HUDBAY MINERALS INC

HudBay Minerals Inc.

Interim Consolidated Financial Statements
For the Period Ended March 31, 2007
(expressed in Canadian Dollars)

HudBay Minerals Inc.

Consolidated Statements of Earnings
Unaudited
(In thousands of Canadian dollars, except share and per share amounts)

	Three months ended March 31	
	2007	2006
Revenue (note 14)	**$ 349,142**	$ 207,963
Expenses:		
Operating	**184,508**	121,782
Depreciation and amortization	**21,874**	15,542
General and administrative	**4,573**	3,677
Stock-based compensation (note 10e)	**4,709**	2,251
Accretion of asset retirement obligation	**789**	660
Foreign exchange loss (gain)	**2,044**	(1,268)
	218,497	142,644
Operating earnings	**130,645**	65,319
(Loss) gain on derivative instruments	**(10,979)**	4,331
Interest and other income	**5,962**	1,172
Interest expense	**(399)**	(4,754)
Exploration	**(7,749)**	(3,134)
Other	**35**	(1,291)
Earnings before income tax	**117,515**	61,643
Tax expense (benefit) (note 9)	**54,439**	(14,343)
Net earnings for the period	**$ 63,076**	$ 75,986
Earnings per share:		
Basic	**$ 0.50**	$ 0.89
Diluted	**$ 0.49**	$ 0.70
Weighted average number of common shares outstanding (note 10f)		
Basic	**126,138,341**	85,392,988
Diluted	**128,232,455**	108,179,593

See accompanying notes to interim consolidated financial statements.

HudBay Minerals Inc.

Consolidated Statements of Retained Earnings
Unaudited
(In thousands of Canadian dollars)

	Three months ended March 31	
	2007	2006
Retained earnings, beginning of period	**$ 642,723**	$ 78,732
Net earnings for the period	**63,076**	75,986
Transition adjustment – financial instruments	**(1,005)**	-
Retained earnings, end of period	**$ 704,794**	$ 154,718

Consolidated Statements of Comprehensive Income
Unaudited
(In thousands of Canadian dollars)

	Three months ended March 31	
	2007	2006
Net earnings for the period	**$ 63,076**	$ 75,986
Other comprehensive income (loss), net of tax (note 11)	**(4,942)**	-
Comprehensive income for the end period	**$ 58,134**	$ 75,986

See accompanying notes to interim consolidated financial statements.

HudBay Minerals Inc.

Consolidated Balance Sheets
Unaudited
(in thousands of Canadian dollars)

	March 31, 2007	December 31, 2006
Assets:		
Current assets:		
Cash and cash equivalents	**$ 517,772**	$ 385,864
Accounts receivable	**101,436**	132,275
Inventories	**174,460**	163,842
Prepaid expenses	**6,463**	7,288
Current portion of fair value of derivatives (note 12)	**6,127**	2,579
Future income and mining tax assets	**118,393**	154,063
	924,651	845,911
Property, plant and equipment (note 4)	**445,293**	444,044
Other assets (note 5)	**21,897**	28,560
	$1,391,841	$1,318,515
Liabilities and Shareholders' Equity:		
Current liabilities:		
Accounts payable and accrued liabilities	**$ 151,170**	$ 139,922
Taxes payable	**10,896**	30,217
Current portion of other liabilities (note 6)	**34,100**	28,087
	196,166	198,226
Long-term debt (note 7)	**10,638**	10,214
Pension obligations	**41,741**	41,675
Other employee future benefits	**66,391**	65,083
Asset retirement obligations	**34,337**	33,548
Fair value of derivatives (note 12)	**16,966**	-
Obligations under capital leases	**4,254**	4,979
Future income tax liabilities	**577**	582
	$ 371,070	$ 354,307
Shareholders' equity:		
Share capital:		
Common shares (note 10b)	**303,226**	308,441
Warrants (note 10c)	**1**	3
Contributed surplus (note 10e)	**17,281**	13,098
Cumulative translation adjustment	**-**	(57)
Retained earnings	**704,794**	642,723
Accumulated other comprehensive income (loss) (note 11)	**(4,531)**	-
	1,020,771	964,208
	$1,391,841	$1,318,515

See accompanying notes to interim consolidated financial statements.

HudBay Minerals Inc.

Consolidated Statements of Cash Flows
Unaudited
(in thousands of Canadian dollars)

	Three months ended March 31	
	2007	2006
Cash provided by (used in):		
Operating activities:		
Net earnings for the period	**$ 63,076**	$ 75,986
Items not affecting cash:		
Depreciation and amortization	**21,874**	15,542
Future tax expense (benefit)	**41,859**	(14,939)
Unrealized foreign exchange gain	**472**	518
Amortization of deferred financing costs	**-**	362
Accretion expense on asset retirement obligation	**789**	660
Stock-based compensation	**4,709**	2,251
Unrealized portion of change in fair value of derivatives	**12,483**	(3,159)
Other	**(2,762)**	752
	142,500	77,973
Change in non-cash working capital (note 13)	**13,391**	(51,847)
	155,891	26,126
Financing activities:		
Repayment of senior secured notes	**-**	(1,168)
Repayment of obligations under capital leases	**(989)**	(936)
Proceeds on exercise of stock options	**1,498**	1,180
Proceeds on exercise of warrants	**10**	4,269
	519	3,345
Investing activities:		
Additions to property, plant and equipment	**(23,961)**	(27,003)
Acquisition of White Pine Copper Refinery, Inc., net of cash acquired	**-**	(17,041)
Additions to environmental deposits	**-**	15
	(23,961)	(44,029)
Effect of exchange rate changes on cash and cash equivalents	**(541)**	262
Change in cash and cash equivalents	**131,908**	(14,296)
Cash and cash equivalents, beginning of period	**385,864**	141,660
Cash and cash equivalents, end of period	**$ 517,772**	$ 127,364
Cash and cash equivalents is comprised of:		
Cash on hand and demand deposits	**$ 73,356**	$ 102,739
Money market instruments	**444,416**	24,625
	$ 517,772	$ 127,364

See accompanying notes to interim consolidated financial statements.

1. Nature of business

HudBay Minerals Inc. (the "Company" or “HudBay”) was formed by amalgamation in 1996 under the Business Corporations Act (Ontario) and was continued under the Canada Business Corporations Act on October 25, 2005. HudBay is an integrated mining company that operates mines, concentrators and a metal production complex in northern Manitoba and Saskatchewan. HudBay also owns a zinc oxide production facility in Ontario, the White Pine copper refinery in Michigan, and the Balmat zinc mine in New York State. Hudson Bay Mining and Smelting Co., Limited (“HBMS”), the principal subsidiary of the Company, was incorporated in 1927 and has been in continuous production in Northern Manitoba since 1930.

2. Basis of presentation and principles of consolidation

These unaudited interim consolidated financial statements include the financial statements of the Company, all of its subsidiaries and the proportionate share of the assets and liabilities of any joint ventures where the Company shares joint ownership.

The interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles (“GAAP”) following the same accounting policies as disclosed in the audited consolidated financial statements for the year ended December 31, 2006, except as noted in note 3.

The unaudited interim consolidated financial statements do not include all of the information and disclosures required by Canadian GAAP for audited annual financial statements. In the opinion of management, all adjustments considered necessary for fair presentation have been included in the unaudited interim consolidated financial statements. The unaudited interim consolidated financial statements should be read in conjunction with the most recent audited annual consolidated financial statements of the Company, including the notes thereto.

3. Adoption of new accounting standards

(a) Financial instruments:

On January 1, 2007, the Company prospectively adopted three new accounting standards that were issued by the Canadian Institute of Chartered Accountants (CICA): Handbook Section 1530, Comprehensive Income, Section 3855, Financial Instruments – Recognition and Measurement, and Section 3865, Hedges.

Comprehensive Income

Section 1530 introduces comprehensive income, which consists of net earnings and other comprehensive income ("OCI"). OCI includes unrealized gains and losses on financial assets classified as available-for-sale, unrealized foreign currency translation gains or losses arising from self-sustaining foreign operations, and changes in the fair value of the effective portion of cash flow hedging instruments. These interim consolidated financial statements include a consolidated statement of comprehensive income. Cumulative changes in OCI are included in accumulated other comprehensive income ("AOCI"), which is presented as a new category of shareholders' equity on the consolidated balance sheet.

Financial Instruments – Recognition and Measurement

Section 3855 establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. It requires that financial assets and financial liabilities, including derivatives, be recognized on the consolidated balance sheet when the Company becomes a party to the contractual provisions of the financial instrument or non-financial derivative contract. Under this standard, all financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Measurement in subsequent periods depends on the financial instrument's classification.

- Financial assets held-to-maturity, loans and receivables, and other financial liabilities are measured at amortized cost using the effective interest method of amortization. Gains and losses are recorded in earnings when the assets are derecognized or impaired, and through the amortization process.
- Available-for-sale financial assets are measured at fair value with gains and losses recorded in OCI, except for impairment losses, until the assets are derecognized, at which time the cumulative gain or loss previously recognized in AOCI is recognized in earnings.
- Financial assets and liabilities classified as held-for-trading are measured at fair value with changes in fair value recognized in earnings and are included in the category "fair value through earnings." Derivative instruments are classified as fair value through earnings, including those derivatives that are embedded in financial or non-financial contracts and are not closely related to the host contracts.

The Company has separated and recorded at fair value embedded derivatives related to provisional pricing in concentrate purchase, concentrate sale, anode sale, and certain other sale contracts. Under the terms of these contracts, prices are set on a specified future date after shipment based on quoted market prices. The Company records the embedded derivatives in accounts receivable for sales contracts and in accounts payable for purchase concentrate contracts. Each period, the provisionally priced metals are marked to market based on the forward

market price for the quotational period stipulated in the contract until the quotational period expires. The Company records mark-to-market adjustments (both gains and losses) in revenue for sales contracts and in operating expenses for purchase concentrate contracts.

Hedges

Section 3865 establishes criteria that must be satisfied in order for hedge accounting to be applied. It sets standards for the identification, designation, documentation and effectiveness of hedging relationships for the following hedging strategies: fair value hedges, cash flow hedges and hedges of foreign currency exposure of a net investment in a self-sustaining foreign operation. The purpose of hedge accounting is to ensure that gains, losses, revenues and expenses from effective hedging relationships are recorded in earnings in the same period. Hedge accounting is discontinued prospectively when the derivative no longer qualifies as an effective hedge, or the derivative is terminated or sold, or upon the sale or early termination of the hedged item.

The Company's policy objective for hedging risk is to reduce the volatility of future earnings and cash flow within the economic goals of the Company. This policy sets out authorization procedures and limits for hedging identified exposures to foreign currency, commodity and energy price risks.

The Company has only cash flow hedging relationships. In a cash flow hedging relationship, the effective portion of the change in the fair value of the hedging derivative is recognized in OCI, while the ineffective portion is recognized in earnings. When hedge accounting is discontinued, the amounts previously recognized in AOCI are reclassified to earnings during the periods when the variability in the cash flows of the hedged item affects earnings. When a hedged anticipated transaction subsequently materializes, the Company's policy is to remove the associated gains and losses that were recognized in OCI and include them in the initial carrying amount of the asset acquired or liability incurred. Gains and losses on derivatives are reclassified immediately to earnings when the hedged item is sold or terminated early.

Impact upon adoption of Sections 1530, 3855 and 3865

As required, the Company applied these standards on a prospective basis; accordingly, comparative amounts for prior periods have not been restated.

The Company recorded the following transition adjustments as at January 1, 2007:

- Reduction to opening retained earnings of $1,193, net of taxes, representing changes made to the value of certain financial instruments, other than available-for-sale assets, in compliance with the measurement basis under the new standards;

- Increase to opening retained earnings of $188, net of taxes, to recognize the remaining deferred gain from cash flow hedging relationships that became ineligible for hedge accounting and were terminated prior to January 1, 2007. The hedging relationships had used US dollar put options to hedge against forecasted US dollar sales.
- Recognition in AOCI of $448, net of taxes, related to the gain on available-for-sale financial assets; and
- Reclassification to AOCI of $37, net of taxes, of net foreign currency losses that was previously presented as a separate item in shareholders' equity at their gross amount of $57.

(b) Accounting Changes:

Effective January 1, 2007, the Company adopted the revised CICA Section 1506 "Accounting Changes", which requires that (i) a voluntary change in accounting principles can be made if, and only if, the changes result in more reliable and relevant information; (ii) changes in accounting policies are accompanied with restated amounts for prior periods and reasons for the change; and (iii) for changes in estimates, the nature and amount of the change should be disclosed. The Company has not made any voluntary change in accounting principles since the adoption of the revised standard.

(c) Future accounting changes:

Capital Disclosures and Financial Instruments – Disclosures and Presentation
On December 1, 2006, the CICA issued three new accounting standards: Handbook Section 1535, *Capital Disclosures*, Section 3862, *Financial Instruments – Disclosures*, and Section 3863, *Financial Instruments – Presentation*. These new standards will be applicable to the Company on January 1, 2008.

Section 1535 specifies the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance.

The new Sections 3862 and 3863 replace Section 3861, *Financial Instruments — Disclosure and Presentation*, revising and enhancing disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

4. Property, plant and equipment

March 31, 2007	**Cost**	**Accumulated depreciation and amortization**	**Net book value**
Property, plant and equipment	**$ 354,044**	**$ 53,577**	**$ 300,467**
Mine development	**214,753**	**86,919**	**127,834**
Mineral exploration properties	**16,992**	**-**	**16,992**
	$ 585,789	**$ 140,496**	**$ 445,293**

December 31, 2006	Cost	Accumulated depreciation and amortization	Net book value
Property, plant and equipment	$ 339,164	$ 46,325	$ 292,839
Mine under development	26,534	-	26,534
Mine development	180,121	72,442	107,679
Mineral exploration properties	16,992	-	16,992
	$ 562,811	$ 118,767	$ 444,044

The Balmat mine began commercial production on January 1, 2007. During 2006, all expenditures associated with the mine start-up, including pre-production operating costs net of revenues, were classified as mine under development

5. Other assets

	March 31, 2007	December 31, 2006
Long-term portion of future tax asset	**$ 7,248**	$ 18,941
Investments, at fair value (2006 at cost)	**5,287**	6,823
Long-term portion of fair value of derivatives (note 12)	**4,350**	1,631
Cash held in trust (note 7)	**3,847**	-
Environmental deposits	**1,165**	1,165
	$ 21,897	$ 28,560

6. Current portion of other liabilities

	March 31, 2007	December 31, 2006
Current portion of long-term debt	**$ 4,000**	$ 4,000
Current portion of pension obligation	**16,204**	16,554
Current portion of other employee future benefits	**2,282**	2,282
Current portion of obligations under capital leases	**3,768**	4,032
Current portion of fair value of derivatives (note 12)	**7,784**	527
Current portion of future income taxes payable	**27**	543
Interest payable on long-term debt	**35**	149
	$ 34,100	$ 28,087

7. Long-term debt

	March 31, 2007	December 31, 2006
Senior Secured Notes	**$ 3,724**	$ 3,380
Province of Manitoba	**10,914**	10,834
	$ 14,638	$ 14,214
Less current portion of long-term debt	**4,000**	4,000
	$ 10,638	$ 10,214

The Company has designated the Senior Secured Notes as fair value through earnings, with changes in fair value recorded to gain (loss) on derivative instruments on the income statement. The Province of Manitoba loan is classified in other financial liabilities and is recorded at amortized cost, which approximates its fair value.

As at January 1, 2007, HBMS had a $50 million revolving credit facility that was scheduled to mature on January 30, 2007. On January 17, 2007 it was further increased to $80 million with the maturity date extended to April 30, 2007. On April 20, 2007, the maturity date was further extended to July 31, 2007.

The borrowings under this facility may be made in either Canadian dollars in the form of (a) Prime Rate Advances or (b) Bankers' Acceptances or in United States dollars in the form of (i) United States Base Rate Advances or (ii) London Interbank Offered Rate (LIBOR) loans. Borrowings under these facilities bear interest, when drawn, at a rate that varies based on the type of borrowing. Canadian or US dollar denominated letters of credit or guarantees may also be used against this facility. The credit facility is secured by a first charge on the issued shares, inventory, inventory-related receivables and certain cash of HBMS, HBED and HMS. As of March 31, 2007 there were no amounts drawn under the facility. The Company is in compliance with covenants under this credit facility.

On February 21, 2007, HBMS completed the covenant defeasance of HBMS outstanding 9 5/8% Senior Secured Notes due 2012 ("the Notes"). The covenant defeasance involved the irrevocable deposit in trust by HBMS with The Bank of New York, as trustee, of approximately US$3,316 (C$3,880) of U.S. government securities, such amount being sufficient to pay the principal of US$2,900 (C$3,387 at the time of covenant defeasance), and interest and premium on the outstanding Notes to the redemption date of January 15, 2009. Pursuant to the terms of the indenture governing the Notes, the collateral securing the Notes was released.

8. Pension and other future employee benefit expense

	Three months ended March 31	
	2007	2006
Defined benefit pension expense	**$ 4,512**	$ 2,858
Defined contribution pension expense	**214**	106
Other future employee benefits expense	**1,710**	1,617
	$ 6,436	$ 4,581

9. Tax expense (benefit)

		Three months ended March 31	
		2007	2006
Tax expense (benefit) applicable to:			
Current	- income taxes	**$ 22**	$ 596
	- mining taxes	**12,558**	-
Future	- income taxes	**38,588**	(14,939)
	- mining taxes	**3,271**	-
Tax expense (benefit)		**$ 54,439**	$ (14,343)

Future taxes in 2006 included a flow-through share income tax component of $3,662.

The net future tax assets (income and mining) reflect a valuation allowance that represents management's estimate of the allowance necessary to reflect the future tax assets at an amount that the Company considers is more likely than not to be realized.

10. Share capital

(a) Preference shares:

Authorized:
Unlimited preference shares

(b) Common shares:

Authorized:
Unlimited common shares

Issued:

	Three months ended March 31, 2007	
	Common shares	Amount
Balance, beginning of period	126,006,001	$ 308,441
Exercise of warrants	3,086	12
Exercise of options	225,821	2,024
Tax impact of flow-through shares	-	(7,251)
Balance, end of period	126,234,908	$ 303,226

In February 2007, the Company renounced $20,075 of the flow-through financing to investors with an effective date of December 31, 2006. In accordance with EIC-146, “Flow-through shares”, the Company reduced its share capital by $7,251 using a tax rate of approximately 36% applied to the temporary taxable differences created by the renunciation.

(c) Warrants:

	Number	Amount
Warrants outstanding, beginning of period	123,101	$ 3
Exercised	(92,580)	(2)
Warrants outstanding, end of period	30,521	$ 1

Warrants outstanding to acquire common shares (30 warrants required to acquire one common share) of the Company at March 31, 2007 have an exercise price of $0.105 and expire December 21, 2009.

(d) Stock option plan:

Pursuant to the Company's stock option plan (the "Plan") approved in June 2005, during the quarter the Company granted additional options to directors and employees of the Company for the 2007 entitlement.

The fair value of the options granted during 2007 has been estimated at the date of grant using a Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 4.28%; dividend yield of 0%; volatility factor of the expected market price of the Company's common stock of 50%; and a weighted average expected life of these options of 4 years.

	Number of shares	Weighted Average exercise price
Balance, beginning of period	3,183,269	$ 6.46
Granted	1,261,711	20.82
Exercised	(225,821)	6.63
Cancelled	(6,666)	9.70
Outstanding, end of period	4,212,493	$10.74

Weighted average fair value of options granted during the quarter was $9.00.

The following table summarizes the options outstanding at March 31, 2007:

Number of options outstanding	Exercise price	Weighted average remaining contractual life (years)	Number of options exercisable	Weighted average remaining contractual life (years)
1,492,053	$2.59	8.1	452,023	8.1
16,667	3.00	1.7	16,667	1.7
75,000	3.35	8.5	-	8.5
1,057,062	9.70	9.0	569,805	9.0
250,000	14.06	9.2	50,000	9.2
60,000	17.77	9.6	20,000	9.6
20,000	21.75	9.8	6,667	9.8
1,241,711	20.80	10.0	413,904	10.0
4,212,493	$10.74		1,529,066	

(e) Contributed surplus:

	March 31, 2007	December 31, 2006
Balance, beginning of year	**$ 13,098**	$ 10,015
Stock-based compensation expense	**4,709**	6,201
Transfer to common share on exercise of stock options	**(526)**	(3,128)
Warrants cancelled/expired	**-**	10
Balance, end of year	**$ 17,281**	$ 13,098

(f) Earning per share data:

	March 31, 2007	March 31, 2006
Net earnings available to common shareholders	**$ 63,076**	$ 75,986
Weighted average common shares outstanding	**126,138,341**	85,392,988
Plus net incremental shares from assumed conversions:		
Warrants	**2,561**	20,716,855
Stock options	**2,091,553**	2,069,750
Diluted weighted average common shares	**128,232,455**	108,179,593

11. Other comprehensive income (loss) ("OCI")

	March 31, 2007
Accumulated OCI, at January 1, 2007:	
Investments, less tax of $97	**$ 448**
Currency translation adjustments, less tax of $20	**(37)**
Accumulated OCI, at January 1, 2007	**$ 411**
OCI (loss) for the period:	
Effective portion of changes in fair value of cash flow hedges	**(4,619)**
Changes in fair value of investments	**(2,082)**
Currency translation adjustments	**(12)**
OCI (loss), before tax	**(6,713)**
Income tax benefit related to OCI	**1,771**
OCI (loss), net of tax for the period	**$ (4,942)**
Accumulated OCI, at March 31:	
Cash flow hedge gains, less tax of $1,669	**(2,950)**
Investments, less tax of $0	**(1,537)**
Currency translation adjustments, less tax of $25	**(44)**
Accumulated OCI (loss), at March 31, 2007	**$ (4,531)**

12. Financial instruments

The Company's main types of financial instruments are cash and equivalents, accounts receivable, accounts payable and accrued liabilities, investments, long-term debt and derivatives.

Risk management using financial instruments

The Company from time to time employs derivative financial instruments, including forward and option contracts, to manage risk originating from actual exposures to commodity price risk, foreign exchange risk and interest rate risk. Hedge accounting under CICA 3865 is applied when certain criteria have been met. The Company does not use derivative financial instruments for trading or speculative purposes.

(a) Foreign currency risk

The Company is exposed to foreign currency risk on sales, purchases and borrowings that are denominated in a currency other than the respective functional currencies of Company entities. The currency giving rise to this risk is primarily US dollars. The Company uses forward exchange or currency collar contracts to limit the effects of movements in exchange rates on foreign currency-denominated assets and liabilities and future anticipated transactions.

The Company holds put options securing the right, but not the obligation, to sell US$4.375 million per quarter at $1.20482, continuing to January 2009. The options have been classified as non-hedge derivative assets and recorded at their fair value of $2,262 as at March 31, 2007. Gains and losses on the options are presented in gain (loss) on derivative instruments on the income statement.

(b) Commodity price risk

From time to time, the Company maintains price protection programs and conducts commodity price risk management through the use of forward sales contracts, spot deferred contracts, option contracts and commodity collar contracts.

Non-hedge contracts

The Company has entered into sales contracts with customers to provide zinc at fixed prices. These forward physical sales contracts expose the Company to changes in market prices of zinc. The Company manages the risk associated with these contracts by entering into forward zinc purchase contracts to convert the fixed price to a floating price arrangement. At March 31, 2007, the Company had outstanding forward contracts to purchase 10,475 tonnes of zinc at prices

ranging from US$1,315 to US$4,334 per tonne with settlement dates in the next year. The forward zinc purchase contracts have been recorded as non-hedge net derivative liabilities at their fair value of $3,740 as at March 31, 2007. A corresponding mark-to-market net loss has been recorded in revenues.

Similarly, the Company has entered into sales contracts with customers to provide zinc oxide at fixed prices. The Company manages the risk associated with these contracts by entering into forward zinc purchase contracts to convert the fixed price related to the zinc portion of zinc oxide composition with a floating price arrangement. At March 31, 2007, the Company had outstanding forward contracts to purchase 2,745 tonnes of zinc at prices ranging from US$3,115 to US$4,500 per tonne with settlement dates in the next year. The forward zinc purchase contracts have been recorded as non-hedge net derivative liabilities at their fair value of $695 as at March 31, 2007. A corresponding mark-to-market net loss has been recorded in revenues.

Under the provisions of Section 3855, the Company now accounts for certain of its forward physical zinc customer sales contracts as derivatives. The mark-to-market gains and losses recorded on these physical zinc customer sale contracts offset in part the mark-to-market gains and losses recorded on the forward zinc purchase contracts related to forward physical zinc customer sales. At March 31, 2007, the Company recorded as derivatives physical zinc customer sales contracts for 9,324 tonnes of zinc at prices ranging from US$1,425 to US$4,473. The Company has recorded their fair value of $3,359 as non-hedge net derivative assets. A corresponding mark-to-market gain has been recorded in revenues.

Cash Flow Hedges

During the year, the Company entered into commodity swap contracts to hedge prices for a portion of future sales of zinc and copper. Cash flow hedge accounting has been applied to the hedging relationships under Section 3865. The risk management objective for these hedging relationships is to mitigate the impact on the Company of fluctuating market zinc and copper prices. Hedged items are identified as the first stated quantity in metric tonnes of anticipated zinc and copper sales in a future month. The Company expects these hedging relationships to be highly effective at achieving offsetting changes in the cash flows of the expected monthly sales of zinc and copper production and the series of zinc and copper swap contracts.

The Company assesses prospective and retrospective hedge effectiveness using linear regression and the hypothetical derivative concept described in Derivatives Implementation Group Issue G7. The Company records the cumulative gain or loss on the hedging derivative to OCI to a maximum amount equal to the cumulative gain or loss on the hypothetical derivative. These amounts are to be adjusted for any gains or losses previously recognized in OCI. Any remaining ineffective gain or loss on the hedging derivative remains in the income statement. All

components of each derivative's change in fair value have been included in the assessment of cash flow hedge effectiveness.

The commodity swap contracts have been recorded as hedging net derivative liabilities at their fair value of $15,459 as at March 31, 2007. For the three months ended March 31, 2007, pre-tax net losses of $4,619 were recorded to OCI for the effective portion of the cash flow hedges, and pre-tax net losses of $1,586 were recorded in earnings for the ineffective portion. This loss has been included in gain (loss) on derivative instruments. The Company also recorded a loss on derivative instruments of $9,254 in earnings equal to the change in fair value between the trade date of the commodity swap contracts and the designation date for the hedging relationships.

Of the $4,619 pre-tax loss deferred in AOCI at March 31, 2007, management estimates that $1,353 will be reclassified to earnings in the next twelve months. This will happen when the anticipated future zinc and copper sales take place and monthly settlements of the related commodity swap contracts occur.

The following commodity swaps have been classified as cash flow hedges:

	Metric Tonnes	Weighted average price US$/MT	Fair value $000s
Zinc swaps – US$ denominated contracts:			
Maturing in 1 year	3,825	3,153	148
Maturing between 1 to 2 years	15,300	3,033	1,903
Maturing between 2 to 3 years	15,300	2,573	(759)
Maturing between 3 to 4 years	11,475	2,283	(1,359)
	45,900	2,702	(67)
Copper swaps – US$ denominated contracts:			
Maturing in 1 year	1,050	5,050	(1,750)
Maturing between 1 to 2 years	4,425	4,935	(5,807)
Maturing between 2 to 3 years	5,100	4,563	(5,085)
Maturing between 3 to 4 years	3,825	4,300	(2,750)
	14,400	4,643	(15,392)
Total fair value at March 31, 2007			(15,459)

(c) Interest rate risk

Interest rates on the Company's debt are disclosed in note 8 to the 2006 annual consolidated financial statements.

(d) Credit risk

Management has a credit policy in place, and the exposure to credit risk is monitored on an ongoing basis. Transactions involving derivatives are with creditworthy counterparties. The Company's swap agreements are governed by master agreements with customary wording under which collateral is not required. Management does not expect any counterparty to fail to meet its obligations. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative assets on the consolidated balance sheet.

Fair values of financial instruments

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's-length transaction between knowledgeable, willing parties who are under no compulsion to act. Fair values are based on quoted market prices, where available. If market quotes are not available, fair value is based on internal valuation modes that use market-based or independent information as inputs. These models could produce a fair value that may not be reflective of future fair value.

- The carrying amount of cash and cash equivalents, accounts receivable and current financial liabilities approximate their fair value due to the short-term maturities of these instruments.
- The Company uses quoted market prices to determine fair value of available-for-sale investments.
- Derivative assets and liabilities are recorded at fair value based on internal valuation models that reflect forward market commodity prices, currency exchange rates, and discount factors based on market US dollar interest rates. Valuations assume all counterparties have a high credit rating.
- Embedded derivatives related to provisional pricing on certain concentrate, anode and other sales contracts are reported in accounts receivable and accounts payable. These items are carried at fair value based on internal valuation models similar to those described above.
- The Company uses the effective interest method to record Long-term debt – Province of Manitoba at amortized cost, which approximates fair value.
- The Company has chosen to designate the Senior Secured Notes as fair value through earnings. Fair value is determined based on the price quoted in Bloomberg, which reflects the street convention rate on a similar debt instrument, with adjustments for accrued interest.

Fair value of derivatives, as presented on the balance sheet:

	March 31, 2007	December 31, 2006
Fair value of derivative assets		
Current portion	**$ 6,127**	$ 2,579
Long-term portion (included in other assets)	**4,350**	1,631
	$ 10,477	$ 4,210

Fair value of derivative liabilities		
Current portion (included current portion of other liabilities)	**$ (7,784)**	$ (527)
Long-term portion	**(16,966)**	-
	$ (24,750)	$ (527)
	$ (14,273)	$ 3,683

13. Supplementary cash flow information

(a) Change in non-cash working capital

	Three months ended March 31	
	2007	2006
Accounts receivable	**$ 31,655**	$ (42,082)
Inventories	**(10,618)**	(14,482)
Accounts payable and accrued liabilities	**10,964**	7,993
Taxes payable	**(19,321)**	1,205
Prepaid expenses	**825**	(107)
Interest payable	**(114)**	(4,374)
	$ 13,391	$ (51,847)

(b) Other

	Three months ended March 31	
	2007	2006
Supplementary cash flow information:		
Interest paid	**$ 432**	$ 8,906
Taxes paid	**31,779**	480

14. Segmented information

The Company is an integrated base metals producer with the majority of the operations in a single reportable operating segment.

The Company's revenue by significant product types:

	Three months ended March 31	
	2007	2006
Revenues:		
Copper	**$ 176,984**	$ 112,483
Zinc	**99,553**	60,120
Zinc oxide	**38,554**	26,040
Precious metals and other	**34,051**	9,320
	$ 349,142	$ 207,963

The above revenues include revenues from the sale of metal produced from purchase concentrate of:

Copper	**$ 50,830**	$ 33,388
Zinc	**$ 8,834**	$ -