASED COMPENSATION For US GAAP purposes the Company accounts for stock-based compensation to employees and directors, under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ("APB 25"), using the intrinsic value based method whereby compensation cost is recorded for the excess, if any, of the quoted market price over the exercise price, at the date the stock options are granted. As at December 31, 2002, no compensation cost would have been recorded for any period under this method. Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ("SFAS 123"), issued in October 1995, requires the use of the fair value based method of accounting for stock options. Under this method, compensation cost is measured at the grant date based on the fair value of the options granted and is recognized over the exercise period. SFAS 123, however, allows the Company to continue to measure the compensation cost of employees and directors in accordance with APB 25. The Company has adopted the disclosure-only provision of SFAS 123. The following pro forma financial information presents the net loss for the year and the basic loss per common share had the Company adopted SFAS 123 for all stock options issued to employees and directors. 2002 2001 2000 --------- -------- --------- Net loss for the year under US GAAP $ (33,658) $ (8,101) $ (47,847) Stock-based compensation costs (319) (1,369) (1,605) --------- -------- --------- Pro forma net loss for the year under US GAAP $ (33,977) $ (9,470) $ (49,452) --------- -------- --------- Pro forma basic loss per share ($0.81) ($0.26) ($1.45) ========= ======== ========= C) COMPREHENSIVE INCOME The Financial Accounting Standards Board ("FASB") issued SFAS No. 130, Reporting Comprehensive Income, which was required to be adopted beginning on January 1, 1998. SFAS 130 establishes standards for the reporting and display of comprehensive income and its components. The impact of adopting SFAS 130 on the Company's financial statements is as follows: 2002 2001 2000 --------- -------- --------- Net loss under US GAAP $ (33,658) $ (8,101) $ (47,847) Other comprehensive income: Foreign exchange adjustment (28) (38) (38) --------- -------- --------- Comprehensive net loss under US GAAP $ (33,686) $ (8,139) $ (47,885) ========= ======== ========= D) DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES The FASB issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, which standardizes the accounting for derivative instruments. This standard was adopted during the year ended December 31, 1999. The Company has assessed its business activities and has determined that application of the requirements of SFAS 133 had no significant impact on the Company's consolidated financial position or results of operations. E) MARKETABLE SECURITIES Marketable securities are carried at the lower of cost and market value under Canadian GAAP. Under SFAS No. 115, portfolio investments classified as available-for-sale securities are recorded at market value. The resulting gains or losses are included in the determination of comprehensive income. This GAAP difference has no impact on these financial statements F) INCOME TAXES Under Canadian GAAP, future income taxes are calculated based on enacted or substantially enacted tax rates applicable to future years. Under US GAAP, only enacted rates are used in the calculation of future income taxes. This GAAP difference did not result in a difference in the financial position, results of operations or cash flows of the Company for the years ended December 31, 2002 and 2001. Notes to Consolidated Financial Statements, continued G) SHARE PURCHASE WARRANTS The Company, from time to time, issues special warrants which are normally comprised of a common share and either a whole or portion of a share purchase warrant. The special warrant is issued at the current market value of the common share and the share purchase warrant is normally exercised at or higher than market value. Under Canadian GAAP, the proceeds of the special warrant are allocated to the common share with no value being assigned to the share purchase warrant. Under US GAAP, the gross proceeds would be allocated between the shares and warrants based on the relative fair value of the special warrant components at the date the Company has a contractual liability to issue the special warrants. H) FINANCIAL STATEMENT PRESENTATION For US GAAP purposes, certain items such as other income and expenses and interest income would be excluded from the calculation of "Loss from Operations". I) CONTROLLED ENTITIES The Company owns a 50 percent interest in two Argentinean corporations (Note 6). Under US GAAP such ventures are accounted for under the equity method as it is considered that the Company cannot exercise sufficient control to warrant consolidation. Under Canadian GAAP, it is considered that the rights of the minority do not impair the Company's right to control and direct the operations and therefore the Company has consolidated, on a proportionate basis, the results of operations and financial position. The effect of this difference would be to reduce Investment and Other Properties and to increase Other Assets by $2,012,000. J) RECENT ACCOUNTING PRONOUNCEMENTS In July 2001, the FASB issued SFAS Nos. 141 and 142 ("SFAS 141" and "SFAS 142"), "Business Combinations" and "Goodwill and Other Intangible Assets." SFAS 141 replaces APB 16 and eliminates pooling-of-interests accounting prospectively. It also provides guidance on purchase accounting related to the recognition of intangible assets and accounting for negative goodwill. SFAS 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. Under SFAS 142, goodwill will be tested annually and whenever events or circumstances occur indicating that goodwill might be impaired. SFAS 141 and SFAS 142 are effective for all business combinations completed after June 30, 2001. Upon adoption of SFAS 142, amortization of goodwill recorded for business combinations consummated prior to July 1, 2001 will cease, and intangible assets acquired prior to July 1, 2001 that do not meet the criteria for recognition under SFAS 141 will be reclassified to goodwill. Companies are required to adopt SFAS 142 for financial years beginning after December 15, 2001, but early adoption is permitted. The Company is required to adopt SFAS 141 and 142 on a prospective basis as of January 1, 2002. The Company has not recorded any goodwill and, therefore, the application of SFAS 141 and 142 did not have a material affect on its consolidated financial position or results of operations. In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"), which addresses financial accounting and reporting for obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and (or) the normal operation of long-lived assets, except for certain obligations of leases. SFAS 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded an entity capitalizes the cost by increasing the carrying amount of the related long-lived assets. Over time the liability is accreted to its present value each period, and the capitalized cost is amortized over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. SFAS 143 is effective for financial statements issued for financial years beginning after June 15, 2002 with earlier application encouraged. The Company is currently evaluating the effects of SFAS 143; however, it does expect that the adoption will not have a material impact on the Company's results of operations or shareholders' equity. In August 2001, the FASB issued SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 replaces SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." The FASB issued SFAS 144 to establish a single accounting model, based on the framework established in SFAS 121, as SFAS 121 did not address the accounting for a segment of a business accounted for as a discontinued operation under APB 30, "Reporting The Results of Operations - Reporting The Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." SFAS 144 also resolves significant implementation issues related to SFAS 121. Companies are required to adopt SFAS 144 for fiscal years beginning after December 15, 2001, but early adoption is permitted. The Company has adopted SFAS 144 as of January 1, 2002. The Company has determined that the application of SFAS 144 did not have a material affect on its consolidated financial position or results of operations. In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statement No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections". Among other things, SFAS No. 145 rescinds both SFAS No. 4, "Reporting Gains and Losses from Extinguishment of Debt", and the amendment to SFAS No. 4, SFAS No. 64, "Extinguishment of Debt Made to Satisfy Sinking Fund Requirements". Through this rescission, SFAS No. 145 eliminates the requirement (in both SFAS No. 4 and SFAS No. 64) that gains and losses from the extinguishment of debt be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect. Generally, SFAS No. 145 is effective for transactions occurring after May 15, 2002. The application of SFAS No. 145 did not have a material effect on the Company's results of operations or its financial position. In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal of Activities". SFAS No. 146 requires that the liability for a cost associated with an exit or disposal activity be recognized at its fair value when the liability is incurred. Under previous guidance, a liability for certain exit costs was recognized at the date that management committed to an exit plan, which was generally before the actual liability had been occurred. As SFAS No. 146 is effective only for exit or disposal activities initiated after December 31, 2002, the Company does not expect the adoption of this statement to have a material impact on the Company's financial statements. In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation" Transition and Disclosure. SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation", to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based compensation. It also amends the disclosure provisions of that statement. The disclosure provisions of this statement are effective for financial statements issued for fiscal periods beginning after December 15, 2002. The Company does not currently have plans to change to the fair value method of accounting for its stock-based compensation. In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantee, Including Indirect Guarantees of Indebtedness of Others," ("FIN 45"). FIN 45 requires that upon issuance of a guarantee, a guarantor must recognize a liability for the fair value of an obligation assumed under a guarantee. FIN 45 also requires additional disclosures by a guarantor in its interim and annual financial statements about the obligations associated with guarantees issued. The recognition provisions of FIN 45 will be effective for any guarantees that are issued or modified after December 31, 2002. The Company does not expect that the adoption will have a material impact on the Company's results of operations or financial position. 17. SUBSEQUENT EVENTS A) On January 22, 2003, the Company sold 3,600 tonnes of zinc at an average price of $829 per tonne. These sales were designated as a hedge and represent sales of 300 tonnes per month for each of the months of March 2003 through and including February 2004. The difference between the average monthly London zinc cash settlement price and the forward sales price will be credited or charged to revenue during the March 2003 through February 2004 period. B) Issued 30,000 common shares for proceeds of $97,250 pursuant to the exercise of employee stock options. C) The Company sold forward 1,750 tonnes of copper at $1,751 per tonne and designated the sale as a hedge of a portion of the Company's copper production for the period March 2003 through December 2003. On February 7, 2003, the Company closed out the copper forward sales and realized incremental revenue of $98,000. This revenue will be recognized evenly over the March through December 2003 period. D) On February 20, 2003, the Company acquired a 100 percent interest in Corner Bay Silver Inc. ("Corner Bay"). The consideration paid to the shareholders of Corner Bay was 7,636,659 common shares of the Company (a "Pan American share"), representing 0.3846 of a share of the Company for each share of Corner Bay and 3,818,329 warrants (the "Pan American warrant") to purchase common shares of the Company, representing 0.1923 of a warrant for each share of Corner Bay. The common shares issued were valued at $54,203,000, which was derived from an issue price of Cdn$11.30 translated at $0.6595 for each U.S. dollar, less a deemed 5% issue expense of $2,707,000. The share purchase warrants were assigned a value of $8,889,000, which was derived from a warrant valued at $2.328 per warrant. The warrants were valued using an option pricing model assuming a weighted average volatility of the Company's share price of 35 percent and a weighted average annual risk free rate of 4.16 percent. The value of the common shares issued by the Company was estimated based on the average closing price of the Company's common shares for the period before and after the date that the terms of the transaction was agreed and announced. Each whole Pan American warrant allows the holder to purchase a Pan American share for a price of Cdn$12.00 for a five-year period ending February 20, 2008. In addition, the Company agreed to grant 553,846 stock options to purchase Pan American shares. These options replace 960,000 fully vested stock options held by employees and shareholders of Corner Bay. The value of the stock options granted was determined to be $1,136,000. The options granted have a weighted average exercise price of Cdn$8.46 and a weighted average remaining life of 26 months. The purchase method of accounting will be applied to account for this acquisition, which results in the allocation of the consideration paid to the fair value of the assets acquired and the liabilities assumed, as follows: AS AT DECEMBER 31 2002 ------------ Fair value of net assets acquired Current assets $ 3,168 Mineral properties 81,455 Other assets 19 ------------ 84,642 Less: Current liabilities (859) Provision for future income tax liability (19,035) ------------ $ 64,748 ============ Consideration paid: Issue of 7,636,659 common shares $ 54,203 Issue of 3,818,329 share purchase warrants 8,889 Issue of 553,846 replacement stock options 1,136 ------------ 64,228 Add: Estimated costs of acquisition 520 ------------ $ 64,748 ============ The purchase consideration of $64,748,000 for 100 percent of Corner Bay exceeds the carrying value of the net assets acquired by $54,385,000, which has been applied to increase the carrying value of mineral properties. The resulting estimated future income tax liability of $19,035,000 has also been applied to increase the carrying value of mineral properties. The most recent financial statements available for Corner Bay are as at December 31, 2002. Consequently this purchase price allocation is provisional and may be changed. DOCUMENT NO. 3 Management's Discussion and Analysis of Financial Condition and Results of Operations INTRODUCTION Pan American Silver Corp. together with its subsidiaries ("Pan American" or the "Company") is a silver mining company that operates three mines - the Huaron mine in central Peru, the Quiruvilca mine in northern Peru and the La Colorada mine in central Mexico. The Company also mines and sells silver-bearing ore from surface stockpiles in central Peru. An unrelated Bolivian mining company operates the Company's San Vicente mine, in Bolivia. Pan American receives a royalty based on minerals extracted at San Vicente. The Company holds a carried 20 per cent interest in a Russian company that owns the Dukat silver project, a 50 percent interest in the Manantial Espejo exploration project in Argentina and various interests in inactive silver investment properties in the Americas. This discussion and analysis focuses on significant factors that affected the Company's performance and such factors that may affect its future performance. It should be read in conjunction with the rest of this Annual Report and especially in conjunction with the audited consolidated financial statements contained herein. Pan American's reporting currency is the United States dollar and all amounts in this discussion and in the consolidated financial statements are expressed in United States dollars, unless identified otherwise. The Company reports its financial position, results of operations and cash flows in accordance with Canadian generally accepted accounting principles. Pan American's significant accounting policies are set out in Note 2 of the audited consolidated financial statements included in pages 44 and 45 of this Annual Report. Differences between Canadian and United States generally accepted accounting principles ("US GAAP") that would affect the Company's reported financial results under US GAAP are set out in Note 16 on pages 53 to 55 of this Annual Report. RISKS, UNCERTAINTIES AND CAUTION REGARDING FORWARD-LOOKING STATEMENTS EXCEPT FOR HISTORICAL INFORMATION CONTAINED IN THIS DISCUSSION AND ANALYSIS, THE FOLLOWING DISCLOSURES ARE FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 OR ARE FUTURE ORIENTED FINANCIAL INFORMATION AND AS SUCH ARE BASED ON AN ASSUMED SET OF ECONOMIC CONDITIONS AND COURSES OF ACTION. THESE INCLUDE ESTIMATES OF FUTURE PRODUCTION LEVELS, EXPECTATIONS REGARDING MINE PRODUCTION AND CAPITAL COSTS, EXPECTED TRENDS IN MINERAL PRICES AND STATEMENTS THAT DESCRIBE PAN

AMERICAN'S FUTURE PLANS, OBJECTIVES OR GOALS. THERE IS SIGNIFICANT RISK THAT ACTUAL RESULTS WILL VARY, PERHAPS MATERIALLY, FROM RESULTS PROJECTED DEPENDING ON SUCH FACTORS AS CHANGES IN GENERAL ECONOMIC CONDITIONS AND FINANCIAL MARKETS, CHANGES IN PRICES FOR SILVER AND OTHER METALS, TECHNOLOGICAL AND OPERATIONAL HAZARDS IN PAN AMERICAN'S MINING AND MINE DEVELOPMENT ACTIVITIES, UNCERTAINTIES INHERENT IN THE CALCULATION OF MINERAL RESERVES, MINERAL RESOURCES AND METAL RECOVERIES, THE TIMING AND AVAILABILITY OF FINANCING, GOVERNMENTAL OR OTHER APPROVALS, POLITICAL UNREST OR INSTABILITY IN COUNTRIES WHERE PAN AMERICAN IS ACTIVE, LABOUR RELATIONS AND OTHER RISK FACTORS LISTED FROM TIME-TO-TIME IN THE COMPANY'S ANNUAL INFORMATION FORM OR FORM 40-F. 2002 SIGNIFICANT EVENTS AND TRANSACTIONS CORNER BAY SILVER INC. ACQUISITION In September 2002, the Company's shareholders and shareholders of Corner Bay Silver Inc. ("Corner Bay") approved a plan of arrangement whereby Pan American would acquire 100 percent of Corner Bay. The acquisition was completed on February 20, 2003. Corner Bay is a silver exploration company with one significant mineral property (the Alamo Dorado property) and working capital amounting to $2.3 million at December 31, 2002. The Alamo Dorado property is located in the State of Sonora, Mexico. It consists of two concessions covering an area of 5,369 hectares (13,266 acres) that, under Mexican law, are renewable for a fifty-year term. In 2001, AMEC E&C Services, Inc., an independent engineering consulting firm was contracted by Corner Bay to prepare a feasibility study on the Alamo Dorado property. Corner Bay and the Company believe that the feasibility study confirmed that the Alamo Dorado property could support project financing and result in an acceptable rate of return. Pan American paid 7,636,659 common shares of the Company, 3,818,329 warrants (the "Pan American warrants") to purchase common shares of the Company and granted 553,846 options (the "Options") to purchase common shares of the Company in order to acquire 100 percent of Corner Bay. The common shares of the Company were valued at $54.2 million, the Pan American warrants were valued at $8.9 million and the options granted had a value of $1.1 million resulting in a purchase price of $64.2 million. One Pan American warrant allows the holder to purchase one share of the Company for Cdn $12 per share (approximately $7.80 per share) for a five-year period ending February 20, 2008. The Options granted have a weighted average remaining life of 26 months and have a weighted average exercise price of Cdn $8.46 per share (approximately $5.50 per share). LA COLORADA EXPANSION On June 14, 2002, the Company's wholly-owned subsidiary Plata Panamericana S.A. de C.V. ("Plata") entered into a $10 million loan agreement to partially fund an expansion of Plata's La Colorada mine in Mexico. The total cost of the expansion was estimated to be $20 million of which $10 million is to be provided by the loan and $10 million from the Company's treasury. Management's Discussion and Analysis of Financial Condition and Results of Operations, continued The expanded La Colorada mine is expected to produce about 2.3 million ounces of silver in 2003 increasing, in subsequent years, to nearly 4 million ounces per year. Equal $1 million semi-annual repayments of the loan commence on November 15, 2004, with the last scheduled repayment to be made on May 15, 2009. Interest on the loan will be payable at the rate of six-month LIBOR plus 3.5 percent per annum until financial completion and six-month LIBOR plus 3.25 percent subsequent to financial completion. The Company has guaranteed Plata's performance under the loan agreement until financial completion is achieved, which is expected to occur before the first scheduled loan repayment. Pan American's interest in and virtually all of the assets of Plata are pledged as security for the loan. After financial completion the Company's ownership interest in Plata is released from the pledge. In order to avoid hedging a significant portion of La Colorada's future silver production as a condition for obtaining the loan, Plata agreed to provide to the lender a portion of future increases in the price of silver. This portion is calculated as 20 percent of the positive difference between the average price per ounce of silver for a year less $4.75 multiplied by the number of ounces produced by La Colorada in the corresponding year all multiplied by the fraction obtained by dividing the greater of the amount of the loan outstanding at the end of a year or the regularly scheduled amount of the loan outstanding divided by $10 million. In effect, this allows Plata to obtain 80 percent of the benefit when average silver prices exceed $4.75 per ounce. This benefit to Plata increases proportionately as the loan is repaid. SILVER-BEARING STOCKPILES In November 2002 the Company entered into two agreements to acquire certain silver-bearing stockpiles located in central Peru from Volcan Minera S.A. de C.V. ("Volcan"). Under the terms of one agreement the Company paid $4.8 million consisting of 636,942 common shares of the Company, marketable securities valued at $500,000 and cash of $317,000 for the right to mine and sell up to 600,000 tonnes of direct smelter ore. Once the Company has received proceeds from the sale of this ore equal to $4.5 million, associated operating costs, deemed interest on the acquisition cost and deemed taxes arising from the sale of this ore, the Company will grant Volcan a one-third share in any future net cash flow from the sale of such ore. Under the terms of the second agreement, the Company has the option to acquire a 60 percent interest in certain other silver-bearing mineral stockpiles by spending $2 million over a three-year period on testing the feasibility of profitably treating and selling this material. In the subsequent one-year period the Company has the further option of increasing its ownership in these mineralized stockpiles to 100 percent by paying $3 million to Volcan and granting Volcan a 7 percent royalty over commercial production from the stockpiles. QUIRUVILCA MINE WRITE DOWN In the third quarter of 2002, the Company determined that due to the mine's recent past performance and its likely future performance in depressed markets for its principal products, the carrying value of the property, plant and equipment of the Quiruvilca mine was impaired. As a result the carrying value of such assets was written down by $15.1 million. During the fourth quarter of 2002 certain planned mine development activities and equipment purchases amounting to $0.3 million were made at the Quiruvilca mine. These expenditures were expensed. Also in the fourth quarter the $1.8 million carrying value of Quiruvilca's spare parts and supplies inventory was written off, which increased the write down to $17.2 million. In addition, Management prepared an estimate of the expected future reclamation costs to be incurred at the Quiruvilca mine and in the fourth quarter charged operations with a $10 million provision for future reclamation resulting in a total charge to operations of $27.2 million. MANANTIAL ESPEJO In March 2002 Pan American acquired a 50 percent interest in the Manantial Espejo property. The purchase price consisted of $0.7 million in cash, 231,511 common shares of the Company and a $0.1 million cash payment to eliminate a 1.2 percent net smelter return royalty over the property. In November Pan American exchanged certain mineral concessions at its Quiruvilca mine for a 3 percent net smelter return royalty over the Manantial Espejo property and subsequently sold one-half of this royalty to the owner of the other 50 percent interest of Manantial Espejo realizing a gain on sale of $0.3 million. During the year Pan American expended $0.5 million, representing the Company's 50 percent share, on exploration at this project. Results of this exploration were encouraging and plans call for Pan American's share of the spending to be about $0.7 million at the project in 2003 on underground development and exploration. COST PER OUNCE OF SILVER CALCULATIONS Elsewhere in this Annual Report, Pan American reports two performance measures - total cash cost per ounce and total production cost per ounce of silver recovered. These measures are widely reported in the mining industry as benchmarks for performance measurement. There is a general understanding within the industry of how these measures are calculated; however, there are no legal or regulatory definitions for them. For purposes of clarification, the following sets out how the Company calculates its cost per ounce performance measures. For total cash cost per ounce recovered - Costs included in the numerator are the sum of: o Costs to explore for, develop access to and mine ore, o Costs to transport, crush and process ore to concentrate, o Costs to support production activities, such as engineering, geology, health and safety, environmental and maintenance, o Costs to truck, store, weigh, assay and ship metals to the buyer, o Costs of administration, insurance and sales activities, o All other cash expenses and production related taxes or royalties, o Smelter treatment charges and price participation payments, o The value of metals lost in the smelting process, and o Any recurring incidental expenses or income. By-product credits netted against costs include: o The sales value of zinc, lead, copper and gold by-products. Total production cost per ounce of silver recovered includes all of the items in the total cash cost per ounce recovered and the following: o All other taxes o Depreciation and amortization o Reclamation Ounces included in the denominator are ounces of silver recovered. The resulting quotients are the Total Cash Cost per Ounce and the Total Production Cost per Ounce of Silver Recovered. Excluded from these performance measure calculations are unusual, non-recurring items such as the gain recognized on the sale of land in 2001 or the Quiruvilca property write down in 2002. METAL PRICES Pan American derives its revenue from the sale of silver, zinc, lead, copper and gold. Metal prices during 2002 were extremely low. Factors contributing to the low metal prices during 2002 include the general economic slowdown in the OECD countries, geo-political uncertainty, the strong U.S. dollar and a lack of investor interest in base and precious metals investments. The Company anticipates that economic growth will resume during 2003 and that metal prices will improve. The following table sets out the average London cash settlement prices for the metals and the periods indicated as well as the Company's forecast prices for 2003. METAL 2003 EST. 2002 2001 2000 ----- --------- ----- ----- ----- Silver - Oz $4.60 $4.60 $4.40 $4.94 Zinc - lb $0.37 $0.35 $0.40 $0.51 Lead - lb $0.20 $0.21 $0.22 $0.21 Copper - lb $0.72 $0.71 $0.72 $0.82 Metals prices for 2002 and 2001 were volatile. The following table sets out the daily high, low and average London Metal Exchange cash settlement prices for base metals and the London Bullion Dealers' price for silver and the annualized historic volatility of those metal prices. SILVER ZINC LEAD

COPPER OZ LB LB LB ------ ----- ----- ------ 2002 - High $5.10 $0.38 $0.24 $0.77 2002 - Avg $4.60 $0.35 $0.21 $0.71 2002 - Low $4.24 $0.33 $0.18 $0.64 2002 - Range $0.86 $0.05 $0.06 $0.13 Volatility 19.5% 17.3% 20.6% 17.2% ------ ----- ----- ------ 2001 - High $4.80 $0.48 $0.22 $0.83 2001 - Avg $4.40 $0.40 $0.22 $0.72 2001 - Low $4.10 $0.33 $0.20 $0.60 2001 - Range $0.70 $0.15 $0.02 $0.23 Volatility 14.3% 15.3% 23.7% 18.3% ------ ----- ----- ------ METAL PRICE HEDGING AND TRADING Pan American's policy is to not hedge the price of silver. The Company has no hedge position in silver. Occasionally Pan American sells base metals forward. At December 31, 2002, the Company had sold forward 10,150 tonnes of zinc at a weighted average price of $830 per tonne ($0.38 per pound). These sales are a hedge of a portion of the Company's 2003 production and a portion of the production for January and February 2004. In February 2003, the Company sold 1,750 tonnes of copper at $1,751 per tonne ($0.79 per pound) and re-purchased the same tonnage at $1,695 per tonne ($0.77 per pound) for a gain of $98,000. This gain will be recognized evenly over the March through December 2003 period. METALS MARKETING The Company has contracts to sell the zinc, lead and associated silver produced by the Quiruvilca and Huaron mines through to the end of 2006 with an option to extend through 2007. Except for treatment charges, the terms of the contracts are fixed. Treatment charges are adjusted during the contract life to within Management's Discussion and Analysis of Financial Condition and Results of Operations, continued a $5 band of prevailing worldwide treatment charges. Copper and associated silver from Huaron and Quiruvilca are sold under frame contracts extending through 2004 for Quiruvilca and 2005 for Huaron. Under these contracts a portion of each year's and each succeeding years' treatment charges are re-negotiated. La Colorada's lead and zinc concentrates are sold under annual contracts. The Company has never had any delivery or payment disputes with its sales counter-parties and management believes that there are no appreciable delivery or credit risks resulting from its sales contracts. MINING OPERATIONS HUARON MINE Huaron is an underground mine with wide veins and lends itself to mechanized mining methods. Contract miners receive a fee for tonnes mined and for the amount of development work completed under Pan American's supervision. Company employees are responsible for processing, engineering, geology, health and safety, environmental and administrative functions. At December 31, 2002, the Huaron mine employed 119 people and contract workers amounted to 853 people. Third party services (principally mining, equipment maintenance, transportation and power) represent 79 per cent of Huaron's costs. Materials represent 12 per cent and labour accounts for about 9 per cent of costs. Following is a table showing Huaron's 2001's production from May, the 2002 production and the expected 2003 production. 2003 EST. 2002 2001 --------- --------- --------- Tonnes milled 637,932 606,300 367,274 Cost per tonne $37.96 $38.71 $39.73 Silver ounces 4,877,947 4,527,971 2,897,946 Zinc tonnes 20,195 20,896 9,574 Lead tonnes 12,040 14,006 8,445 Copper tonnes 2,701 1,740 959 Tonnes Shipped Zinc concentrate 39,990 43,988 14,237 Lead concentrate 24,252 26,219 14,723 Copper concentrate 10,220 6,249 3,915 The table below sets out how Huaron's net smelter return ("NSR") per tonne of ore varies as ore grades or metal prices change. MINUS 10% 2003 PLAN PLUS 10% --------- --------- -------- Silver value/tonne $ 28.92 $ 32.13 $ 35.34 Zinc $ 6.25 $ 8.44 $ 10.63 Lead $ 2.31 $ 3.11 $ 3.92 Copper $ 1.63 $ 2.23 $ 2.84 ------- ------- ------- NSR per Tonne $ 39.10 $ 45.91 $ 52.73 Pan American forecasts Huaron's 2003 average NSR per tonne at approximately $45.91 and its budgeted average cost per tonne is $37.96, which should generate approximately $5.1 million in operating cash flow. Sustaining capital will be about $1.0 million resulting in a net cash inflow of $4.1 million for the year. In 2002, Management had projected that Huaron's NSR per tonne would be about $43.09 and its cost per tonne milled would be about $38.50 per tonne. For 2002, the mine's NSR per tonne was better than expected at $44.61 while its cost per tonne was slightly higher than expected at $38.71. More underground development work than planned for was carried out in 2002. This additional development work accounted for the marginally higher than planned cost per tonne. The higher than expected NSR is attributable to greater than expected metals production more than offsetting the negative effect of generally lower than anticipated metal prices. DIRECT SMELTING ORE SALES In November 2002 Pan American acquired the right from a Peruvian mining company to mine and sell ore from certain stockpiles. During November and December 2002, the Company sold 9,018 tonnes containing 101,459 ounces of silver that generated nearly $0.2 million in cash. For 2003, the Company expects to sell 45,000 tonnes of this ore containing 535,000 ounces of silver to generate a net cash flow of about $1.4 million. QUIRUVILCA MINE The Quiruvilca mine is an underground narrow vein mine that does not lend itself to modern mechanized mining. Consequently, it is very labour intensive and, at December 31, 2002, employed 495 people and 763 people as contract workers. Third party services (principally transportation, power and contract miners) account for about 52 per cent of Quiruvilca's costs. Labour accounts for 28 per cent and materials (explosives, drill bits and steel, grinding media and reagents) represent about 20 per cent of costs. Following is a table showing Quiruvilca's historic and expected 2003 production. 2003 EST. 2002 2001 2000 1999 ----------- ---------- ----------- ---------- ---------- Tonnes milled 523,374 508,352 568,451 615,382 562,584 Cost per tonne $40.66 $40.01 $43.23 $44.14 $45.34 Silver ounces 2,650,076 2,509,689 3,259,372 3,611,589 3,236,774 Zinc tonnes 18,969 17,852 21,009 24,462 23,340 Lead tonnes 8,251 6,468 8,358 8,740 7,319 Copper tonnes 715 1,107 1,204 1,215 1,098 Tonnes Shipped Zinc concentrate 32,655 27,511 39,475 42,039 41,224 Lead concentrate 14,397 9,901 12,975 14,899 11,265 Copper concentrate 3,361 4,706 5,602 5,970 5,372 Quiruvilca's revenue depends on ore grade, recovery rates and metal prices. Recovery rates are reasonably consistent from year-to-year; however, variations in ore grades and metals prices occur. The table below sets out how Quiruvilca's NSR per tonne of ore milled changes as ore grades or metal prices change. MINUS 10% 2003 PLAN PLUS 10% --------- --------- -------- Silver value/tonne $ 18.28 $ 20.49 $ 22.70 Zinc $ 8.96 $ 11.46 $ 13.97 Lead $ 2.42 $ 3.09 $ 3.77 Copper $ 0.65 $ 0.84 $ 1.04 -------- --------- -------- NSR per Tonne $ 30.30 $ 35.88 $ 41.47 For 2003, Management expects Quiruvilca's average NSR per tonne to be $35.88 and its expected average cost per tonne to be $40.66, which would result in an operating loss of approximately $2.5 million. Sustaining capital will be about $0.4 million resulting in a net cash outflow of about $2.9 million for 2003. In 2002, Management expected that Quiruvilca would realize an average NSR per tonne of $40.27 and that its operating costs would be about $41.67 per tonne milled. The average NSR per tonne realized for the year was $34.39 or nearly $6.00 per tonne less than anticipated. The principal reason for this difference was that metal prices, with the exception of silver, were lower than planned for - zinc was $0.05 per pound lower, copper was $0.04 per pound lower and lead was $0.02 per pound lower. Also contributing to the lower NSR per tonne was the amount of metal produced. The 2002 Quiruvilca mine plan called for an average silver grade of 200 grams per tonne, 4.10% zinc per tonne and 1.65% lead per tonne. The actual tonnes mined averaged 176 grams of silver, 3.95% zinc and 1.44% lead. These differences were primarily responsible for lower than planned silver production of about 645,000 ounces, lower zinc production of approximately 2,700 tonnes and lower lead production of nearly 1,700 tonnes. Quiruvilca's operating cost per tonne was slightly better than planned for, but this better than expected performance was overwhelmed by the lower than expected value of metals produced. LA COLORADA MINE Following is a summary of La Colorada's historic production and its expected 2003 production. 2003 EST 2002 2001 --------- ------- ------- Tonnes milled 163,155 50,662 47,317 Silver ounces 2,267,348 626,035 782,853 Zinc tonnes 518 333 311 Lead tonnes 595 316 384 During 2002 the Company started a $20 million expansion of the La Colorada mine. The expansion is scheduled to be complete early in the third quarter of 2003. Commencing in the third quarter the daily production rate of the mine will be incrementally increased from 200 tonnes per day to 800 tonnes per day. At full production, 600 tonnes of mill throughput will consist of oxide ore that will produce silver dore and 200 tonnes will be sulphide material that will produce lead-silver and zinc concentrates. Management expects that for 2003 La Colorada will generate a NSR per tonne of about $60.52 and have an operating cost per tonne milled of $43.16 resulting in operating cash flow of about $2.8 million. Sustaining capital will be about $0.9 million resulting in net cash flow of $1.9 million. The expansion program is being financed by $10 million from the Company's treasury and from a $10 million project loan entered into by the Company's wholly-owned Mexican subsidiary Plata Panamericana S.A. de C.V. ("Plata"). At this time the expansion program is both on schedule and budget. At December 31, 2002, the Company had expended $8.3 million and had made commitments to spend $1.7 million on the expansion. On March 7, the Company drew down $4 million of the project loan facility. Once the expansion program started and until it is complete the net costs or revenues at La Colorada are being capitalized as part of the cost of the mine expansion. For 2002, $1.2 million in net costs were capitalized as part of the mine expansion and $0.6 million of net costs incurred prior to the expansion start up were charged to operations. LIQUIDITY AND CAPITAL RESOURCES At December 31, 2002, cash and cash equivalents were $10.2 million - a $6.9 million increase from December 31, 2001. This increase was due to cash generated from financing activities of $18.5 million and partially consumed by investing activities of $10.9 million and operating activities of $0.7 million. Financing activities included the issuance of shares for net cash receipts of $21.9 million and debt repayments of $3.3 million. Investing Management's Discussion and Analysis of Financial Condition and Results of Operations, continued activities consisted of expenditures on property, plant and equipment of $9.8 million including $8.3 million at La Colorada, $0.7 million at Huaron and $0.6 million at Quiruvilca and $1.2 million on mineral properties including $0.8 million on Manantial Espejo, in Argentina and $0.4 million on the Corner Bay acquisition. Working capital at December 31, 2002 amounted to $2.4 million an improvement of $2.5 million from the prior year end. The improvement is due to the $6.9 million increase in cash partially offset by the reclassification of $3.0 million of prepaid taxes to long-term assets, the $1.8 million write down of Quiruvilca's spare parts and supplies inventory and net changes in other non-cash working capital accounts. During 2003, Pan American expects that Quiruvilca will consume cash or working capital of about $2.9 million, Huaron will generate about $4.1 million, ore stockpile sales will generate $1.4 million and La Colorada will generate about $1.9 million. Exploration, general and administration expenses will require approximately $3.3 million and debt repayments will use $1.7 million resulting in a net decrease in cash or working capital of $0.5 million. Capital resources at December 31, 2002 amounted to shareholders' equity of $55.5 million, long-term bank loans and capital leases of $3.9 million and deferred revenue of $0.9 million. The Plata project loan of $10 million is available to complete the expenditures required for La Colorada mine expansion. Management believes that the Company's liquid assets and access to the La Colorada loan is more than sufficient to fund planned operating and capital expenditures and discharge liabilities as they come due. Cash at December 31, 2001 amounted to $3.3 million, which was a decrease of $4.2 million from December 31, 2000. During 2001, operating activities consumed $2.1 million, investing activities used $6.5 million and net loan repayments required $5.0 million. Cash was generated by the issue of common shares for net proceeds of $9.4 million. Low metals prices caused operations to use cash. Huaron construction activities required expenditures of $5.4 million, $0.6 million was spent at Quiruvilca and $0.7 million at La Colorada. The working capital deficiency at December 31, 2001 was $0.1 million. Working capital was $1.8 million at December 31, 2000. The $1.9 million decrease was due to a loss from operations of $6.6 million, net of depreciation and amortization and reclamation provisions. This loss was funded by a $1.4 million operating line of credit, increases in accounts payable and accrued liabilities of $3.3 million and concentrate advances of $4.1 million, offset by $2.2 million used by other non-cash working capital items. RESULTS OF OPERATIONS The net loss for 2002 was $33.7 million including the write down and increased future reclamation provision at Quiruvilca of $27.2 million. Excluding the unusual Quiruvilca write down and the unusual gain on the sale of land recorded in 2001, the 2002 loss of $6.4 million represents a $5.1 million improvement from 2001. This improvement is due to better results from the Huaron mine and the capitalization of $1.2 million in net costs at La Colorada. In 2002, revenue was $7.8 million greater than in 2001. This increase was due to higher production and sales of metals. Increased production was due to a full year's operation of the Huaron mine, which more than offset lower production from the Quiruvilca mine. Operating costs were $2.6 million more in 2002 than last year. Cost increases of $8.6 million occurred at Huaron because it operated for the full year compared to a partial year in 2001. Cost reduction efforts at Quiruvilca and a lower production level in 2002 resulted in a $4.3 million reduction in costs relative to 2001. At La Colorada, pre-operating costs of $1.2 million associated with the capital expansion project were deferred, which had the effect of lowering this mine's costs, relative to the prior year by $0.7 million and a build up in metals inventory reduced operating costs by $1.0 million. Other costs were as expected. General and administrative costs were $0.5 million lower than last year due to the effect of staff reductions and ongoing cost saving efforts. Depreciation and amortization expense was $0.6 million more due to a full year's amortization at Huaron. Similarly, the reclamation provision, excluding the unusual $10 million provision at Quiruvilca, was $0.2 million more in 2002 than in 2001. Exploration expense increased because of activities at the Manantial Espejo project. Other income, in 2002, was $0.8 million more than in the prior year principally because of a $0.3 million gain on the exchange of land for a royalty interest over Manantial Espejo and the eventual sale of a one-half interest in this royalty and revenue of $0.2 million from the company operating Pan American's San Vicente mine in Peru. For 2003, general and administration costs are likely to increase slightly because of expected increases in staff and insurance premiums. These increases will be partially offset by a reduction in the corporate office rent due to the downsizing of office space. Depreciation and amortization and reclamation expenses will increase once the La Colorada expansion is complete. Interest expense will increase due to the La Colorada loan. In 2001 the net loss improved relative to 2000 by $37.8 million. A $3.5 million gain on the sale of land occurred in 2001 and in 2000 the carrying value of various mineral properties, most notably the Dukat project in Russia, was written down by $42.7 million. After excluding unusual items the loss in 2001 of $11.6 million compared to a loss of $3.1 million in 2000. The operating results for 2001 relative to 2000 were adversely affected by the impact of lower metal prices and operating cost increases that exceeded the benefits resulting from increased metal production. Revenue in 2001 was $7.4 million more than in 2000, principally because of the start up of the Huaron mine. Relative to 2000, lower metal prices had a negative impact on revenue of about $13.8 million and increased production had a positive impact of $21.8 million. Operating costs in 2001 were $13.0 million higher when compared to 2000. The increase was caused by the start up of the Huaron mine. DISCLOSURE CONTROLS AND PROCEDURES Disclosure controls and procedures are defined by the Securities and Exchange Commission as those controls and other procedures that are designed to ensure that information required to be disclosed by the Registrant in reports filed or submitted by it under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. The Registrant's Chief Executive Officer and Chief Financial Officer have evaluated the Registrant's disclosure controls and procedures within 90 days prior to filing of this Annual Report on Form 40-F and have determined that such disclosure controls and procedures are effective. INTERNAL CONTROLS Since the most recent evaluation of the Registrant's internal controls, there have not been any significant changes in the Registrant's internal controls or in other factors that could significantly affect internal controls, including any corrective actions with regard to significant deficiencies and material weaknesses. The design of the Registrant's system of controls and procedures is based, in part, upon assumptions about the likelihood of future events. There can be no assurance that the design of such system of controls and procedures will succeed in achieving its goals under all potential future conditions, regardless of how remote. PRINCIPAL ACCOUNTANT FEES AND SERVICES Audit Fees The aggregate fees billed by the Registrant's principal accountant for the fiscal year 2002 for professional services rendered by the principal accountant for the audit of the Registrant's annual financial statements or services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements for such year was $107,730. Audit-Related Fees No fees were billed by the Registrant's principal accountant for the fiscal year 2002 for assurance and related services by the principal accountant that are reasonably related to the performance of the audit or review of the Registrant's financial statements and are not reported above as audit fees. Tax Fees The aggregate fees billed by the Registrant's principal accountant for the fiscal year 2002 for professional services rendered by the principal accountant for tax compliance, tax advice and tax planning were $7,360. All Other Fees The aggregate fees billed by the Registrant's principal accountant for the fiscal year 2002 for all other products and services provided by the principal accountant not described above were $77,810. Professional services provided included: quarterly reviews of consolidated financial statements; the review and preparation of documents and financial statements in connection with the public offering of common shares by the Registrant; the review and preparation of documents and financial statements in connection with the Registrant's acquisition of Corner Bay Silver Inc.; certifications required by lenders in connection with the Registrant's expansion of the La Colorada mine; and a payroll audit. Since the enactment of the Sarbanes-Oxley Act of 2002 on July 30, 2002, all audit and non-audit services performed by the Registrant's auditor for the fiscal year ended December 31, 2002 were pre-approved by the audit committee of the Registrant. UNDERTAKING AND CONSENT TO SERVICE OF PROCESS A. UNDERTAKING The Registrant undertakes to make available, in person or by telephone, representatives to respond to inquiries made by the Commission staff, and to furnish promptly, when requested to do so by the Commission staff, information relating to the securities in relation to which the obligation to file this Annual Report on Form 40-F arises, or transactions in such securities. B. CONSENT TO SERVICE OF PROCESS The Registrant filed with the Commission a Form F-X on June 11, 1996, which Form F-X remains current. EXHIBIT INDEX PAGE NUMBER DOCUMENT NUMBER ------ -------- ------ 1. Pan American Silver Corp. Notice of Meeting and Information Circular (the "Circular") for the 2003 Annual Meeting of Members, dated April 9, 2003 2. Consent of Deloitte & Touche LLP.. 3. Certification of CEO and CFO Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.. SIGNATURE Pursuant to the requirements of the Exchange Act, the Registrant certifies that it meets all of the requirements for filing on Form 40-F and has duly caused this annual report to be signed on its behalf by the undersigned, thereto duly authorized. PAN AMERICAN SILVER CORP. Dated: May 20, 2003 By: /s/ Robert Pirooz ------------------------------- Robert Pirooz Vice President, Legal Affairs CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002 I, Ross J. Beaty, certify that: 1. I have reviewed this annual report on Form 40-F of Pan American Silver Corp.; 2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report; 3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report; 4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have: a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared; b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and c. presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date; 5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (and persons performing the equivalent function): a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and 6. The registrant's other certifying officer and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses. Date: May 20, 2003 /s/ Ross J. Beaty ------------------------------ By: Ross J. Beaty Title: Chief Executive Officer CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002 I, Anthony Hawkshaw, certify that: 1. I have reviewed this annual report on Form 40-F of Pan American Silver Corp.; 2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report; 3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report; 4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have: a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared; b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and c. presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date; 5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (and persons performing the equivalent function): a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and 6. The registrant's other certifying officer and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses. Date: May 20, 2003 /s/ Anthony Hawkshaw ------------------------------ By: Anthony Hawkshaw Title: Chief Financial Officer EXHIBIT INDEX PAGE NUMBER DOCUMENT NUMBER ------ -------- ------ 1. Pan American Silver Corp. Notice of Meeting and Information Circular (the "Circular") for the 2003 Annual Meeting of Members, dated April 9, 2003. 2. Consent of Deloitte & Touche LLP... 3. Certification of CEO and CFO Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002..