APEX SILVER MINES LTD
Form 10-Q
August 09, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(MARK ONE)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006.

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE TRANSITION PERIOD FROM TO .

COMMISSION FILE NUMBER 1-13627

APEX SILVER MINES LIMITED
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

CAYMAN ISLANDS, BRITISH WEST INDIES (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	**NOT APPLICABLE** (I.R.S. EMPLOYER IDENTIFICATION NO.)
WALKER HOUSE **MARY STREET** **GEORGE TOWN, GRAND CAYMAN** **CAYMAN ISLANDS, BRITISH WEST INDIES** (ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	**NOT APPLICABLE** (ZIP CODE)

(345) 949-0050
(REGISTRANT S TELEPHONE NUMBER, INCLUDING AREA CODE)

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

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

LARGE ACCELERATED FILER o ACCELERATED FILER x NON-ACCELERATED FILER x

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

AT AUGUST 3, 2006, 58,410,300 ORDINARY SHARES, $0.01 PAR VALUE PER SHARE, WERE ISSUED AND OUTSTANDING.

APEX SILVER MINES LIMITED
FORM 10-Q
QUARTER ENDED JUNE 30, 2006

INDEX

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

APEX SILVER MINES LIMITED
An Exploration and Development Stage Company
CONSOLIDATED BALANCE SHEETS
(Expressed in United States dollars)

	June 30, 2006 (unaudited)	December 31, 2005
	(in thousands, except share data)	
Assets		
Current assets		
Cash and cash equivalents	$ 11,851	$ 4,808
Restricted cash	37,934	135,182
Short term investments	113,165	132,000
Restricted investments	144,061	67,491
Materials and supply inventory	3,495	
Prepaid expenses and other assets	11,148	5,824
Total current assets	321,654	345,305
Property, plant and equipment, net	505,741	379,138
Ore inventories	8,909	
Deferred financing costs	20,134	21,604
Value added tax recoverable	34,881	20,052
Restricted investments	77,258	12,392
Other	2,098	2,020
Total assets	$ 970,675	$ 780,511
Liabilities and Shareholders Equity		
Current liabilities		
Accounts payable and other accrued liabilities	$ 56,060	$ 74,487
Accrued interest payable	3,267	3,096
Derivatives	13,845	5,652
Current portion of long term debt	2,708	2,270
Total current liabilities	75,880	85,505
Long term debt	382,275	320,021
Derivatives	130,265	50,621
Asset retirement obligation	4,936	2,003
Total liabilities	593,356	458,150
Minority interest in subsidiaries	41	34
Commitments and contingencies (Note 11)		
Shareholders equity		
Ordinary Shares, $.01 par value, 175,000,000 shares authorized; 58,406,400 and 50,444,890 shares issued and outstanding at respective dates	584	504
Accumulated other comprehensive income (loss)	719	(243)
Additional paid in capital	664,679	486,762
Accumulated deficit during development stage	(288,704)	(164,696)
Total shareholders equity	377,278	322,327
Total liabilities and shareholders equity	$ 970,675	$ 780,511

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

3

APEX SILVER MINES LIMITED
An Exploration and Development Stage Company
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(Expressed in United States dollars)
(Unaudited)

	Three Months Ended June 30, 2006	2005	Six Months Ended June 30, 2006	2005	For the Period from December 22, 1994 (inception) through June 30, 2006
	(in thousands, except share data)				
Operating income and expenses:					
Exploration	$ (1,557)	$ (1,435)	$ (3,007)	$ (2,761)	$ (76,438)
Administrative	(5,686)	(4,917)	(10,999)	(8,846)	(80,857)
Gain (loss) on commodity derivatives	(61,076)	2,430	(120,055)	2,056	(175,505)
Gains (loss) on foreign currency derivatives and transactions	123	(666)	236	(1,284)	964
Other operating expense (1)	(94)		(142)		(142)
Amortization and depreciation	(101)	(17)	(196)	(33)	(1,592)
Total operating expenses	(68,391)	(4,605)	(134,163)	(10,868)	(333,570)
Other income and expenses:					
Interest and other income	5,264	3,643	8,168	7,043	42,840
Gain on extinguishment of debt			2,875		9,640
Interest expense and other borrowing costs (2)	(255)	(1,872)	(774)	(3,862)	(11,696)
Total other income and expense	5,009	1,771	10,269	3,181	40,784
Loss before minority interest and income taxes	(63,382)	(2,834)	(123,894)	(7,687)	(292,786)
Income taxes	(53)		(107)		(486)
Minority interest in (income) loss of consolidated subsidiary		11	(7)	11	4,568
Net loss	$ (63,435)	$ (2,823)	$ (124,008)	$ (7,676)	$ (288,704)
Other comprehensive income:					
Unrealized gain (loss) on securities	$ 77	$ (22)	$ 467	$ (157)	$ 224
Reclassification for loss on securities included in net income			495		495
Other comprehensive gain (loss)	77	(22)	962	(157)	719
Comprehensive loss	$ (63,358)	$ (2,845)	$ (123,046)	$ (7,833)	$ (287,985)
Net loss per Ordinary Share basic and diluted (3)	$ (1.10)	$ (0.06)	$ (2.28)	$ (0.16)	
Weighted average Ordinary Shares outstanding	57,551,214	47,983,111	54,483,319	47,831,454	

(1) Other operating expense is accretion expense associated with our asset retirement obligation at San Cristobal.

(2) Interest expense and other borrowing costs are net of $6.4 million and $11.0 million capitalized for the three and six month periods ended June 30, 2006, respectively and $1.4 million and $2.5 million for the three and six month periods ended June 30, 2005, respectively and $20.3 million for the inception to date period ended June 30, 2006.

(3) Diluted earnings per share were anti-dilutive for all periods presented.

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

APEX SILVER MINES LIMITED
An Exploration and Development Stage Company
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in United States dollars)
(Unaudited)

	Six Months Ended June 30, 2006 (in thousands)	2005	For the period from December 22, 1994 (inception) through June 30, 2006
Cash flows from operating activities:			
Net cash used in operating activities	$ (33,780)	$ (9,935)	$ (140,657)
Cash flows from investing activities:			
Purchase of available for sale investments	(188,212)	(330,112)	(1,381,404)
Sale of available for sale investments	126,388	408,165	1,190,340
Purchase of held-to-maturity investments		(17,524)	(239,207)
Sale of held-to-maturity investments	1,003	89,702	188,010
Purchase of available for sale restricted investments	(226,080)		(241,030)
Sale of available for sale restricted investments	181,900		181,900
Purchase of held-to-maturity restricted investments	(46,862)		(74,205)
Sale of held-to-maturity restricted investments	30,819	1,868	45,595
Payment of derivative premiums & settlements, net	(32,219)		(32,320)
Advances for construction of port facility			(2,000)
Advances to suppliers and contractors	(4,089)	(1,296)	(7,964)
Release from (transfer to) restricted cash to collateralize credit facility, letters of credit and interest payments, net	97,247	(96,892)	(40,897)
Capitalized property, plant and equipment	(135,903)	(55,733)	(418,833)
Net cash used in investing activities	(196,008)	(1,822)	(832,015)
Cash flows from financing activities:			
Proceeds from issuance of Ordinary Shares net of offering costs of $4.8 million	156,795	5,343	580,358
Proceeds from issuance of convertible notes			339,987
Payment of debt issuance costs	(209)	(3,375)	(24,530)
Payments of notes payable and long term debt	(1,204)		(4,480)
Borrowings under project finance facility	80,000		80,000
Proceeds from exercise of stock options and warrants	1,449	91	13,188
Net cash provided by financing activities	236,831	2,059	984,523
Net increase (decrease) in cash and cash equivalents	7,043	(9,698)	11,851
Cash and cash equivalents - beginning of period	4,808	27,740	
Cash and cash equivalents - end of period	$ 11,851	$ 18,042	$ 11,851

See Note 13 for supplemental cash flow information.

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

APEX SILVER MINES LIMITED
An Exploration and Development Stage Company

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in United States dollars)

1. Basis of Preparation of Financial Statements

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

In the opinion of management, these financial statements reflect all adjustments that are necessary for a fair statement of the results for the periods presented. All adjustments were of a normal recurring nature. These interim financial statements should be read in conjunction with the annual financial statements of the Company included in its 2005 Annual Report on Form 10-K.

2. Significant Accounting Policies

Effective January 1, 2006 the Company adopted Financial Accounting Standards No. 123R, Share-Based Payment (FAS No. 123R), using the modified prospective approach, which revised Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (FAS No. 123), and superseded Accounting Principles Board (APB) Opinion 25, Accounting for Stock Issued to Employees and its related implementation guidance. The Company is currently evaluating whether it will adopt the short-cut method for calculating the pool of windfall tax benefits as allowed by Financial Accounting Standards Board (FASB) Statement of Position FAS No. 123R-3. The Company had previously adopted FAS No. 123 effective January 1, 2004. FAS No. 123R requires measurement and recording in the financial statements of the costs of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award, recognized over the period during which an employee is required to provide services in exchange for the award. Additionally, FAS No. 123R requires companies that did not previously include the effects of estimated forfeitures in the FAS No. 123 expenses they reported, to record a cumulative adjustment to the income statements presented in the period of adoption of FAS No. 123R in order to reflect the effect of the estimated forfeitures. The forfeiture rate used by the Company prior and subsequent to the adoption of FAS No. 123R has not changed and, therefore, the Company did not record a cumulative effect adjustment related to prior period estimated forfeitures. The adoption of FAS No. 123R did not have a material impact on the Company s financial position or results of operations and is not expected to have a material impact in the future (see Note 10).

During March 2005, a committee of the Emerging Issues Task Force (EITF) reached a consensus (EITF Issue No. 04-6) that stripping costs incurred during the production phase of a mine are variable production costs that should be included in the costs of inventory produced during the period that the stripping costs are incurred. The FASB ratified the EITF consensus. The EITF consensus is effective for the first reporting period in fiscal years beginning after December 15, 2005. In January 2006, the EITF issued additional guidance defining the commencement of production as the period when saleable minerals are first extracted in greater than *de minimis* amounts. During the first quarter 2006, the Company began mining significant amounts of oxide ore reserves at its San Cristobal project, which have been placed in stockpiles for future processing. The quantity and value of the minerals mined were sufficient to declare the start of ore production according to the EITF consensus. The Company has included the costs associated with the oxide ore production as ore inventories on its financial statements. The Company expects the mining and stockpiling of significant amounts of oxide ore to continue throughout the year, with the commencement of sulfide ore mining and stockpiling in the third quarter of the year.

The Company records costs related to production activities as inventory held for sale in the ordinary course of business or work in process for such sale. Work-in-process inventories include ore produced and stockpiled for which further processing is necessary before a product is ready for sale. The Company uses the average cost method to assign costs to the units of ore stockpiled during the period. Inventories are carried at the lower of cost or the current net realizable value. If costs held in inventory exceed their net realizable value, the excess cost is recognized as a loss in the current period. Net realizable value reflects the gross realizable value (estimated selling price) reduced by estimated costs of completion and disposal as of the balance sheet date. Gross realizable value reflects the anticipated average realization that the inventory will generate when it is sold.

New Accounting Standards

In March 2006 the EITF reached a tentative consensus (EITF Issue No. 05-1) that the issuance of equity securities to settle an instrument that becomes convertible upon the issuer s exercise of a call option should be accounted for as a conversion (as opposed to an extinguishment) if, at issuance, the debt instrument contains a substantive conversion feature other than the issuer s call option. The EITF concluded that if an instrument is deemed convertible at issuance, then a subsequent conversion of the instrument is in accordance with a conversion privilege that existed at issuance and is, therefore, outside the scope of APB Opinion No. 26, Early Extinguishment of Debt. Therefore, the issuance of shares to settle the debt pursuant to the original terms of the instrument should be afforded conversion treatment. If the instrument does not contain a substantive conversion feature at issuance, the issuance of equity securities to settle the instrument should be recognized as a debt extinguishment. EITF Issue No. 05-1 became effective for interim or annual reporting periods beginning after June 28, 2006, following its ratification during June 2006. The Company previously accounted for two transactions involving the buy-back of its convertible debt as an extinguishment under APB Opinion No. 26. Ratification of EITF Issue No. 05-1 will require similar future transactions to be accounted for as conversions.

Financial Accounting Standards No. 154, Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3 (FAS No. 154) is effective for years beginning after December 15, 2005. FAS No. 154 changes the requirements for the accounting and reporting of a change in accounting principle. The statement applies to voluntary changes as well as changes required by accounting pronouncements which do not otherwise provide specific transition provisions, requiring retrospective application to prior period s financial statements where practical. FAS No. 154 did not have a material impact on the Company s financial position or results of operations for the period and is not expected to have a material impact in the future.

In June 2006, the FASB issued Financial Accounting Standards Interpretation No. 48, Accounting for Uncertainty in Income Taxes, (FIN 48) an interpretation of Financial Accounting Standards Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation requires that the Company recognize in the financial statements, the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods and disclosure. The provisions of FIN 48 are effective beginning January 1, 2007 with the cumulative effect of the change in accounting principle recorded as an adjustment to the opening balance of retained earnings. The Company is currently evaluating the impact of adopting FIN 48 but does not believe it will have a material impact on its financial position or results of operations.

3. Investments

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Short-term investments include investments with maturities greater than three months, but not exceeding twelve months. Long-term investments include investments with maturities greater than twelve months.

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

The Company generally records its investments as short term or long term based on the underlying maturity date of the investments held. However, in certain instances the Company has been required to place investment funds in escrow where the restrictions on the use of such funds expire beyond the maturity dates of the underlying investments. In this instance, where the expiration date of the restriction is greater than one year, the Company classifies the investment as long term. At June 30, 2006, as required by the project financing facility, the Company placed $71.1 million of investments in escrow to fund possible overruns of the San Cristobal Project. The underlying investments in this escrow account have maturity dates of less than twelve months, however, because the escrow account will not be released until after completion of the San Cristobal project, the Company classified these investments as long term. (See Note 11 for additional discussion of restricted investments)

The Company invests only in government and corporate securities rated investment grade or better. The following tables, based on quoted market prices, summarizes the Company s investments at June 30, 2006 and December 31, 2005:

June 30, 2006	**Cost (in Thousands)**	**Market**	**Balance**
Short-term investments			
Available for sale			
Auction rate securities	$ 111,500	$ 111,500	$ 111,500
Common stock	946	1,665	1,665
Total short term	$ 112,446	$ 113,165	$ 113,165
Restricted Investments:			
Short-term			
Available for sale			
Auction rate securities	$ 115,880	$ 115,880	$ 115,880
Total available for sale	115,880	115,880	115,880
Held to maturity			
Corporate notes	2,242	2,239	2,242
Government bonds	25,939	25,822	25,939
Total held to maturity	28,181	28,061	28,181
Total short term	$ 144,061	$ 143,941	$ 144,061
Long-term			
Available for sale			
Auction rate securities	$ 23,400	$ 23,400	$ 23,400
Total available for sale	23,400	23,400	23,400
Held to maturity			
Corporate notes	3,559	3,550	3,559
Government bonds	50,299	49,974	50,299
Total held to maturity	53,858	53,524	53,858
Total long term	$ 77,258	$ 76,924	$ 77,258

December 31, 2005	Cost (in Thousands)	Market	Balance
Short-term investments			
Available for sale			
Common stock	$ 434	$ 686	$ 686
Bond funds	3,381	2,885	2,885
Auction rate securities	127,426	127,426	127,426
Total available for sale	131,241	130,997	130,997
Held to maturity			
Corporate notes	1,003	998	1,003
Total held to maturity	1,003	998	1,003
Total short term	$ 132,244	$ 131,995	$ 132,000
Restricted Investments:			
Short-term			
Available for sale			